

Tyne and Wear Pension Fund

Administered by South Tyneside Council

Funding Strategy Statement

Approved by Pensions Committee
on 4th February 2008

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1. Overview

- 1.1 This Funding Strategy Statement has been prepared in accordance with Regulation 76A of the Local Government Pension Scheme Regulations 1997 (the Regulations).
- 1.2 The Statement describes the strategy of South Tyneside Council, acting in its capacity as Administering Authority (the Administering Authority), for the funding of the Tyne and Wear Pension Fund (the Fund).
- 1.3 The Statement sets out two types of information:
 - generic information on the purpose and aims of the Fund and on the policy context,
 - Fund specific information in relation to the strategy itself.
- 1.4 It is the responsibility of the Administering Authority to prepare, publish and maintain the Statement, having regard to guidance produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) in a document entitled “Guidance on Preparing and Maintaining a Funding Strategy Statement” and also to the Fund’s Statement of Investment Principles.
- 1.5 The CIPFA guidance and the Statement of Investment Principles may be viewed on the Fund’s website, for which the address is www.twpf.info . The CIPFA guidance is contained in the password protected Employer Section.
- 1.6 Extracts from the most relevant Regulations are contained in Appendix A.

2. Purposes of the Statement

- 2.1 The three main purposes of this Statement are:
 - To establish a clear and transparent strategy, specific to the Fund, which will identify how employers’ pension liabilities are best met.
 - To support the regulatory requirement in relation to the desirability of maintaining as nearly constant employer contribution rates as possible.
 - To take a prudent longer-term view of funding the Fund’s liabilities.

3. Consultation

- 3.1 Regulation 76A(1) requires the Administering Authority to consult with such persons as it considers appropriate in the preparation of the Statement.
- 3.2 CIPFA provides further guidance that this must include meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers.
- 3.3 Employers participating in the Fund have been consulted on the contents of this Statement and their views have been taken into account in formulating the Statement. However, the Statement describes a single strategy for the Fund as a whole.
- 3.4 In addition, the Administering Authority has had regard to the Fund's Statement of Investment Principles published under Regulation 9A of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (the Investment Regulations).
- 3.5 The Fund Actuary, Hewitt Bacon and Woodrow Ltd., has also been consulted on the contents of this Statement.

4. Purpose and aims of the Fund

Purpose of the Fund

- 4.1 The purpose of the Fund is:
- To pay out monies in respect of Local Government Pension Scheme (Scheme) benefits, transfer values, costs, charges and expenses.
 - To receive monies in respect of contributions, transfer values and investment income.

The aims of the Fund in relation to the Funding Strategy

- 4.2 The aims of the Fund in relation to Funding Strategy are set out below.

The first aim is to enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the Scheduled Bodies, Resolution Bodies, Admitted Bodies and to taxpayers.

- 4.3 The Administering Authority recognises that the requirement to keep employer contribution rates as nearly constant as possible can run counter to the following requirements:
- the regulatory requirement to secure solvency,
 - the requirement that the costs should be reasonable, and
 - maximising income from investments within reasonable cost parameters (see the fourth aim).
- 4.4 Producing low volatility in employer contribution rates requires material investment in assets that 'match' the employer's liabilities. In this context, 'match' means assets that behave in a similar manner to the liabilities as economic conditions alter. Such assets would tend to comprise gilt edged investments for the liabilities represented by benefits payable by the Scheme.
- 4.5 Other classes of assets, such as shares and property, are perceived to offer higher long-term rates of return, on average. The Administering Authority invests a substantial proportion of the Fund in such assets which is consistent with the requirement to maximise the returns from investments. However, these assets are more risky in nature and that risk can manifest itself in volatile returns over short-term periods and a failure to deliver the expected return in the long term.
- 4.6 This short-term volatility in investment returns can produce a consequent volatility in the measured funding position of the Fund at successive valuations, with knock on effects on employer contribution

rates. The impact on employer rates can be mitigated by use of a range of smoothing mechanisms at each valuation.

- 4.7 The Administering Authority recognises that there is a balance to be struck between the investment policy adopted, the smoothing mechanisms used at valuations, and the resultant smoothness of employer contribution rates from one valuation period to the next.
- 4.8 The Administering Authority also recognises that the position is potentially more volatile for Admission Bodies with short-term contracts where utilisation of smoothing mechanisms is less appropriate.

The second aim is to ensure that sufficient resources are available to meet all liabilities as they fall due.

- 4.9 The Administering Authority recognises the need to ensure that the Fund has, at all times, sufficient liquid assets to be able to pay pensions, transfer values, costs, charges and other expenses. It is the Administering Authority's policy that such expenditure is met, in the first instance, from incoming employer and employee contributions to avoid the expense of disinvesting assets. The Administering Authority monitors the position on a daily basis to ensure that all cash requirements can be met.

The third aim is to manage employers' liabilities effectively.

- 4.10 The Administering Authority seeks to ensure that all employers' liabilities are managed effectively. In a funding context, this is achieved by seeking regular actuarial advice, ensuring that employers and Pension Committee members are properly informed, and through regular monitoring of the funding position.

The fourth aim is to maximise the income from investments within reasonable risk parameters.

- 4.11 The Administering Authority recognises the desirability of maximising investment income within reasonable risk parameters. Investment returns higher than those available on government stocks are sought through investment in other asset classes such as shares and property. The Administering Authority ensures that risk parameters are reasonable by:
- restricting investment to the levels permitted by the Investment Regulations,
 - restricting investment to asset classes generally recognised as appropriate for UK pension funds,
 - analysing the potential risk represented by those asset classes in collaboration with the Investment Advisor and the Fund's Investment Managers.

5. Responsibilities of the key parties

- 5.1 The three parties whose responsibilities to the Fund are of particular relevance are the Administering Authority, the Employers and the Fund Actuary.

Administering Authority

- 5.2 The key responsibilities of the Administering Authority are set out below.

The first key responsibility is to collect employer and employee contributions and, as far as the Administering Authority is able to, ensure these contributions are paid by the due date.

- 5.3 Individual employers must pay contributions in accordance with Regulations 79, 80 and 81 of the Regulations.
- 5.4 The Administering Authority has advised all employers of its policy on the remittance of pension contributions and the procedures that will be taken in the event of late or non payment.
- 5.5 It is a legal requirement that pension contributions be paid to the Fund by the 19th of the month following the month that they were deducted from employees' pay. The Administering Authority has exercised its discretion under Regulation 81 to require contributions to be paid on the 14th of the month. If the 14th of the month is a non-banking day, payment is required on the last banking day preceding the 14th. This allows for efficient utilisation and investment of funds as pensions are paid on the 16th of the month. It also provides a margin of safety so that minor problems can be resolved without the need to involve the Pensions Regulator.
- 5.6 The Administering Authority will ensure that action is taken to recover assets from Admission Bodies whose Admission Agreement has ceased by:
- requesting that the Fund Actuary calculates the deficit at the date of the closure of the Admission Agreement,
 - notifying the Admission Body that it must meet any deficit.

The second key responsibility is to invest surplus monies in accordance with the Regulations.

- 5.7 The Administering Authority will comply with the Investment Regulations.

The third key responsibility is to ensure that cash is available to meet liabilities as and when they fall due.

5.8 The Administering Authority recognises this duty and discharges it in the manner set out in the aims of the Fund in relation to the Funding Strategy.

The fourth key responsibility is to manage the valuation process in consultation with the Fund Actuary.

5.9 The Administering Authority ensures it communicates effectively with the Fund Actuary to:

- agree timescales for the provision of information and provision of valuation results,
- ensure provision of data of suitable accuracy,
- ensure that the Fund Actuary is clear about the Funding Strategy,
- ensure that participating employers receive appropriate communication throughout the process,
- ensure that reports are made available as required by Guidance and Regulation.

The fifth key responsibility is to prepare and maintain a Statement of Investment Principles and a Funding Strategy Statement after due consultation with interested parties.

5.10 The Administering Authority will ensure that both documents are prepared and maintained in the required manner.

The sixth key responsibility is to monitor all aspects of the Fund's performance and funding and amend these two documents if required.

5.11 The Administering Authority monitors the funding position and the investment performance of the Fund on a quarterly basis.

5.12 The Statement of Investment Principles and Funding Strategy Statement are formally reviewed annually, unless circumstances dictate earlier amendment.

Individual employers

5.13 Individual employers are responsible for:

- deducting contributions from employees' pay,
- paying all contributions, including their employer contribution as determined by the Actuary, promptly by the due date,

- exercising discretions within the regulatory framework and ensuring the Administering Authority has copies of current policies covering those discretions,
- paying for added years in accordance with agreed arrangements,
- paying the Strain on the Fund costs resulting from early retirements or exercises of discretion allowing the early payment of deferred benefits. Payment is due immediately unless it has been agreed that payment can be spread over three years,
- notifying the Administering Authority promptly of all changes to membership, or other changes which affect funding,
- notifying the Administering Authority promptly of possible or intended changes that could affect the basis of participation in the Fund.

The Fund Actuary

5.14 The key responsibilities of the Fund Actuary are set out below.

The first key responsibility is to prepare valuations.

5.15 The Fund Actuary will prepare valuations, including the setting of employers' contribution rates, after agreeing assumptions with the Administering Authority and having regard to the Funding Strategy Statement and relevant admission agreements.

5.16 Valuations will also be prepared in accordance with generally accepted actuarial methods and reported on in accordance with Guidance Note 9 issued by the Institute and Faculty of Actuaries, to the extent that the Guidance Note is relevant to the Scheme.

The second key responsibility is to prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

5.17 Such advice will take account of the funding position and Funding Strategy Statement, along with other relevant matters.

6. Funding Strategy

- 6.1 From the perspective of an employer, the key issues regarding funding strategy are likely to revolve around employer contribution rates that are payable from time to time and, in particular, the degree of change in rates from year to year and the impact that this has on budgets.
- 6.2 In the broadest sense, the prime determinants of employer contribution rates are the financial and demographic experience of the Fund. The Fund's assets and liabilities move relative to one another as investment returns fluctuate, economic conditions vary and the membership profile changes. This creates funding surpluses or deficiencies and requires changes to contribution rates.
- 6.3 It is not the purpose of this Statement to address those wider issues. Investment strategy is covered in the Fund's Statement of Investment Principles, whilst wider economic conditions and demographic experience are beyond the control of the Administering Authority (except to the extent that it can influence the pay progression and turnover rates of its own staff).
- 6.4 In the narrower context of Funding Strategy, the most important determinants of contribution levels:
- Solvency and Funding Target,
 - Valuation methods,
 - Funding assumptions,
 - Recovery period,
 - Grouping,
 - Stepping,
 - Smoothing.
- 6.5 These areas are discussed in the following sections of this Statement.
- 6.6 All concerned must understand how each area introduces an element of risk, and that it is the net total of these risks that is important.
- 6.7 Whilst maintaining as nearly constant as possible employer contribution rates is desirable, this is in direct conflict with the aims of maximising investment returns and securing solvency. As such, the position must be one of balance between the competing objectives.

7. Solvency and Funding Target

- 7.1 The Regulations require contribution rates to be set to ensure the solvency of the Fund.
- 7.2 Solvency is not defined in the Regulations.
- 7.3 The Administering Authority defines solvency as being achieved when the value of the Fund's assets is greater than or equal to the value of the Fund's liabilities in respect of service prior to the measurement date when measured using 'ongoing' actuarial methods and assumptions.
- 7.4 Ongoing actuarial methods and assumptions are taken to be measurement by use of the Projected Unit method of valuation, using assumptions generally recognised as suitable for an open, ongoing UK pension fund with a sponsoring employer of sound covenant.
- 7.5 The financial assumptions used to assess the funding level will have regard to the yields available on long-term fixed interest and index linked gilt-edged investments.
- 7.6 The Administering Authority has also agreed with the Fund Actuary that the assumptions will make partial allowance for the higher long-term returns that are expected on the assets actually held by the Fund, and understands the risks of such an approach if those additional returns fail to materialise.
- 7.7 Therefore, for the purposes of setting a strategy, there is a focus on a solvency target of 100% of the ongoing liabilities of the Fund. This means targeting holding assets at any point in time which are equal to the liabilities represented by the benefit promises that have been made to members, deferred pensioners and pensioners to that date. The implication here is that if, for any reason, the Fund ceased to operate, it should have sufficient assets to meet the benefit payments that have been promised.
- 7.8 However, this does not necessarily go far enough. In a situation where the Fund ceased, contributors would become entitled to early leaver benefits that would be revalued up to retirement in line with increases in the Retail Prices Index. If, however, the Fund were to continue, those promised benefits would remain linked to final pay, and would therefore increase at a different (and probably higher) rate. Targeting early leaver benefits could therefore be too little because, if the Fund continues, it will not have enough assets in later years if pay increases exceed price inflation. Therefore, the target is set taking account of future expected pay increases.

8. Valuation methods

- 8.1 The Fund is not static. Over time, members leave and new members join. At any valuation a measurement can be undertaken of the solvency position relative to the membership at that time, but that measurement will not take into account new members who will join after the valuation date.
- 8.2 Contribution rates are set by use of the Projected Unit valuation method for most employers. This is consistent with the aim of enabling employer contribution rates to be kept as nearly constant as possible and in anticipation of the Fund continuing for the foreseeable future.
- 8.3 This method produces contribution rates which target solvency over fixed periods in the future. It will tend to produce more stable contribution rates for those employers who expect a future flow of new entrants to the Fund, which would tend to keep the age distribution of members stable. This is seen as a reasonable expectation where the Fund is open to new members.
- 8.4 For employers that are closed to new members, the existing membership will age as time passes. Under these circumstances the contribution rate produced by the Projected Unit method will tend to rise from one valuation to the next. It is therefore desirable to consider the use of an alternative method - the Attained Age method.
- 8.5 This method is used for a small number of employers, as shown in Appendix B. It targets solvency over the future working lifetime of a group of membership and tends to produce more stable contribution rates for those employers where no, or few, new entrants to the Fund are expected.

9. Funding assumptions

9.1 Two types of assumptions are used to measure the funding target:

- financial assumptions,
- demographic assumptions.

Financial assumptions

9.2 There are three assumptions that are key to the process in that they have the biggest impact on the results of the measurement:

- Pension increases – the Scheme provides increases in line with increases in the Retail Prices Index on the majority of pensions paid. Information on expectations of price inflation is available in the market place by examining the yields on index linked and fixed interest government stocks. The pension increase assumption is generally set by examination of this information.
- Pay increases – over the long term, pay increases tend to exceed price inflation by between 1% and 2% per annum. The Fund Actuary generally uses an assumption at the middle of this range, subject to adjustment only where there is compelling reason to do so.
- Future investment returns – this is the most complex area and it is discussed in more detail below.

9.3 A starting point for considering future investment returns would be to consider how the Fund could be arranged to provide the benefits with the lowest level of risk possible for the participating employers. To achieve this, the Fund would be invested entirely in government index linked and fixed interest stocks.

9.4 Yields available on government stock for future periods are readily obtained from the gilt markets. A starting point would therefore be to assume future yields in line with gilt yields.

9.5 However, in common with most other UK pension funds, the Fund is invested primarily in other asset classes such as shares and property, with a view to obtaining higher rates of investment return. It would therefore be tempting to look at the returns earned on those asset classes in the past and extrapolate into the future.

9.6 The problem with that approach is that these types of investment are expected to provide higher yields because they are less predictable – the higher yield being the price of that unpredictability. It is therefore imprudent to take advance credit for too much of these extra returns in advance of them actually materialising. Indeed, financial economists would tend to say that no credit whatsoever should be taken.

9.7 Higher employers' contribution rates would be expected to result if no advance credit was taken. The Administering Authority and the Fund

Actuary have therefore agreed that it is sufficiently prudent and consistent with the Regulations to take advance credit for some of the anticipated extra returns, but not all.

Demographic assumptions

- 9.8 These assumptions cover such areas as rates of mortality, ill health, turnover of staff, marital statistics and promotional increases in pay.
- 9.9 The Fund Actuary sets the assumptions by examination of the actual experience of the Fund as a whole, and by reference to national statistics and standard tables. The assumptions are designed to be applicable to the long-term future, and should therefore not be too influenced by recent events. In addition, it is usually not practical or desirable to set demographic assumptions at an employer specific level. This is because the number of employees is too small for most employers to provide statistically significant data on which different assumptions could be based. Also, such activity would significantly increase the cost of the valuation process.

10. Recovery period

- 10.1 Where a valuation reveals that the Fund is in surplus or deficiency against the solvency measure, employer contribution rates are adjusted to target restoration of the solvent position over a period of years (the recovery period).
- 10.2 Where there is a deficiency, the safest way of ensuring solvency would be to require an immediate capital injection from employers to restore solvency straight away.
- 10.3 However, such an approach would produce very volatile contribution rates. This is not consistent with the objective of as nearly constant rates as possible.
- 10.4 Therefore, the policy is to allow deficiencies to be recovered over a number of years. This produces smoother contribution rates.
- 10.5 Adopting this approach introduces an element of risk, which increases the longer the deficit recovery period chosen. The risk is that, by adopting this approach, relatively little action is taken to restore solvency between valuations. An employer may therefore end up in a worse position at the next valuation than if it had sought to restore solvency more quickly. This could produce difficulties in the future if experience is poor. Therefore, excessively lengthy recovery periods are to be avoided.
- 10.6 The recovery period for each employer is set by the Administering Authority, in consultation with the Fund Actuary and the employer, with a view to balancing the various funding requirements against the risks arising from the financial strength of the employer and the nature of its participation in the Fund.
- 10.7 The CIPFA guidance refers to the statutory position of the employers that make up the core of the Scheme, such as the main scheduled bodies, and to the statutory basis of the Scheme itself. It states that:
- “It would not, therefore, be imprudent for administering authorities to establish longer-term recovery periods than those used in the private sector where this was thought prudentially appropriate and relevant to local circumstances, and linked to the Scheme’s triennial valuation exercise”.
- 10.8 Some employers are not funded in the same way as the main scheduled bodies. Long-term continuation of that funding is arguably a more risky assumption. Therefore, in some cases, it is appropriate to set shorter recovery periods to maintain an appropriate overall level of risk for the Fund.
- 10.9 The guidance refers to this matter by stating that:
- “When considering the application of Funding Strategy Statement principles to non-local authority employers (who have no local tax raising powers), administering authorities will need to balance

carefully the need to set appropriate employer contribution levels against the financial standing of those employers”.

- 10.10 In terms of practical limits, analysis carried out by the Fund Actuary has shown that the smoothing impact of recovery periods tends to drop off markedly once the period extends beyond the average future working lifetime of the contributing membership.
- 10.11 Having considered the risk in relying on long recovery periods, the CIPFA guidance and the analysis carried out by the Fund Actuary, the Administering Authority is prepared to agree to recovery periods that are longer than the average future working lifetime of the membership of that employer for employers of sound covenant. The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible.
- 10.12 For the 2007 valuation, the Administering Authority has agreed with the Fund Actuary a limit of 22 years.
- 10.13 This compares to a limit of 25 years that was set for the 2004 valuation.
- 10.14 The approach is then to set recovery periods for each employer that are as short as possible within this framework. This applied particularly for employers with a lower financial standing than that of the main scheduled bodies.
- 10.15 Where an employer has a guarantee from a statutory body participating in the Fund, the Administering Authority considers whether the guarantee can, with the agreement of the guarantor, be taken into account in assessing the recovery period to be used.
- 10.16 Some employers have fixed participation periods in the Fund. In most cases, it would be imprudent to use a recovery period longer than the remaining participation period as this would effectively target under funding at the end of participation. The maximum period that will generally be permitted is therefore the remaining period of participation.

11. Grouping

- 11.1 Consistent with the requirement to keep employer contribution rates as nearly constant as possible, the Administering Authority permits certain employers to be treated as a group for the purposes of setting contribution rates.
- 11.2 This approach is used where there is either a degree of homogeneity between employers or for some smaller employers for whom contribution rates could otherwise be very volatile due to the increased likelihood that demographic movements would have a material effect.
- 11.3 The employer groupings at the 2007 valuation were:
- Smaller Admitted Bodies – Open Group
 - Smaller Admitted Bodies – Closed Group
 - Smaller Admitted Bodies – Moribund Group.
- 11.4 The Administering Authority recognises that grouping can give rise to cross subsidies from one employer to another over time. This can arise from different membership profiles of the different employers and from different experience. For example, an excess of ill health retirements from one employer could lead to it being subsidised by other grouped employers. However, over longer time periods it would be expected that the experience will even out between employers and each employer will, on average, pay a fair level of contributions.
- 11.5 The benefit of grouping is that it should produce a less volatile contribution rate on average for each individual employer.
- 11.6 The Administering Authority's policy is to consider the position carefully at each valuation and decide whether grouping is appropriate for any employer. This will include consideration of whether those employers that have decided to not admit any new members should be grouped separately and valued using the Attained Age method. The group of employers that do admit new members would continue to be valued using the Projected Unit method.
- 11.7 For employers with more than fifty contributing members, the Administering Authority would look for evidence of homogeneity between employers before considering grouping.
- 11.8 Grouping is unlikely to be permitted for employers whose participation is for a fixed period.
- 11.9 Each employer that is grouped will be advised that this is the case, and which other employers it is grouped with. The employer must consider whether it is comfortable with the approach. If the employer objects to this grouping, it will be offered its own contribution rate.
- 11.10 Those employers who participate in a group are shown in Appendix C.

Terminal valuations for grouped employers

- 11.11 Employers that participated in a group but which have had a terminal valuation cease to participate in the group.
- 11.12 The approach to carrying out a terminal valuation for an employer that participates in a group is as follows:
- With respect to the asset share, the Fund Actuary would take the notional group assets at the last valuation and identify the employer's notional share of those assets at that time. The asset share would then be rolled forward from this figure, taking into account the actual cash flow data for that employer since the valuation date. In this way the employer is, effectively, treated individually since the last valuation for the purposes of establishing the asset share.
 - With respect to the liabilities, the actual liability data for the employer itself is used. Therefore, in effect, the employer is treated individually for liability purposes.
- 11.13 This approach largely removes any cross subsidisation since the last valuation and ensures that the employer fully meets its obligations to the Fund.

12. Stepping

- 12.1 Consistent with the requirement to keep employer contribution rates as nearly constant as possible, the Administering Authority will consider, at each valuation, whether new contribution rates should be payable immediately, or should be reached by a series of steps over future years.
- 12.2 This is similar to setting a longer recovery period in that it seeks to reduce the impact of changes in contribution rates by phasing the change over a number of years. A natural consequence of this approach is that the ultimate rate payable will be higher than if there had been no stepping, to allow for the underpayment in the earlier years of the stepping process.
- 12.3 The risks involved with this approach are similar to those regarding use of a recovery period, but are more extreme. Where rates are stepped, the rate paid in the early years will be below that required to restore solvency over the recovery period, but may also be below the rate required simply to keep up with the flow of benefit promises being made. In this circumstance, the impact of adverse experience can be even more severe than described above.
- 12.4 The Administering Authority discusses the risks inherent in such an approach with the Fund Actuary and examines the financial impact and risks associated with each employer.
- 12.5 For the 2007 valuation, the Administering Authority's policy is to limit the number of permitted steps to six annual steps.
- 12.6 This compares to a limit of three steps that was used at the 2004 valuation.
- 12.7 Given the risks involved, it is most unlikely that stepping would be permitted for employers with limited duration of participation or where the recovery period is already constrained due to a perceived higher level of risk.

13. Smoothing

- 13.1 Having set the assumptions, the funding target and funding method, a measurement of the funding position can then be made.
- 13.2 The measured funding position alters as economic conditions change because the assumptions are set by reference to prevailing economic conditions.
- 13.3 Even more so, a measurement carried out one week could produce a very different result to one carried out the next because the market value of the assets can change very rapidly on a daily basis.
- 13.4 In this kind of fluctuating environment, it can be difficult to set contribution rates that remain as nearly constant as possible.
- 13.5 A smoothing adjustment can be applied to the Fund's asset value to produce a result that is smoother over time.
- 13.6 Any smoothing adjustment is an arbitrary tool. There is no theoretically correct adjustment. Application of the adjustment will tend to alter the results of the solvency investigation. Whether the result has been altered in the right direction cannot be known in advance. Use of a smoothing adjustment therefore constitutes a risk.
- 13.7 The policy is to consider the use of a smoothing adjustment, but to ensure that its application will not materially alter the outcome of the measurement relative to the underlying unsmoothed position.
- 13.8 A smoothing adjustment was applied at the 2004 valuation because asset values remained depressed following the equity bear market from 2000 to 2003.
- 13.9 Following consideration of the asset values for the 2007 valuation, it has been concluded that a smoothing adjustment will not be applied at this valuation.

14. Recovery of deficits on closure of an employer

- 14.1 When an employer closes, the Fund Actuary will carry out a terminal valuation. The Administering Authority will then pursue the recovery of any deficiency from that employer. The only exception to this is where a successor organisation that is also a participating employer in the Fund formally adopts the deficiency of the closing organisation as its own.
- 14.2 If an employer (other than a transferee admission body) fails and cannot pay the contributions due, Regulations require that all employers in the Fund must pay revised contributions to meet the shortfall.
- 14.3 In recent years, the Administering Authority has adopted a policy of generally requiring admission bodies (other than transferee admission bodies) to obtain a guarantor. A guarantor is required to agree that it will meet the shortfall if the admission body closes and cannot pay the contributions due.
- 14.4 Some longer standing admission bodies do not have a guarantor. If one of these were to close in circumstances where they could not pay the contributions due, then all employers in the Fund would be required to pay revised contributions to meet the shortfall.
- 14.5 The position is different for transferee admission bodies. If a transferee admission body fails and cannot pay the contributions due, then the Scheme employer in relation to that transferee admission body must pay revised contributions to meet the shortfall.

15. Identification of risks and counter measures

- 15.1 The Administering Authority's overall policy on risk is to identify all risks to the Fund and to consider the position both in aggregate and at an individual risk level.
- 15.2 The Administering Authority will monitor the risks to the Fund, and will take appropriate action to limit the impact of these both before, and after, they emerge wherever possible.
- 15.3 If required, an interim valuation is carried out between formal valuations to help to assess the impact of experience diverging from the assumed experience.
- 15.4 The main risks to the Fund are set out below.

Demographic

- 15.5 The main demographic risks include changing retirement patterns, longevity and commutation take up rates. The Administering Authority will ensure that the Fund Actuary investigates these matters at each valuation or, if appropriate, more frequently, and reports on developments. The Administering Authority will agree with the Fund Actuary any changes that are necessary to the assumptions underlying the measure of solvency to allow for observed or anticipated changes.
- 15.6 If significant demographic changes become apparent between valuations, the Administering Authority will notify all participating employers of the anticipated impact on costs that will emerge at the next valuation. In addition, any bonds that are in place for transferee admitted bodies should be reviewed.

Regulatory

- 15.7 These risks relate to changes to regulations, national pension requirements or HMRC rules. The Administering Authority will keep abreast of all proposed changes and, where possible and appropriate, and after careful consideration, express its opinion during consultation periods. The Administering Authority's policy will be to ask the Fund Actuary to assess the impact on costs of any changes and, where these are likely to be significant, the Administering Authority will notify employers of this likely impact and the timing of any change.

Ill Health

- 15.8 The Administering Authority will carry out a review in each of the first two years of a valuation period to compare actual ill health retirement experience against the assumed experience.
- 15.9 Employers' contribution rates are increased, if required.

Governance

- 15.10 This covers the risk of unexpected structural changes in the Fund membership (for example the closure of an employer to new entrants or the large scale withdrawal or retirement of groups of staff) and the related risk of the Administering Authority not being made aware of such changes in a timely manner.
- 15.11 The Administering Authority's policy is to require regular communication between itself and employers and to ensure regular reviews of such items as bond arrangements and funding levels. The Administering Authority also asks employers to complete an Employer Review Questionnaire each year. This allows the Administering Authority to seek to ensure that each employer continues with appropriate membership of the Fund.

Statistical / Financial

- 15.12 This covers items such as the performance of markets and the Fund's Investment Managers, asset reallocation in volatile markets, pay and price inflation varying from anticipated levels, and the effect of possible increases in employer contribution rates on service delivery and on employers.
- 15.13 The Administering Authority receives quarterly updates on the effect of market movements on the Fund's overall funding position, reviews each investment manager's performance quarterly and considers the asset allocation of the Fund by carrying out asset liability studies. These processes seek to ensure that the assumptions used remain justified.

Solvency measure

- 15.14 The Administering Authority recognises that allowing for future investment returns in excess of those available on government bonds introduces an element of risk, in that those additional returns may not materialise. The Administering Authority's policy is to monitor the underlying position assuming no such excess returns are achieved to ensure that the funding target remains realistic relative to the risk position.

Smoothing

- 15.15 The Administering Authority recognises that utilisation of a smoothing adjustment in the solvency measurement introduces an element of risk, in that the smoothing adjustment may not provide a true measure of the underlying position. The Administering Authority's policy is to review the impact of this adjustment at each valuation to ensure that it remains within acceptable limits.

Recovery period

- 15.16 The Administering Authority recognises that permitting surpluses or deficiencies to be eliminated over a recovery period rather than

immediately introduces a risk that action to restore solvency is insufficient between successive measurements. The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of recovery period to no longer than 22 years.

Stepping

- 15.17 The Administering Authority recognises that permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient in the early years of the process. The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the number of permitted steps to six annual steps.

16. Links to investment policy as set out in the Statement of Investment Principles

Total Fund Investment Policy

- 16.1 The Administering Authority has produced this Funding Strategy Statement having taken an overall view of the level of risk in the investment policy as set out in the Statement of Investment Principles and the Funding Strategy set out in this Statement.
- 16.2 An asset liability modelling study is carried out in order to assist in setting the Fund's investment policy. This study examines the Fund's financial position, the profile of its membership, the nature of its liabilities and includes an analysis of the expected ranges of outcomes from differing investment policies. The study is carried out at the Total Fund level, not at the level of each employer. The strategic asset allocation benchmark that is derived from the study is, therefore, set in the light of the overall liabilities of the Total Fund.
- 16.3 The current strategic asset allocation is based upon a study carried out as at 30th November 2004 by the Fund's Investment Advisor, Hymans Robertson, based upon the liabilities shown by the 2004 valuation. Having considered the outcome of this study, the Administering Authority concluded that a diversified portfolio, of which about 67.5% is invested in UK and overseas equities, 22.5% in bonds and 10% in property, represented a suitable strategic asset allocation benchmark for the Fund. The degree and nature of risks attaching to such a portfolio, when taken in conjunction with the expected returns, were considered to be appropriate for the Fund.

Investment policies for individual employers

- 16.4 The Administering Authority will examine ways of providing individual employers, at their request and at their own risk and cost, with an investment strategy that may be more tailored to their individual liabilities.
- 16.5 Such an approach could be of interest to employers that wish to adopt a low risk strategy, or that have a finite membership in the Fund such as contractors, or to employers whose liabilities differ markedly from the Total Fund liabilities.

Monitoring of Investment Policy

- 16.6 The Administering Authority will continue to monitor the suitability of the investment policy in the light of the Fund's developing liabilities and finances.
- 16.7 The Administering Authority will continue to review the Funding Strategy Statement and the Statement of Investment Principles to ensure that the overall risk profile remains appropriate. Such reviews may use asset liability modelling or other analysis techniques.

17. Monitoring

- 17.1 The Administering Authority plans to review formally this Statement as part of the triennial valuation process unless circumstances arise that require earlier action.
- 17.2 The Administering Authority will monitor the funding position of the Fund on an approximate basis at regular intervals between valuations, and will discuss with the Fund Actuary whether any significant changes have arisen that require action. If it is considered appropriate, an indicative interim valuation is carried out.
- 17.3 This purpose of this monitoring process is to give employers advance warning of likely changes that may be required following the next triennial valuation. This allows improved budgeting decisions to be made and allows an employer to take an informed decision on paying additional contributions.

Appendix A

Relevant Regulations

Regulation 76A Funding strategy statement

1. Each administering authority shall, after consultation with such persons as they consider appropriate, prepare, maintain and publish a written statement setting out their funding strategy.
2. In preparing and maintaining the statement, the administering authority shall have regard to:
 - (a) the guidance set out in the document published in March 2004 by CIPFA, the Chartered Institute of Public Finance and Accountancy and called "CIPFA Pensions Panel Guidance on Preparing and Maintaining a Funding Strategy Statement (Guidance note issue No. 6)"; and
 - (b) the statement of investment principles published by the administering authority under regulation 9A of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.
3. The first such statement shall be published on or before 31st March 2005.
4. The statement shall be revised and published by the administering authority following, and in accordance with, any
 - (a) material change in their policy on the matters set out in the statement; and
 - (b) material change to the statement of investment principles under regulation 9A(4) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.

Regulation 77 Actuarial valuations and certificates

1. Each administering authority must obtain
 - (a) an actuarial valuation of the assets and liabilities of each of their pension funds as at 31st March in 1998 and in every third year afterwards,
 - (b) a report by an actuary, and
 - (c) a rates and adjustments certificate.
2. Each of those documents must be obtained before the first anniversary of the date ("the valuation date") as at which the valuation is made or such later date as the Secretary of State may agree.
3. A rates and adjustments certificate is a certificate specifying
 - (a) the common rate of employer's contribution, and
 - (b) any individual adjustments,for each year of the period of three years beginning with 1st April in the year following that in which the valuation date falls.
4. The common rate of employer's contribution is the amount which in the actuary's opinion should be paid to the fund by all bodies whose employees contribute to it so as to secure its solvency, expressed as a percentage of the pay of their employees who are active members.
5. The actuary must have regard

- (a) to the existing and prospective liabilities of the fund arising from circumstances common to all those bodies, and
 - (b) to the desirability of maintaining as nearly constant a rate as possible.
- 5A. The actuary must have regard to the administering authority's funding strategy statement published under regulation 76A.
6. An individual adjustment is any percentage or amount by which in the actuary's opinion contributions at the common rate should in the case of a particular body be increased or reduced by reason of any circumstances peculiar to that body.
7. A rates and adjustments certificate must contain a statement as to the assumptions on which the certificate is given as respects
- (a) the number of members who will become entitled to payment of pensions under provisions of the Scheme, and
 - (b) the amount of the liabilities arising in respect of such members, during the period covered by the certificate.
8. A report under paragraph (1)(b) must contain a statement as to the demographic assumptions used in making the valuation, showing how they relate to the events which have actually occurred in relation to members of the Scheme since the last valuation.
9. The authority must provide the actuary preparing a valuation or a rates and adjustment certificate with the consolidated revenue account of the fund and such other information as he requests.
10. The authority must send copies of any valuation, report or certificate under this regulation or revision under regulation 78
- (a) to the Secretary of State,
 - (b) to each body with employees who contribute to the fund in question, and
 - (c) to any other body which is or may become liable to make payments to that fund.
11. They must also send the Secretary of State
- (a) a copy of the consolidated revenue account with which the actuary was provided under paragraph (9), and
 - (b) a summary of the assets of the fund at the valuation date (unless such a summary is contained in the report).

Regulation 79 Employers Contributions

1. An employing authority must contribute to the appropriate fund in each year covered by a rates and adjustments certificate under regulation 77 or 78 the amount appropriate for that authority as calculated in accordance with the certificate and paragraph (4).
2. During each of those years an employing authority must make payments to the appropriate fund on account of the amount required for the whole year.
3. Those payments on account must-
 - (a) be paid at the end of the intervals determined under regulation 81(1), and

- (b) equal the appropriate proportion of the whole amount due under paragraph (1) for the year in question.
4. An employer's contribution for any year is the common percentage for that year of the pay on which contributions have during that year been paid to the fund under Part II by employees who are active members (other than contributions under regulation 18(3)), increased or reduced by any individual adjustment specified for that employer for that year in the rates and adjustments certificate.
 5. The common percentage is the common rate of employer's contribution specified in that certificate, expressed as a percentage.
 6. Where an employee -
 - (a) is treated, under regulation 17(3A), as if she had paid contributions, or
 - (b) has paid contributions during a period of maternity, paternity or adoption absence,

the pay on which the common percentage is calculated is the pay the employee would have received if she had not been absent.

Regulation 80 Employer's further payments

1. Where an authority pass a resolution under regulation 52 they must pay the appropriate sum to the appropriate fund before the expiry of the relevant period (as defined in paragraph (7) of that regulation) unless before the end of that period they have agreed as mentioned in paragraph (6)(a) of that regulation.
2. [Deleted by CLG.]
3. The appropriate sum for a member is such sum as is shown as appropriate in guidance issued by the Government Actuary.
4. Any extra charge on the appropriate fund resulting from-
 - (a) a resolution under regulation 15 or 52 of these Regulations, or
 - (b) a member's becoming entitled to an ill-health pension calculated under regulation 28 by reference to an enhanced membership period,

must be repaid to the fund by the employing authority concerned (but, in the case of a resolution under regulation 52, only so far as not paid under paragraph (1)).
5. The appropriate administering authority may require the employing authority concerned to make additional payments to the appropriate fund in respect of any extra charge on the fund resulting from a pension and retirement grant becoming immediately payable to a member under regulations 26, 31(1) 31(6) or 35(1A).

Regulation 81 Payments by employing authorities to appropriate administering authorities

1. Every employing authority must pay to the appropriate administering authority, on or before such dates falling at intervals of not more than 12 months as the appropriate administering authority may determine (but in the case of the

amounts mentioned in sub-paragraph (a) not later than the time required under section 49(8) of the Pensions Act 1995)-

- (a) all amounts from time to time deducted from the pay of their employees under these Regulations;
 - (b) any amount received by them under regulation 18, (by deduction or otherwise) during the interval;
 - (c) any extra charge payable under regulation 80 of which they have been notified by the administering authority during the interval; and
 - (d) a contribution towards the cost of the administration of the fund, which shall include any amount specified in a notice given in accordance with regulation 81A(2).
2. Paragraph (1)(d) does not apply where the cost is paid out of the fund under regulation 5(6) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.
3. If the annual amount payable under paragraph (1)(d) cannot be settled by agreement, it must be determined by the Secretary of State.
- 3A If the disagreement is about an amount specified in a notice given in accordance with regulation 81A(2), the Secretary of State shall have regard to—
 - (a) the provisions of the pension administration strategy prepared by the appropriate administering authority that are relevant to the case; and
 - (b) the extent to which the appropriate administering authority and the employing authority have complied with those provisions in carrying out their functions under these Regulations.
4. Every payment under paragraph (1)(a) is to be accompanied by a statement showing-
 - (a) the name and pay of each of the employing authority's employees who is an active member;
 - (b) which employees are paying voluntary contributions;
 - (c) the amounts which represent deductions from the pay of each of the employees and the periods covered by the deductions, distinguishing amounts representing deductions for voluntary contributions.
5. An administering authority may direct the information mentioned in paragraph (4) to be given to them instead in such form and at such intervals (not exceeding 12 months) as they specify in the direction.
6. Paragraphs (1) and (4) do not apply to an employing authority which is an administering authority.
7. Voluntary contributions are contributions other than those under Part II.

Appendix B

Employers for whom the Attained Age method will be used

Balfour Beatty Power Networks

Baltic Flour Mills Visual Arts

Jarvis Accommodation Services

Jarvis - Sandhill View

Mitie (Boldon School)

Morrison (Birtley)

No Limits Theatre

Southern Electric Contracting

Stagecoach Travel Services (Busways)

Walker Profiles (North East)

All employers in the Small Admitted Bodies - Closed Group

Appendix C

Employers participating in grouped arrangements for valuation purposes

Smaller Admitted Bodies - Open Group

Association of North East Councils

Benwell Young Peoples Development Project

Community Action on Health

Gateshead Law Centre

Hebburn Neighbourhood Advice

International Centre for Life Trust

Kenton Park Sports Centre

Museums, Libraries and Archives North East, including Information North

National Glass Centre

Newcastle Community Law Centre

Newcastle Healthy City Project

Newcastle Tenants Confederation

North Eastern Regional Employers Organisation

Northern Grid for Learning

Ozanam House Probation Hostel Committee

Raich Carter Sports Centre

Simonside Community Centre

Saint Mary Magdalene and Holy Jesus Charity

Theatre Royal Trust Limited

Thomas Gaughan Community Centre

Tyne and Wear Development Company Limited

Tyne and Wear Play Association

Smaller Admitted Bodies - Closed Group

Age Concern

Childcare Enterprise Limited

Disability North

Managed Business Space

Percy Hedley Foundation

Search Project

South Tyneside Football Trust

South Tyneside Groundwork Trust

Tyne and Wear Enterprise Trust Limited

Wallsend Peoples Centre

Smaller Admitted Bodies - Moribund Group

Hospital of Saint Mary the Virgin

Norcare

Northern Council for Further Education

North Tyneside Disability Advice Centre

One North East

Port of Tyne Authority

Sunderland Empire Theatre Trust Limited

Valley Citizens Advice Bureau

Wallsend Citizens Advice Centre