

Tyne and Wear Pension Fund

Administered by South Tyneside Council

Funding Strategy Statement

Update – 12th September 2005

Index

Subject	Page Number
Overview	3
Purposes of the Statement	3
Consultation	3
Purposes and aims of the Fund	4
Responsibilities of the key parties	6
Solvency	9
Funding Strategy	10
Identification of risks and counter measures	13
Links to investment policy as set out in the Statement of Investment Principles	15
Future Monitoring	16
Appendix A – Employers for whom the Attained Age method will be used	17
Appendix B – Employers participating in grouped arrangements for valuation purposes	18

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). 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).
- 1.2 As required by Regulation 76A(2), the Statement has been prepared having regard to guidance published by CIPFA in March 2004.

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 employer's pension liabilities are best met going forward.
 - 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 In accordance with Regulation 76A(1), all employers participating within 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.
- 3.2 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).
- 3.3 The Fund Actuary, Hewitt Bacon and Woodrow, 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 the 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. For the liabilities represented by benefits payable by the Scheme, such assets would tend to comprise gilt edged investments.
- 4.5 Other classes of assets, such as shares and property, are perceived to offer higher long-term rates of return, on average, and consistent with the requirement to maximise the returns from investments the Administering Authority invests a substantial proportion of the Fund in such assets. 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 smoothing adjustments 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 Fund's Actuary, Investment Advisors and Fund 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, ensuring 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 which 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. However, the long-standing practice of the Fund, as set out in the Employer's Guide, is for contributions to be paid on the 14th of the month. Receipt of contributions by the 14th allows for efficient utilisation (pensions are paid on the 16th of the month) and investment of funds. The payment of contributions on the 14th 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 at the cessation of the Agreement.

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 will be 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 future funding.

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. Solvency

- 6.1 The Administering Authority will prudentially seek to secure the solvency of the Fund. For this purpose 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.
- 6.2 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.
- 6.3 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. 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.
- 6.4 Consistent with the aim of enabling employer contribution rates to be kept as nearly constant as possible, and having regard to the risks inherent in such an approach, the Administering Authority has also agreed with the Fund Actuary the use of explicit smoothing adjustments in making the solvency measurement. It is unlikely that use of these smoothing adjustments will be extended to employers whose participation in the Fund is for a fixed period (for example, an employer admitted by virtue of having been awarded a best value outsourcing contract).

7. Funding Strategy

Valuation Methods

- 7.1 Consistent with the aim of enabling employer contribution rates to be kept as nearly constant as possible, contribution rates are set by use of the Projected Unit valuation method for most employers.
- 7.2 The Projected Unit 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.
- 7.3 The Attained Age method is used for a small number of employers. This method 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.
- 7.4 Those employers for whom the Attained Age method will be used are shown in Appendix A.

Recovery period

- 7.5 Where a valuation reveals that the Fund is in surplus or deficiency against the solvency measure, employer contribution rates will be adjusted to target restoration of the solvent position over a period of years (the recovery period). The recovery period applicable for each participating employer is set by the Administering Authority in consultation with the Fund Actuary and the employer, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.
- 7.6 The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefit payments over long periods of time. For employers of sound covenant, the Administering Authority is prepared to agree to recovery periods that are longer than the average future working lifetime of the membership of that employer. The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible. However, the Administering Authority also recognises the risk in relying on long recovery periods and has agreed with the Fund Actuary a limit of 25 years. The Administering Authority's policy is to set recovery periods for each employer that are as short as possible within this framework.
- 7.7 Where an admission body has a guarantee from a statutory body participating in the Fund, the Administering Authority will consider whether the guarantee can, with the agreement of the guarantor, be taken into account in assessing the recovery period to be used.

- 7.8 For employers whose participation in the fund is for a fixed period it is unlikely that the Administering Authority and Fund Actuary would set a recovery period longer than the remaining term of participation.

Grouping

- 7.9 Consistent with the requirement to keep employer contribution rates as nearly constant as possible, the Administering Authority permits some employers to be treated as a group for the purposes of setting contribution rates. In particular, this approach is used 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.
- 7.10 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. The benefit of grouping is that it should produce a less volatile contribution rate on average for each individual employer.
- 7.11 The Administering Authority's policy is to consider the position carefully at each valuation and to notify each employer that is grouped that this is the case, and which other employers it is grouped with. If the employer objects to this grouping, it will be offered its own contribution rate. For employers with more than fifty contributing members, the Administering Authority would look for evidence of homogeneity between employers before considering grouping. For employers whose participation is for a fixed period grouping is unlikely to be permitted.
- 7.12 Those employers who participate in a group are shown in Appendix B.

Treatment and recovery of deficits on closure of an employer

- 7.13 When an organisation participating in the Fund closes the Fund Actuary will carry out a terminal valuation. The Administering Authority will then pursue the recovery of any deficiency from that organisation. The only exception to this is where a successor organisation which is also a participating employer in the Fund formally adopts the deficiency of the closing organisation as their own.
- 7.14 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.
- 7.15 In recent years the Administering Authority has adopted a policy of 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.

- 7.16 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.
- 7.17 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.

Stepping

- 7.18 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. The Administering Authority will discuss with the Fund Actuary the risks inherent in such an approach, and will examine the financial impact and risks associated with each employer. The Administering Authority's policy is to limit the number of permitted steps to three annual steps.

Monitoring of the Funding Level between Valuations

- 7.19 The Administering Authority will monitor the funding level between triennial valuations. If it is considered appropriate, an indicative interim valuation is carried out. 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.

8. Identification of risks and counter measures

- 8.1 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. 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. The main risks to the Fund are set out below.

Demographic

- 8.2 The main demographic risks include changing retirement patterns and longevity. 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.
- 8.3 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 and will review the bonds that are in place for transferee admitted bodies.

Regulatory

- 8.4 These risks relate to changes to regulations, national pension requirements or Inland Revenue rules. The Administering Authority will keep abreast of all proposed changes and, where possible 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.

Governance

- 8.5 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.
- 8.6 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

- 8.7 This covers items such as the performances of markets and the Fund's investment managers, asset reallocation in volatile markets, pay and price inflation varying from anticipated levels, or the effect of possible increases in employer contribution rates on service delivery and on employers.
- 8.8 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 regularly considers the asset allocation of the Fund by carrying out asset liability studies. Interim valuations are carried out yearly between formal valuations to help to assess the impact of experience diverging from the assumptions used. These processes seek to ensure that the assumptions used remain justified.

Solvency measure

- 8.9 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 will be 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

- 8.10 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

- 8.11 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 25 years.

Stepping

- 8.12 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 three annual steps.

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

- 9.1 The Administering Authority has produced this Funding Strategy Statement having taken an overall view of the level of risk in the investment policy set out in the Statement of Investment Principles and the funding policy set out in this statement.
- 9.2 In order to assist in setting the Fund's investment policy, an asset liability modelling study is carried out. 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.
- 9.3 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 Committee 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 by the Committee to be appropriate for the Fund.
- 9.4 The Administering Authority will continue to monitor the suitability of the investment policy in the light of the Fund's developing liabilities and finances.
- 9.5 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.

10. Future monitoring

- 10.1 The Administering Authority plans to review formally this Statement as part of the triennial valuation process unless circumstances arise which require earlier action.
- 10.2 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 Actuary whether any significant changes have arisen that require action.

Appendix A

Employers for whom the Attained Age method will be used

Jarvis (Sandhill View PFI)

National Car Parks Ltd.

Stagecoach Busways

All employers in the Small Admitted Bodies - Closed Group

Appendix B

Employers participating in grouped arrangements for valuation purposes

The Colleges Group

City of Sunderland College

Gateshead College

Newcastle College

North Tyneside College

South Tyneside College

Tynemouth College

Smaller Admitted Bodies - Open Group

Association of North East Councils

Benwell Young Peoples Development Project

Brunswick Young Peoples Project

Disability North

Gateshead Law Centre

Hebburn Neighbourhood Advice

International Centre for Life Trust

Kenton Park Sports Centre

National Glass Centre

Newcastle Healthy City Project

Newcastle Community Law Centre

Newcastle Tenants Confederation

North East Innovation and Development Company Limited

North East Museums, Libraries and Archives Council

North Eastern Regional Employers Organisation

Northern Council for Further Education

Northern Counties School for the Deaf

Ozanam House Probation Hostel Committee

Praxis Service

Raich Carter Sports Centre

Search Project

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
Tyne Deaf Youth Project

Smaller Admitted Bodies - Closed Group

Age Concern
Childcare Enterprise Limited
Managed Business Space
South Tyneside Groundwork Trust
Tyne and Wear Enterprise Trust Limited
Tyne and Wear Small Business Group
Wallsend Peoples Centre

Smaller Admitted Bodies - Moribund Group

AQA
HEFCE
Hospital of Saint Mary the Virgin
Information North
Newcastle Family Service Unit
Norcare
Norland Road Community Centre
North Tyneside Disability Advice Centre
One North East
Port of Tyne Authority
Sunderland Empire Theatre Trust Limited
Sunderland Outdoor Activities Association
Valley CAB
Wallsend Citizens Advice Centre