AGENDA ITEM 11

Essex Pension Fund Board	EPB/23/10
date: 15 December 2010	

Funding Strategy Statement (FSS)

Report by Head of Investments

Enquiries to Martin Quinn on 01245 431412

1. Purpose of the Report

1.1 To report the responses to the recent consultation exercise on the draft FSS for 2010/11 and to put forward further proposals in regard to the approval of the FSS for 2010/11.

2. Recommendations

2.1 That the responses be noted;

2.2 That the proposed course of action in regard to the Grouped Employers be approved; and

2.3 That the draft FSS, amended if appropriate in the light of the SABG discussions, be brought back to the Board for its final approval on 9 March 2011.

3. Background

3.1 At its last meeting on 25 August 2010 the Board received the draft FSS for 2010/11 and approved it to be sent out for consultation. The draft FSS and approved consultation letter was sent out to the majority of employers in the Fund, excluding schools, together with those parties providing services to the Fund. That consultation exercise has now been carried out with the results set out below.

4. Consultation Responses

4.1 There have been relatively few formal responses received and these are set out in full at Annex A. However in addition to the formal responses, an informal dialogue has been taking place with many of the employers as their individual results, flowing from the draft funding strategy, have been communicated to them. It would appear that the draft FSS is generally viewed with favour and is producing generally acceptable results.

5. Grouped Employers

5.1 It has become apparent in considering the detailed contribution implications for the Small Admission Bodies Group (SABG) that there is a need to hold further dialogue with the SABG both collectively and individually before reaching a final decision on the treatment of the SABG in the funding strategy. It is therefore proposed that the necessary meetings should be arranged and the results discussed with members. Further consideration is also required of the implications for the other grouping of employers - the Town & Parish Councils. The final recommended treatment of both groups would then be incorporated in a final draft of the FSS to be submitted to the Board on 9 March 2011. It has been confirmed with the Fund Actuary that this will fit in with his timetable for the production of his Triennial Actuarial Report, although he will be involved in our discussions.

6. Link to Essex Pension Fund Objectives

6.1 Funding
6.2 To achieve and maintain assets equal to 100% of projected accrued liabilities assessed on an ongoing basis
6.3 To enable employer contributions to be kept as nearly constant as possible
6.4 To manage employer liabilities effectively
6.5 To ensure that sufficient resources are available to meet all liabilities as they fall due

[The current funding objectives are under review in the determination of the funding strategy for 2010/11.]

7. Risk Implications

7.1 The risk implications of setting the funding strategy are set out in the draft FSS.

8. Communication Implications

8.1 Any decisions made as a result of this report will be communicated to interested parties through the normal process of publication of the minutes of this meeting and subsequently the publication of the FSS.

9. Finance and Resources Implications

9.1 None directly as a result of this report. There will be financial implications for employers in the Fund which will be set out in the Actuary’s triennial report to be published later this financial year.

10. Background Papers

10.1 Emails from:
10.1.1 Debbie Came, Essex Probation dated 19/11/10.
10.1.2 David Hall, Greenfields Community Housing dated 26/11/10 and 30/11/10.
10.1.3 Caroline Fozzard, Southend-on-Sea Borough Council dated 26/11/10.

Consultee and Response	Comment
ESSEX PROBATION Question: Do you agree with these proposals or have any comments? In particular in formulating this strategy the initial view has been to stabilise employer contributions by mitigating increases where possible but also underpinning the *minimum* contribution rates by not allowing any reduction in employer contributions unless a reduction would have been due under the standard deficit recovery period in accordance with the 2007 valuation funding strategy. Do you consider it to be appropriate to adopt an objective, where possible, for: no increase in contributions?	
Only if this does not adversely impact on future valuation outcomes – i.e. deferring the inevitable or placing too much reliance on reduced costs of government review.	It is difficult to see how adopting an objective of no increase in contributions, against a background of increased deficits, cannot have an adverse impact on future valuation outcomes. However the strategy as a whole does not place any reliance on reduced costs of government review and, if the valuation assumptions prove to be correct, should not lead to a subsequent need to increase contributions.
no reduction in contributions?	
Would not see a reduction in contributions as viable given longer term expectations.	Noted.
Question: Do you agree that we should allow employers, able to demonstrate an appropriate strength of covenant, to increase their deficit recovery periods up to the maximum permitted level and to take into account the higher level of investment return in terms of the recovery cost of any emerging deficit?	
Yes so long as the risk of so doing is held by the individual employer and will not at a later stage become a burden to other employers in the	That is the intention.

scheme. There needs to be clear and transparent criteria where this decision is taken and agreed by the pension fund managers. Question for Transferor Scheme Employers: Are you in agreement with the proposal to allow your contractors to extend their deficit recovery periods, potentially beyond the term of their current contract, as well as make use of the allowance for the higher investment return? (This would of course be subject to your specific consent but should enable the contractor to better manage their cash flow. Should the contract terminate the outstanding deficit would become payable immediately but you as Transferor Scheme Employer underwrite/guarantee its payment.) Not applicable to our situation. Would this require a renegotiation of a contract as presumably the former arrangements would have impacted on the price of the service and would appear to transfer all the risk to the tranferor.	It is correct that the pension arrangements would have impacted on the price of the service. The existing pensions transfer arrangements already require the Transferor Scheme Employer to underwrite/guarantee the payment with the option of requiring the contractor to provide a bond to mitigate the inherent risk. The arrangement suggested could impact on the contractual relationship but this will depend on how it is currently operated.
Question (in particular to employers who were formerly local education authorities): Do you agree with this proposal or have any comments? N/A	Noted
Question: Do you agree with the 2010 proposals shown above or do you have any comments? In particular do you agree with the adoption of "least risk" as a strengthened basis for the calculation of termination payments? Agree fully with the least risk basis given increasing expectation of services moving to other agencies/third sector etc.	Noted
Question: Do you agree with the above strengthened policies in regard to admissions and bulk transfers or do you have any comments? Agreed.	
Question - Does there come a point where the transferor guarantees become so significant (i.e. guarantees are provided for a number of associated bodies/contracts) that this becomes a risk to the guarantor and how will this be measured and dealt with by the Fund?	Yes this is a risk but the covenant of the scheduled bodies (who are the major transferors) is such that it does not pose a problem for the Fund but it is a matter to which individual employers should have regard.

Question: Do you agree with: a. The Fund's investment strategy? Yes b. The Actuary's assumptions? Yes or do you have any comments – in particular on the maximum level of increased investment return that should be incorporated in the FSS? No comment Question: Do you agree with the approach that the Fund has taken to risk or do you have any comments on: a. The general approach? Yes b. Specific risks identified? Yes c. Risks that have not been identified? No risks identified in relation to fraud etc. and mitigation steps	Noted Noted Noted Noted Noted These do feature in the Pension Fund's risk register. The funding strategy risk assessment can be expanded to include these and other matters.
GREENFIELD COMMUNITY HOUSING Thank you for providing a copy of the Draft Funding Strategy Statement 2010. We have reviewed the draft document and are pleased to provide a consultation response as set out below. Greenfields Community Housing is a Community Admission Body within the scheme, and has been a member since November 2007. We have commented only on the aspects of the Strategy Statement which affect, or are likely to affect, Greenfields most significantly as a Community Admission Body. We note the long term objectives on solvency and target funding levels and agree with these objectives. In adopting this we welcome the intention to stabilise employer contribution rates. Flexibility for employers with a strong covenant We welcome the flexibility that the draft statement introduces in respect of community admission bodies, particularly in respect of allowing for "best estimate" investment returns in dealing with any deficits and deficit recovery periods. Our opinion is that Greenfields has a strong employer covenant and as such we would wish to discuss with the Administering Authority evidence that we may be able to provide to support this. Whilst Greenfields is not a public body, and does not have a guarantee provided by one, the business	Noted Noted Noted

is that of a registered provider of housing in perpetuity. Our existing financial business plan, which we are happy to share with the Administering Authority, is for a period of 30 years although there is no fixed term of management of the housing properties that are now owned by Greenfields.	
Financial assumptions – salary inflation We note that the key assumptions include an allowance for promotional increases. We consider that this assumption is too high in respect of Greenfields and suggest the Actuary consider reducing this. Within Greenfield's Business Plan we assume and budget for annual salary growth at a level equivalent to inflation plus 0.5%. The increment of 0.5% is intended to allow for incremental progression through salary scales which are available to staff. Our policy is that the annual cost of living review would reflect inflation estimates, however over that last three years the level of award has been below reported inflation levels at 2% in 2009, 0% in 2010 and projected, but yet to be agreed, at between 0% and 2% in 2011. You will also be aware that we closed the Scheme to new entrants in 2008 – the effect of this is the majority of remaining members have relatively long service compared to the average and tend to be at or near the top of available salary progression scales. We therefore would not expect to see a significant impact of incremental salary progression within pensionable salaries.	The assumption proposed is representative of the expectation of salary growth for the Fund as a whole over the long term (20 years +). It is not representative of the expectation of individual employers in the short term as the process would become impractical given the number of employers in the Fund. Any deviation from the assumption in the short term will feed into the results for employers at subsequent valuations in terms of an improvement (lower than assumed increases) or deterioration (higher then assumed increases) in the funding position. The overall structure of the assumptions is reasonable in the context of the competing factors of affordability vs deficit repair for the Fund.
Pension Bond In my most recent conversations with Kevin McDonald, within your team, we discussed possible methods of provision of a bond that would be acceptable to the Scheme. We welcome the opportunity to consider the option of contingent asset security and escrow deposit accounts as alternatives to a traditional third party bond. We have researched these internally and continue to do so. We are currently pursuing legal advice on the practicality of the various options available. We note also that the bond amount is likely to be assessed during the triennial valuation and that any new bond agreement would be held until that has been determined and agreed.	Alternatives to a bond will be explored as we further develop the process for admission bodies in the Fund. There is no reason for the Fund not to explore alternatives but they have to be a practical and cost effective option to the Fund when compared to the Pension Bond.

SOUTHEND-ON-SEA BOROUGH COUNCIL Please find below the responses from Southend-on-Sea Borough Council regarding the consultation on the Essex Pension Fund Funding Strategy Statement:	
Q1 – we agree with these proposals. Given the current level of the deficit we consider it appropriate for the current strategy to adopt an objective of no reduction in contributions. However, we support the view to stabilise employer contributions by mitigating increases where possible.	Noted
Q2 – we agree that employers who demonstrate an appropriate strength of covenant should be allowed to increase their deficit recovery periods up to the maximum permitted level.	Noted
Q3 – we agree with this proposal.	Noted
Q4 – we agree with the 2010 proposals, in particular the adoption of "least risk" as a strengthened basis for calculation of termination payments.	Noted
Q5 – we agree with the strengthened policies in regard to admissions and bulk transfers.	Noted