

Essex County Council Pension Fund

Funding Strategy Statement

This Statement has been prepared by Essex County Council (the Administering Authority) to set out the funding strategy for the Essex County Council Pension Fund (the Fund), in accordance with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) and the guidance paper issued in March 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.

1. Introduction

The Local Government Pension Scheme (Administration) Regulations 2008 (as amended) ("the Administration Regulations") replaced the Local Government Pension Scheme Regulations 1997 (as amended) providing the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Fund the Administering Authority will prepare and publish their funding strategy;
- In preparing the FSS, the Administering Authority must have regard to:-
 - the guidance issued by CIPFA for this purpose; and
 - the Statement of Investment Principles (SIP) for the Fund published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009;
- The FSS must be revised and published whenever there is a material change in the policy on the matters set out in either the FSS or the SIP.

Benefits payable under the Local Government Pension Scheme (the Scheme) are guaranteed by statute and therefore the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.

The Scheme is a defined benefit final salary scheme under which the benefits are specified in the governing legislation (the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) ("the BMC Regulations"). The required levels of employee contributions are also specified in the Regulations.

Employer contributions are determined in accordance with the Regulations (principally Administration Regulation 36) which require that an actuarial valuation is completed every three years by the Actuary appointed by the Fund, including a rates and adjustments certificate. Contributions to the Fund should be set so as to “secure its solvency”, whilst the Actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible. The Actuary must have regard to the FSS in carrying out the valuation.

2. Purpose of the FSS in policy terms

Funding is defined as the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the Actuary.

The purpose of this FSS is:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory requirement to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives that need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the Administering Authority to implement and maintain.

3. Aims and purpose of the Fund

The aims of the Fund are to:

- enable employer contribution rates to be kept as stable as possible;
- manage employers' liabilities effectively;
- ensure that sufficient resources are available to meet all liabilities as they fall due; and
- maximise the returns from investments within reasonable risk parameters;
- minimise the risks to the Fund from its admission arrangements by strengthening its admission arrangements and pursuing a policy of positive engagement.

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income; and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses,

as defined in the Local Government Pension Scheme (Administration) Regulations 2008 (as amended), the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended).

4. Responsibilities of the key parties

Although a number of parties, including investment fund managers, investment advisers and external auditors, have responsibilities to the Fund, the key parties for the strategy are seen as the Administering Authority, each individual employer and the Fund Actuary.

The Administering Authority should:

- collect employer and employee contributions;
- invest surplus monies in accordance with the Regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the Fund Actuary;
- prepare and maintain an FSS and a SIP, both after due consultation with interested parties; and
- monitor all aspects of the Fund's performance and funding and amend the FSS/SIP when necessary.

The Individual Employer should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with BMC Regulation 3)
- pay over all contributions, including their own as determined by the Fund Actuary, promptly by the due date;
- exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain; and

- notify the Administering Authority promptly of all changes to membership or, other changes proposed, which affect future funding.

The Fund Actuary should:

- prepare valuations, including the setting of employers' contribution rates, after agreeing assumptions with the Administering Authority and having regard to the FSS;
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters; and
- advise on funding strategy, the preparation of the FSS, and the inter-relationship between the FSS and the SIP.

5. Solvency issues and target funding levels

To meet the requirements of the Administration Regulations the Administering Authority's long-term funding objective is to achieve and then maintain assets equal to 100% of projected accrued liabilities, assessed on an ongoing basis including allowance for projected final pay. The actuarial assumptions to be used in the calculation of the funding target are set out in the Appendix.

The key assumptions making up the funding strategy and as adopted for the 2010 actuarial valuation are that:

- our long-term aim is to achieve 100% funding of pension liabilities;
- the Scheme is expected to continue for the foreseeable future;
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term;
- we wish to minimise fluctuations in employers' contributions in order to assist them with their financial planning and to meet their financial responsibilities to the Fund;
- the Fund is relatively immature in terms of its membership profile with a high proportion of contributors and we can therefore take advantage of that fact in setting our investment strategy;
- we have a large number of employing bodies with different characteristics including size and strength of covenant.

The effective date of the current actuarial valuation of the Fund is 31 March 2010. The preliminary results of the valuation indicate that overall the assets of the Fund represented [**to be confirmed**]% of projected accrued liabilities at the valuation date.

The Administering Authority after due consideration of all of the information available to it including consultation with the Fund Actuary and other interested parties, has adopted the following objectives to achieve the funding target:

- we will set employers' contribution rates to achieve 100% funding of liabilities in the long term;
- employer contribution rates will be made up of two separate elements:
 - an ongoing rate to recover the costs of future service; and
 - a deficit recovery contribution to recover the shortfall revealed by the actuarial valuation;
- we will for the purpose of our administration, the calculation of contribution rates and for the setting of maximum deficit recovery periods, deal with certain employers and types of employers in discrete groups as set out below:
 - town and parish councils; and
 - the small admission bodies detailed in Schedule A;the rules under which the groups will be operated are set down in Schedule B;
- we will set deficit recovery periods for the above groups of employers. Those deficit recovery periods will be set at levels that
 - as far as possible are likely to reduce the level of deficit during the inter-valuation period if all of the Actuary's assumptions prove correct; and
 - safeguard the interests of the Fund by having regard to the strength of covenant and the financial stability of the grouped employers;
- schools, including former grant maintained schools, will be treated as part of the local authority within whose area of responsibility they fall for the purpose of setting contribution rates and deficit recovery periods; any discretions in respect of these matters will fall to the local authority; schools that opt to become academies become stand-alone employers in their own right but inherit responsibility for the share of scheme deficit attributable to the former school(s) from which they were formed and that share of scheme deficit will then be taken into account in calculating their separate contribution rate.
- we will set standard and maximum deficit recovery periods for the remaining employers but will leave them the freedom to decide to repay their share of the deficit over a shorter period should they so choose;
 - the standard deficit recovery periods will be set at levels that safeguard the interests of the Fund by having regard to the Fund's judgement of the strength of covenant and the financial stability of individual employers;
 - individual employers will, at the discretion of the Fund, be able to increase their deficit recovery period up to the maximum deficit recovery period subject to providing assurance of greater strength of

covenant and financial stability. (e.g. transferor Scheme employer consent, provision of a bond, a deposit, a parent company guarantee or other surety);

- no reduction in the level of an employer's contributions will be allowed unless the deficit recovery period adopted by that employer is equal to or less than the standard deficit recovery period.

- The deficit recovery periods for the grouped employers will be as follows:

Employer Category	Deficit Recovery Period
town and parish councils	30 years (20 year period for purpose of any possible contribution reductions)
Small admission bodies	The average remaining working life of the small admission bodies' group work-forces as at 1 April 2010

- The deficit recovery periods for other employers will be as follows:

Employer Category	Standard Deficit Recovery Period	Maximum Deficit Recovery Period
scheme employers	20 years	30 years
Arms length management organisations of scheme employers	20 years	30 years
care trusts	20 years	30 years
admission bodies working on contracts for scheme employers	The period that the contract still has to run.	30 years
Other admission bodies	The average remaining working life of the employer's work-force as at 1 April 2010	30 years

- that the grouped employing bodies (small admitted bodies and town and parish councils) deficit recovery contributions and ongoing rate contributions will be phased in, in steps, over the 3 year period 2011/12 to 2013/14;
- that certain individual employers, detailed in Schedule C, will be given the opportunity to phase in the increase in their contributions in steps over the 3 year period 2011/12 to 2013/14;
- On the cessation of an employer's participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer would be due to the Scheme as a termination contribution, unless it was agreed by the administering authority and the other parties involved that the assets and liabilities relating to the employer would be transferred within the Scheme to another participating employer. The "least risk" basis of assessment of a termination payment will apply for all admission bodies, except where a successor or guarantor body inherits ongoing responsibility for the orphan liabilities arising on cessation of the admission.

- In certain instances, and in particular for Fund employers which are considered by the Administering Authority to provide a high level of covenant, an allowance may be made as part of the recovery plan for investment performance at a higher level than that assumed for assessment of the **funding target**. This higher level of return assumed will, in particular, reflect the actual investment strategy of the Fund, on the basis that this is to be maintained over the entire recovery period. The assumptions to be used in these Recovery Plan calculations are set out in the Appendix.
- All transferee admission bodies (i.e. “best value” contractors delivering services to scheme employers) should be accepted for admission into the Fund so long as all the necessary regulatory requirements for admission are satisfied.
No special conditions or requirements will apply for transferee admission bodies given their ultimately close links with the Scheme Employer, although the Fund retains the right to seek special terms or conditions if these are considered warranted in specific cases.
In the case of a transferee admission body, or any participating employer acting as guarantor in the case of non-transferee admission bodies, implementation of an alternative funding basis or approach (including on termination) will be subject to agreement from the relevant guarantor body/scheme employer. Any special funding arrangements between the scheme employer and transferee admission body should be covered by the commercial arrangements, i.e. outside the Fund and not part of the admission agreement.
No future transferee admission bodies will be eligible to join the Small Admitted Bodies Group.
- Community admission bodies will be accepted for participation in the Fund, or otherwise, on a case by case consideration of the merits of admission and the associated risks to the Fund. In general, a guarantee or alternative surety will be required for all community admission body cases, with this requirement waived at the Fund’s discretion on an exceptions basis.
For community admission bodies the Fund will consider application of special conditions or requirements as deemed appropriate. Examples of such conditions are:
 - a guarantee from another Fund employer with sufficient covenant strength
 - a surety bond or other contingent asset
 - an independent review of covenant, including the possibility of a parent guarantee.
 All community admission bodies will be allowed flexibility to elect to adopt a funding approach prior to termination in line with the “least risk” exit debt basis, if that is their preference.”

- In the case where a contractor wishes to offer a broadly comparable scheme, rather than apply to become an admitted body of the Fund, standardised bulk transfer terms will be offered via the Actuary's Letter. The letter will be structured so as to target an asset transfer to the contractor's Broadly Comparable scheme such that it is equivalent to 100% of the past service liabilities reserved for by the Fund in respect of the transferring members' accrued service as at the date of transfer. The Fund will only agree to any variations in the standard in exceptional circumstances and with the prior agreement of the transferring scheme employer."

In determining the deficit recovery period(s) the Administering Authority has had regard to:

- the responses made to the consultation with employers on the FSS principles;
- the need to balance a desire to attain the target as soon as possible against the major increases in the level of employers' contributions which a shorter period would require; and
- The Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.

6. Link to investment policy set out in the SIP

The preliminary results of the 2010 valuation show the liabilities to be [**to be confirmed**]% covered by the current assets, with the funding deficit of [**to be confirmed**]% being covered by future deficit contributions.

In assessing the value of the Fund's liabilities in the valuation, allowance has been made for asset out-performance as described in Section 5, taking into account the investment strategy adopted by the Fund, as set out in the SIP.

It is not possible to construct a portfolio of investments that produces a stream of income exactly matching the expected liability payment stream. However, it is possible to construct a portfolio that closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

Investment of the Fund's assets in line with the least risk portfolio would minimise fluctuations in the Fund's ongoing funding level between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out the valuation it would not be appropriate to make any allowance for out-performance of the investments. On this basis of assessment, the assessed value of the Fund's liabilities at the 2010 valuation would have been significantly higher, by approximately [**to be confirmed**], and the declared funding level would have been correspondingly reduced, to approximately [**to be**

confirmed] %.

Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements or at the minimum contribute to offsetting increases in contributions arising from issues such as increased longevity. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The current benchmark investment strategy, as set out in the SIP, is:

In preparation for the 2010 valuation process, the Fund's investment consultants, Hymans Robertson, were asked to update the investment expectations for the Fund. The following is a summary of their findings which will in due course be reflected in an updated version of the SIP to be considered by the ISC later in the year:

Expected strategic return on assets

At 31 March 2010, Hymans Robertson's assumptions with regard to the long term returns on asset classes were:

Asset class	20 year return (% p.a.)
UK Equity	7.9%
Overseas / Global Equity	7.6%
Private Equity	9.0%
Fixed Interest Gilts	4.7%
Index-linked Gilts	4.5%
Corporate Bonds	5.5%
LIBOR+	5.0%
Property	5.8%
Infrastructure	5.8%

Given the Fund's long term strategic allocation of assets at that time (re-weighting for Private equity) of:

%	
10.0	UK Equity
53.0	Overseas / Global Equity
6.0	Private equity (including activism)
1.2	Fixed Interest Gilts
3.8	Index-Linked Gilts
5.5	Corporate Bonds
6.0	LIBOR + (including Company Loans)
12.0	Property
2.5	Infrastructure

this would imply a long term strategic expected return of 7.0% p.a. on an arithmetic weighted average of these individual returns. This does not take account of any expected return from active management (including currency) or the benefit we might expect from diversification (which we expect to come through as 'bonuses'). Using Hymans Robertson's

internal asset model (which, in this case, also does not take account of active management, but does allow for the benefits of diversification) some analysis was performed with respect to various expected returns and the probability of achieving that return. The model (based on the current structure) calculates a central expected return of 7.9% p.a. The overall expected return on a portfolio of assets does not solely reflect the arithmetic weighted average of the returns on the individual asset classes. This is due to diversification i.e. when you combine a portfolio of assets which are not fully correlated to each other, the expected portfolio return is greater than the arithmetic combination of the individual returns. This reflects the lower volatility of the portfolio compared to the volatility of the sum of the parts. This is sometimes referred to as 'volatility drag'.

The probability of achieving particular levels of out-performance relative to the liabilities is as follows:

	1 year	3 years	20 years
Probability of achieving liabilities + 1.0% p.a	57%	63%	77%
Probability of achieving liabilities + 2.5% p.a	53%	56%	62%
Probability of achieving liabilities + 3.5% p.a	50%	52%	51%

The Actuary's current market related assumptions in regard to the 2010 valuation are:

	%
A liability based fixed interest gilt yield of:	4.5
A liability based index linked gilt real yield of:	0.7
Adjustment for inflation risk premium and CPI:	<u>0.8</u>
Therefore implied inflation of:	<u>3.0</u>

His asset out performance assumptions, consistent with previous actuarial valuations are:

Past service liabilities

Pre-retirement =	gilts + 2.5%
Post – retirement =	gilts + 1%
Total fund =	gilts + 1.9%*

*(to be recalculated based on the 2010 valuation liability profile)

<u>Future service liabilities</u> =	Inflation + 3.75%
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Given the above assumptions as to fixed interest gilt yields and inflation these give the following assumed investment return requirements for the fund relative to conditions as at 31 March 2010:

	%
Past service liabilities = 4.5% + 1.9% =	6.40
Future service liabilities = 3.0% + 3.75% =	6.75

Examination of the Fund Returns expected by Hymans Robertson shows a long term strategic expected return (for the individual asset classes) of 7.0% and a long term strategic expectation for the whole fund allowing for the benefit of diversification of 7.9%.

It will be seen that there is a margin between the valuation assumptions required to meet the funding target and the long term investment return expected for the Fund. This gives a degree of comfort in the funding plan, providing a buffer to assist the Fund in riding out periods of adverse experience or other events.

7. Identification of risks and counter-measures

Awareness of the risks that may impact on the funding strategy and expectations of future solvency is crucial to determining the appropriate measures to mitigate those risks.

The funding of defined benefits is by its nature uncertain. The funding strategy is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial valuation and may require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the Actuary that the greatest risk in the funding strategy is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the overall 1.9% per annum required.

The following chart shows the Fund's approximate funding level after three years from the 2010 valuation under various future scenarios (described in detail at Schedule D), based on employer contribution rates adopting the standard deficit recovery periods but without any allowance for the effects of stepping (which are not expected to be significant).

[Chart to be inserted once valuation results known]

The Administering Authority has itself undertaken an exercise to identify those risks that are specific to the Fund and the measures to be taken to counter those risks.

The resultant risk assessment is attached to this FSS as Schedule E.

8. Monitoring and Review

The Administering Authority has taken advice from the Fund Actuary in preparing this Statement, and has also consulted with its institutional investment advisers Hymans Robertson, its independent investment advisers Keith Neale and Tony Hardy and the Pension Fund's Investment Steering Committee.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of the then current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions and/or deviation in the progress of the funding strategy;
- if there have been significant changes to Fund membership, or LGPS benefits;
- if there have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy; and
- if there have been any significant special contributions paid into the Fund.

Employers who at 1 April 2010 were deemed to be members of the Small Admitted Body Group

Harlow Women's Aid
Brentwood Leisure Trust
Rural Community Council of Essex
Harlow Sports Centre
Harlow Welfare Rights & Advice
Basildon Women's Refuge
Impulse Leisure
Itec Learning Technologies Ltd
Ardleigh Reservoir Committee
East of England Tourist Board
Hamilton Lodge Trust Ltd (Disabilities Trust)
Race Equality Foundation
Essex Association of Local Councils
Cambridge Access Validating Agency
Chelmsford Community Transport Ltd
Renaissance Southend Ltd
Trading Standards Institute
Braintree Womens Aid
Chelmsford Agency for Volunteering
Essex Local Valuation Tribunal
Harwich Connexions Transport Co-operative Ltd
Open College Network Eastern Region
Chelmsford Citizens Advice Bureau
Essex County Scout Council
Hatfield Peveral Day Nursery
Phoenix Group Homes
The Inclusion Trust
Wivenhoe Park Management Ltd
Castle Point Citizen's Advice Bureau
Chelmsford Council for Voluntary Service
Colchester Women's Aid
Essex and Suffolk Water Company
Rainbow Services
Thames Gateway South Essex Partnership Ltd
Southend Women's Aid

Grouped Bodies Rules of Operation

To be inserted

Employers who will be given the opportunity to introduce the increase in their deficit recovery contributions and/or their ongoing rate contributions in steps over the 3 year period 2011/12 to 2013/14:

To be confirmed following risk analysis

Schedule D

[Alternative future scenarios to be completed once valuation results are finalised]

Essex County Council Pension Fund

Funding Strategy Risk Assessment

Risk	Consequence	Actions taken or proposed to mitigate effects
Investment markets perform below actuarial assumptions	Increases required in employers' contributions	<ul style="list-style-type: none"> - Diversified portfolio - Monitoring against targets - Reallocation of assets - Keep employers informed
Market yields move at variance with actuarial assumptions	Increases required in employers' contributions	<ul style="list-style-type: none"> - Diversified portfolio - Monitoring against targets - Reallocation of assets - Keep employers informed
Investment managers fail to achieve performance targets	Increases required in employers' contributions	<ul style="list-style-type: none"> - Diversified structure - Monitoring against targets - Change managers where considered appropriate - Keep employers' informed
Asset reallocation in volatile markets may lock in past losses	Increases required in employers' contributions	<ul style="list-style-type: none"> - Monitoring against benchmark - Automatic rebalancing process in place which prevents lock-in of losses
Illiquidity of certain markets and asset classes	Difficulty in realising investments	<ul style="list-style-type: none"> - Monitoring - Factor into disinvestments strategy
Pay and price inflation significantly different from actuarial assumptions	Increases required in employers' contributions	<ul style="list-style-type: none"> - Monitoring - Keep employers informed
The effect of increases in employer's contributions on employers' ability to pay	Employers default on their contributions	<ul style="list-style-type: none"> - Take view on strength of individual employer's covenant when setting terms of admission agreement (inc. bonds) and in setting term of deficit recovery - Keep employers' contributions as stable and affordable as possible - Pursue a policy of positive engagement with a view to strengthening employer covenants wherever possible
Mortality rates continue to improve.	Increases required in employers' contributions	<ul style="list-style-type: none"> - Strengthening of actuarial valuation assumptions - Monitoring - Keep employers informed

Risk	Consequence	Actions taken or proposed to mitigate effects
Frequency of early retirements increases	Increases required in employers' contributions	<ul style="list-style-type: none"> - Ensure that employers are made aware of consequences of their decisions - Ensure that employers are financially responsible for consequences of their decisions - Monitoring situation on ill health retirements - Keep employers informed
Adverse changes to LGPS regulations	Increases required in employers' contributions	<ul style="list-style-type: none"> - Ensuring that Fund concerns are raised in consultation process and decision makers lobbied - Monitor - Keep employers informed
Adverse changes to other legislation, tax rules etc.	Increases required in employers' contributions	<ul style="list-style-type: none"> - Ensure that Fund concerns are raised in consultation process and decision makers lobbied - Monitor - Keep employers informed
Administering authority unaware of structural changes in an employer's membership	Individual employer's contribution becomes inappropriate requiring review and increase.	<ul style="list-style-type: none"> - Ensure that employers are reminded of their responsibilities. - Monitor and send reminders of employers responsibilities re this where appropriate - Investigate the adoption of an administration strategy to clarify employer responsibilities
Administering authority not advised of an employer closing to new entrants	Individual employer's contribution becomes inappropriate requiring review and increase.	<ul style="list-style-type: none"> - Ensure that employers are reminded of their responsibilities - Monitor and send reminders of employers responsibilities re this where appropriate - Investigate the adoption of an administration strategy to clarify employer responsibilities
Failure in supervision of investment managers	Increases required in employers' contributions	<ul style="list-style-type: none"> - Ensure ISC properly resourced, sufficient time made available to consider issues, reports prepared on all matters of concern, suitable training given, proper decision making processes employed and arrangements in place to ensure continuity maintained
Loss of key staff at investment managers	Increases required in employers' contributions	<ul style="list-style-type: none"> - Monitor - Replace managers if considered appropriate

Risk	Consequence	Actions taken or proposed to mitigate effects
An employer ceasing to exist with insufficient funding or adequacy of bond	Increases required in employers' contributions	<ul style="list-style-type: none"> - Admission arrangements strengthened for new admissions under the "community of interest" provisions to require that they are either sponsored by a scheduled body, guaranteeing their liabilities or required to provide a bond, indemnifying the fund as a whole - Take view on strength of individual employer's covenant when setting terms of admission agreement (inc. bonds) and in setting term of deficit recovery - Monitor - Keep employers informed - Pursue a policy of positive engagement with a view to strengthening employer covenants wherever possible
Loss of key staff at Administering Authority	Failure to achieve funding strategy	<ul style="list-style-type: none"> - Monitor - Structure duties and training to assist in continuity - Replace staff as soon as possible - Recruitment and retention measures

Actuarial Valuation as at 31 March 2010

Method and assumptions used in calculating the funding target

Method

The actuarial method to be used in the calculation of the funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted (The Attained Age method), which makes advance allowance for the anticipated future aging and decline of the current closed membership group.

Financial assumptions

Investment return (discount rate)

A yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") of 2.5% p.a. for the period pre-retirement and 1% p.a. post-retirement.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date. The allowance for this out-performance is based on the liability profile of the Scheme, with a higher assumption in respect of the "pre-retirement" (i.e. active and deferred pensioner) liabilities than for the "post-retirement" (i.e. pensioner) liabilities. This approach thereby allows for a gradual shift in the overall equity/bond weighting of the Fund as the liability profile of the membership matures over time.

Individual Employers

Having determined the AOAs as above for the Fund overall, it is important to consider how the financial assumptions in particular impact on individual participating employers. As employers in the Fund will have different mixes of active, deferred and pensioner members, adopting a different pre/post retirement investment return approach is equivalent to hypothecating a different equity/bond mix investment strategy for each employer. Such an approach would be inconsistent with the Fund practice, as set out in the FSS, of allocating investment performance pro rata across all employers based on a "mirror image" investment strategy to the whole Fund. In completing the calculations for individual employers therefore, a single, composite, pre and post retirement asset out-performance assumption of X.X% pa has been calculated which, for the Fund as a whole, gives the same value of the funding target as the separate pre and post retirement AOAs. {Further comment required if any employers are to fund on a least risk basis, or if any other employer bespoke assumptions are to be adopted.}

Inflation (Retail Prices Index) To be updated for IRP and CPI adjustments

The inflation assumption will be taken to be the investment market's expectation for inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities.

Salary increases

The assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases.

Pension increases

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

Mortality TO BE REVISED IN LIGHT OF DEMOGRAPHICS ANALYSIS

The mortality assumptions will be based on the most up-to-date information published by the Continuous Mortality Investigation Bureau, making allowance for future improvements in longevity and the experience of the scheme. The mortality tables used are [tbc].

Members who retire on the grounds of ill health are assumed to exhibit average mortality equivalent to that for a good health retiree at an age [5] years older.

Method and assumptions used in calculating the cost of future accrual

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target except that the financial assumptions adopted will be as described below.

The financial assumptions for assessing the future service contribution rate should take account of the following points:

- contributions will be invested in market conditions applying at future dates, which are unknown at the effective date of the valuation, and which are not directly linked to market conditions at the valuation date; and
- the future service liabilities for which these contributions will be paid have a longer average duration than the past service liabilities.

The financial assumptions in relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real return (i.e. return in excess of price inflation) of 3.75% per annum, with a long term average assumption for price inflation of 3.0% per annum. These two assumptions give rise to an overall discount rate of 6.75% p.a.

Adopting this approach the future service rate is not subject to variation solely due to different market conditions applying at each successive valuation, which reflects the requirement in the Regulations for stability in the “Common Rate” of contributions. In market conditions at the effective date of the 2010 valuation this approach gives rise to a more optimistic stance in relation to the cost of accrual of future benefits compared to the market related basis used for the assessment of the funding target.

At each valuation the cost of the benefits accrued since the previous valuation will become a past service liability. At that time any mismatch against gilt yields and the asset out-performance assumptions used for the funding target is fully taken into account in assessing the funding position.

Summary of key whole Fund financial assumptions used for calculating funding target and cost of future accrual (the “normal cost”) for the 2010 actuarial valuation

Long-term gilt yields	
Fixed interest	4.5% p.a.
Index linked	0.7% p.a.
Adjustment for CPI and IRP	0.8% p.a.
Implied CPI price inflation	3.0% p.a.
Past service Funding Target financial assumptions	
Investment return pre-retirement	7.0% p.a.
Investment return post-retirement	5.0% p.a.
Salary increases	4.5% p.a.
Pension increases	3.0% p.a.
Future service accrual financial assumptions	
Investment return	6.75% p.a.
CPI price inflation	3.0% p.a.
Salary increases	4.5% p.a.
Pension increases	3.0% p.a.

Assumptions used in calculating contributions payable under the recovery plan

The contributions payable under the recovery plan are calculated using the same assumptions as those used to calculate the **funding target**, with the exception that, for certain employers, the required contributions are adjusted to allow for the following variation in assumptions during the period of the recovery plan:

Investment return on existing assets and future contributions

An overall additional return of **Z.Z%** pa above the liabilities consistent gilt yield (4.5%pa effective as at the valuation date) reflecting the underlying investment strategy of the scheme and, in particular, including the assets of the scheme that underlie the pensioner as well as the non-pensioner liabilities. This is equivalent to a total rate of investment return of **Y.Y%** pa effective as at the 2010 valuation date.

The investment return assumed for the contributions under the recovery plan is taken to apply throughout the recovery period. As a result, any change in investment strategy which would act to reduce the expected future investment returns could invalidate these assumptions and therefore the funding strategy.

The above variation to assumptions in relation to the recovery plan can only be applied for those employers which the Administering Authority deems to be of sufficiently high covenant to support the anticipation of investment returns, based on the current investment strategy, over the entire duration of the recovery period. No such variation in the assumptions will apply in any case to any employer which does not have a funding deficit at the valuation (and therefore for which no recovery plan is applicable). Where the variation in the assumptions does apply, the resultant total contributions implemented following the 2010 valuation will be subject to a minimum of both:

- the contributions originally planned for 2011/12 onwards based on the 2007 actuarial valuation, and
- the normal future service contribution rate for the employer concerned.