

Funding Strategy Statement

The Fund's Joint Pension Fund Panel and Board has recently undertaken a review of the Funding Strategy Statement (FSS). The Statement was reviewed and updated in conjunction with the actuarial valuation of the Fund as at 31 March 2013 to reflect the details of the Fund's risk based funding strategy. It has been further updated to reflect the requirements of the LGPS regulations 2013, which came into force after the 2013 valuation was finalised and to incorporate recently agreed changes to the Groups which the Administering Authority operates for funding purposes. The FSS has been prepared in accordance with the updated guidance produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) in 2012.

Introduction

The Local Government Pension Scheme Regulations 2013 require the Hampshire Pension Fund to prepare and publish a FSS. The Fund's actuary must have regard to this statement when setting employers' contribution rates.

As required by 2013 Regulation 58, the Statement has been reviewed (and where appropriate revised) having regard to guidance published by CIPFA on 3 October 2012.

This FSS should be read in the context of the Fund's Statement of Investment Principles (SIP), which sets out in detail the Fund's investment arrangements and strategy. The current version of this is attached for information. The administering authority has had regard to the SIP in preparing this FSS.

Consultation

In accordance with Regulation 58, all Fund employers have been consulted on the contents of this Statement and their views have been considered in formulating it. However, the Statement describes a single strategy for the Fund as a whole.

The Fund's actuary, Aon Hewitt Limited, has also been consulted on the content of this Statement.

Purpose of the Funding Strategy Statement

The purposes of this Funding Strategy Statement are to set out the processes by which the administering authority:

- Establishes a clear and transparent funding strategy, specific to the Fund, to meet employer's pension liabilities going forward.
- Aims to meet the regulatory requirement in relation to the desirability of maintaining as nearly constant a common rate of contributions as possible.
- Takes a prudent longer-term view of funding the Fund's liabilities noting that whilst the funding strategy applicable to individual employers or categories of employers must be reflected in the Funding Strategy Statement its focus should at all times be on those actions which are in the best long term

interests of the Fund.

Aims of the Fund

The Fund has three main aims:

- To manage the employers' liabilities effectively
- To enable employers' contribution rates to be kept as stable as possible and affordable for the Fund's employers.
- To maximise the income from investments within reasonable risk parameters.

The main aims of the Fund are explained in more detail below.

To manage the employers' liabilities effectively

Hampshire County Council as administering authority makes sure that the Fund's liabilities are managed effectively. This is achieved by commissioning actuarial valuations every three years as required by law. These determine the employers' contribution rates required to make sure liabilities can be managed effectively. The administering authority also commissions additional work in relation to the specific issues described below.

The Fund's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term.

The Fund is deemed to be solvent when the assets held are equal to 100% of the Solvency Target.

The administering authority will make sure that the Fund always has enough cash available to pay pensions, transfer values to other pension funds, and other costs and expenses. Such expenditure will normally be met from incoming contributions from employees and employers and investment income, to avoid the cost of selling any of the Fund's investments. The position is reviewed every three months to make sure enough cash is available to meet the Fund's obligations.

The administering authority operates a group funding framework. Many employers are grouped for the purpose of determining employers' contributions in respect of the liabilities and more details are given later in this statement.

Exiting the fund - subsumed liabilities

Where an employer is leaving the Fund and will no longer have any contributing members, another employer, or group of employers, in the Fund may agree to provide future funding in respect of any emerging deficiencies.

In such circumstances the liabilities are known as subsumed liabilities, as responsibility for them is subsumed by the accepting employer or group. The administering authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of the liabilities of the accepting employer or group. Generally this will mean assuming continued investment in more risky investments than Government bonds.

Exiting the fund - orphan liabilities

Where an employer is leaving the Fund and will no longer have any contributing members, and the residual liabilities are not subsumed, the administering authority will act on the basis that it will have no further access for funding from that employer once any exit valuation, carried out in accordance with 2013 Regulation 64, has been completed and any sums due have been paid. Residual liabilities of employers from whom no further funding can be obtained are known as orphan liabilities.

The administering authority will seek to minimise the risk to other employers in the Fund of having to make good any deficiency arising on the orphan liabilities. To achieve this, the administering authority will seek sufficient funding from the outgoing employer to match the liabilities with low risk investments, generally Government fixed-interest and index-linked bonds.

Exiting the fund – valuations

Where an admission body exits the fund, an exit valuation will be carried out in accordance with Regulation 64. That valuation will take account of any activity as a consequence of exiting the fund regarding any existing contributing members (for example any bulk transfer payments due) and the status of any liabilities that will remain in the Fund.

In particular, the exit valuation will distinguish between residual liabilities which will become orphan liabilities, and liabilities which will be subsumed by other employers or otherwise continue to be funded to the satisfaction of the Administering Authority. For orphan liabilities the funding target in the exit valuation will anticipate investment in low risk investments such as Government bonds. For subsumed liabilities the exit valuation will anticipate continued investment in assets similar to those held in respect of the subsuming employer's (or group of employers') liabilities.

The valuation will further take account of a number of other factors such as whether the exiting employer is a going concern or is ceasing to exist, and whether there is a Guarantor.

Regardless of whether the residual liabilities are orphan liabilities or subsumed liabilities, the departing employer (or Guarantor if the employer is unable to pay) will generally be expected to make good the funding obligation revealed in the exit valuation. In other words, the fact that liabilities may become subsumed liabilities does not necessarily remove the possibility of an exit payment being required.

For those employers who are grouped with other employers for funding purposes, the exit valuation may also include allowance for any cross subsidies anticipated from other employers with which it is grouped. This would allow the employer to take immediate credit for contributions expected to be paid over the long term from other group employers in respect of the outgoing employer's share any group deficiency.

Interim reviews for admission bodies

Regulation 64(4) provides the administering authority with the power to carry out valuations in respect of admission bodies and other employers which are expected to cease at some point in the future, and for the Fund's actuary to certify revised contribution rates, between triennial valuation dates.

The administering authority's overriding objective at all times is that, where possible, the funding target for that body is clear, and that contribution rates payable are appropriate for that funding target. However, this is not always possible as any date of exit may be unknown (for example, participation may be assumed at present to be indefinite), and because market conditions change daily.

The administering authority's general approach in this area is as follows:

- Where the date of exit is known, and is more than three years away, or is unknown and assumed to be indefinite, interim valuations will generally not be required by the administering authority.
- For paragraph 1(d)(i) bodies (2013 Regulations – Schedule 2 Part 3) falling into the above category, the administering authority sees it as the responsibility of the Relevant Scheme Employer to instruct it if an interim valuation is required. Such an exercise would be at the expense of the Relevant Scheme Employer unless otherwise agreed.
- A material change in circumstances, for example the date of exit becoming known, material membership movements or material financial information coming to light may cause the administering authority to review the situation informally and subsequently request a formal interim valuation.
- Where an employer is due to leave the Fund within the next three years, the administering authority will monitor developments and may see fit to request an interim valuation at any time in order to try to effect a smoother transition to exit.

In addition, the administering authority reserves the right to request an interim valuation of any employer at any time in accordance with Regulation 64(4).

Inter-valuation funding valuations

In order to monitor developments, the administering authority may from time to time request informal valuations or other calculations. Generally, in such cases the calculations will be based on an approximate update of the asset and liability values, and liabilities calculated using assumptions consistent with the latest valuation. It is unlikely that the liabilities would be calculated using individual membership data, or that the demographic assumptions would be reviewed.

Guarantors

Some employers may participate in the Fund by virtue of the existence of a Guarantor. The administering authority maintains a list of employers and their Guarantors. For any new admission body wishing to join the Fund, the administering authority will require a Guarantor. The administering authority, unless notified otherwise, sees the role of a Guarantor to include the following:

- If an employer leaves the Fund and defaults on any of its financial obligations

to the Fund, the Guarantor is expected to provide the Fund with the amount certified by the Fund's actuary as due, including any interest payable.

- If the Guarantor is also an employer in the Fund and is judged by the administering authority to have suitable financial security, the Guarantor may clear some of the financial liability by subsuming the residual liabilities into its own pool of Fund liabilities. In other words, it agrees to be a source of future funding in respect of those liabilities should future deficiencies emerge.

During the period of participation of the employer a Guarantor may at any time agree to the future subsumption of any residual liabilities of that employer. That action may reduce the funding target for the employer, which may, in turn, lead to reduced contribution requirements.

In extreme circumstances the Guarantor may be permitted to subsume all assets and liabilities of an employer including the inheritance of any deficiency. However, where the Guarantor is a grouped employer, the administering authority may insist upon the Guarantor meeting the contributions required to clear the deficiency inherited by the Guarantor, to protect the other employers in the Guarantor's group from this element of the group's deficiency.

Bonds and other securitisation

Paragraph 7 of Part 3 of Schedule 2 of the 2013 Regulations creates a requirement for a new admission body to carry out to the satisfaction of the administering authority (and the Relevant Scheme Employer in the case of paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations), an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.

Where the level of risk identified by the assessment is such as to require it the admission body shall enter into an indemnity or bond with an appropriate party. Where it is not desirable for an admission body to enter into an indemnity or bond, the body is required to secure a guarantee in a form satisfactory to the administering authority from an organisation who either funds, owns or controls the functions of the admission body.

The administering authority's approach in this area is as follows:

- In the case of paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations, and other admission bodies with a Guarantor, so long as the administering authority judges the Relevant Scheme Employer or Guarantor to have suitable financial security, any bond exists purely to protect the Relevant Scheme Employer against default of the admission body. It is entirely the responsibility of the Relevant Scheme Employer or Guarantor to arrange any risk assessments and decide the level of required bond. The administering authority can supply some standard calculations provided by the Fund's actuary to aid the Relevant Scheme Employer or Guarantor, but this should in no way be taken as advice on this matter. Levels of required bond cover can fluctuate and the administering authority recommends that Relevant Scheme Employers review required cover regularly, at least once a year.
- In the case of paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of

the 2013 Regulations, where the administering authority does not judge the Relevant Scheme Employer to have suitable financial security, the administering authority must be involved in assessing the required level of bond to protect the Fund. Admission can only proceed once the administering authority has agreed the level of bond cover. Levels of required bond cover can fluctuate and the administering authority will require the Relevant Scheme Employer to review required cover jointly with it regularly, at least once a year.

- In the case of bodies other than paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations, the administering authority must be involved in assessing the required level of bond to protect the Fund. Admission can only proceed once the administering authority has agreed the level of bond cover. Levels of required bond cover can fluctuate and the administering authority will review required cover regularly, at least once a year.

To enable employers' contribution rates to be kept as stable as possible and affordable for the Fund's employers (subject to the administering authority not taking undue risks) whilst achieving and maintaining solvency

Achieving stability in employers' contribution rates requires investment in assets that 'match' the Fund's liabilities. In this context, 'match' means behaving in a similar way to the liabilities as economic conditions alter. Of the main strategic asset classes, index-linked and fixed-interest investments would tend to be the best match for the Fund's liabilities.

Other asset classes, such as shares and property, offer the potential for higher long-term rates of return leading to more affordable contribution rates for employers. A substantial proportion of the Fund's investments are held in these asset classes with the aim of increasing investment returns. However, these asset classes are more risky and can lead to volatile returns over short-term periods, and a failure to deliver the anticipated returns in the long term.

This short-term volatility in investment returns can lead to similar volatility in the Fund's solvency level in successive actuarial valuations, which in turn can mean volatility in employers' contribution rates. Such volatility can be reduced by using smoothing adjustments as advised by the Fund's actuary.

Maintaining stability in employers' contribution rates can run counter to the main aim of ensuring solvency. There is a need to strike a balance between the investment policy, smoothing adjustments used when carrying out actuarial valuations, and the stability of employers' contribution rates from one valuation period to the next.

The position can be even more volatile for admission bodies and other employers which participate in the Fund for a fixed period (for example, non-local authority employers awarded contracts to provide local authority services), where use of smoothing adjustments is less appropriate.

The administering authority recognises that a balance needs to be struck regarding the financial demands made of admission bodies. On the one hand, the administering authority requires all admission bodies to be fully self funding (either

on a grouped or an individual basis), such that other employers in the Fund are not subject to expense as a consequence of the participation of those admission bodies. On the other hand, requiring contributions to target full funding at all times, without further smoothing, may cause failure of the body in question in periods of extreme economic conditions, leading to significant costs for other participating employers.

Under economic circumstances which the administering authority judges to be extreme, the administering authority may determine that the contribution pattern required to target full funding can be temporarily relaxed for bodies in the Admission Body Group to enable contributions to remain affordable in the short term. Effectively the contribution pattern can be back-end loaded to a greater extent than would otherwise be permitted. However should a body in the Admission Body Group leave the Fund during the relaxation period, that body would be required to make good its funding deficiency including any underpayment on account of contributions having been relaxed. Only if that body is unable to meet any exit deficiency and there is no Guarantor would other solutions to the ongoing funding of the body's liabilities be sought (such as the Scheduled Bodies funding group providing future funding for any deficiency which cannot be met by the outgoing community admission body).

At subsequent valuations the position will be reassessed with a view to returning admission bodies to paying contributions which target full funding.

To maximise the income from investments within reasonable risk parameters

Returns should be higher over the long term than those from index-linked stocks by investing in other asset classes such as shares, property and alternative investments. However, investment is restricted as specified in the LGPS investment regulations.

Risk parameters are controlled by restricting investment to asset classes generally recognised as appropriate for UK pension funds. From time to time the administering authority reviews the potential risks of investing in the various asset classes, with help from the Fund's actuary and its investment managers.

The Fund's funding strategy requires the assets to deliver a long-term return of 2.3% a year above a low-risk portfolio. This is defined as a portfolio invested 95% in index-linked gilts and 5% in fixed-interest gilts. An investment management structure has been developed and managers appointed to deliver this long-term return within an acceptable level of risk. Details of the structure and managers are in the Statement of Investment Principles.

Purposes of the Fund

The purposes of the Fund are:

- to pay out pensions and benefits, transfer values for Fund members moving to other schemes, and other costs, charges and expenses
- to receive contributions, transfer values for Fund members moving from other schemes, and investment income.

Responsibilities of the key parties

The three main parties with obligations to the Fund are the County Council as administering authority, the other employers in the Fund, and the Fund's actuary. The administering authority delegates responsibility for fulfilling its obligations to the Joint Pension Fund Panel and Board.

The County Council's obligations as administering authority

- To administer the Fund.
- To collect investment income and other amounts due to the Fund as set out in the Local Government Pension Scheme 2013 Regulations including employers' and employees' contributions and, as far as possible, make sure they are paid by the due date as specified in the LGPS regulations.
- To invest surplus money in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the Investment Regulations).
- To pay from the Fund the relevant entitlements as set out by the Local Government Pension Scheme 2013 Regulations.
- To make sure that cash is always available to meet the Fund's liabilities when they are due.
- To manage the valuation process in consultation with the Fund's actuary, agreeing appropriate timescales and providing accurate data.
- To monitor regularly the Fund's investment performance and funding level.
- To prepare and maintain a Statement of Investment Principles and a Funding Strategy Statement.
- To notify the Fund's actuary of any material events which could affect funding strategy or funding levels.
- To effectively manage any potential conflicts of interest arising from its dual role as both administering authority and as a Scheme Employer.

Individual employers' obligations

- To deduct contributions from employees' pay, and make employers' contributions at the rates specified by the Fund's actuary, paying both to the administering authority by the due date.
- To develop a policy on certain discretions and exercise discretions allowed to employers within the LGPS regulations.
- To pay for agreed additional costs not covered by the employers' normal contributions.
- To keep the administering authority fully informed of all changes to membership, or other changes that could affect future funding .

The Fund actuary's obligations

The Fund's actuary will prepare advice and calculations and provide advice on:

- funding strategy and the preparation of the Funding Strategy Statement and will prepare actuarial valuations every three years, as required by law, or more frequently if required, including the setting of employers' contribution rates and issue of a Rates and Adjustments Certificate, after agreeing assumptions with the administering authority and having regard to the Funding Strategy Statement. Actuarial valuations will be carried out and reported on in accordance with the Technical Actuarial Standards as issued by the Financial Reporting Council as appropriate.
- bulk transfers
- individual benefit-related matters
- valuations on the cessation of admission agreements or when an employer ceases to employ any active members
- bonds and other forms of security for the administering authority against the financial effect on the Fund of the employers default
- assessment of the strength of covenant of employers or groups of employers for funding purposes
- the Fund's actuary will also assist the administering authority in assessing whether employer contributions need to be revised between actuarial valuations as required by the Regulations, and
- ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the administering authority.

Such advice will take account of the funding position and Funding Strategy Statement, as well as other relevant matters when instructed to do so.

Funding Strategy

Risk based approach

The Fund utilises a risk based approach to funding strategy.

A risk based approach entails carrying out the actuarial valuation on the basis of the assessed likelihood of meeting the funding objectives, rather than relying on a 'deterministic' approach which gives little idea of the associated risk. In practice, three key decisions are required for the risk based approach:

- what the Solvency Target should be (the funding objective - where the administering authority wants the Fund to get to),
- the Trajectory Period (how quickly the administering authority wants the Fund to get there), and
- the Probability of Funding Success (how likely the administering authority wants it to be now that the Fund will actually achieve the Solvency Target by the end of the Trajectory Period).

These three choices, supported by risk modelling carried out by the Fund's actuary, define the appropriate levels of contribution payable now and, by extension, the appropriate valuation approach to adopt now. Together they measure the riskiness of the funding strategy.

These three terms are considered in more detail below.

Solvency Target and Funding Target

Solvency and 'funding success'

The administering authority's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term. The Solvency Target is the amount of assets which the Fund wishes to hold at the end of the Trajectory Period (see later) to meet this aim, and is the value of the Fund's liabilities evaluated using appropriate actuarial methods and assumptions.

The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target.

For Scheduled Bodies, and certain other bodies of sound covenant whose participation is indefinite in nature, appropriate actuarial methods and assumptions are taken to be measurement by use of the Projected Unit method of valuation, and using assumptions such that, if the Fund's financial position continued to be assessed by use of such methods and assumptions, and contributions were paid in accordance with those methods and assumptions, there would be a better than evens chance that the Fund would continue to be 100% funded after a period of 25 years. The level of funding implied by this is the Solvency Target. For the purpose of this Statement, the required level of chance is defined as the Probability of Maintaining Solvency. The administering authority will generally assume indefinite investment in a broad range of assets of higher risk than risk-free assets for scheduled bodies and certain other bodies.

For certain Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund could potentially be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit, the required Probability of Maintaining Solvency will be set at a more prudent level dependent on circumstances. For most such bodies, the chance of achieving solvency will be set commensurate with assumed investment in an appropriate portfolio of Government index linked and fixed interest bonds after exit.

Probability of Funding Success

The administering authority deems funding success to have been achieved if the Fund, at the end of the Trajectory Period, has achieved the Solvency Target. The Probability of Funding Success is the assessed chance of this happening based on the level of contributions payable by members and employers.

Consistent with the aim of enabling employers' contribution rates to be kept as nearly constant as possible, the required chance of achieving the Solvency Target at the end of the relevant Trajectory Period for each employer or employer

group can be altered at successive valuations within an overall envelope of acceptable risk.

The administering authority will not permit contributions to be set following a valuation that have an unacceptably low chance of achieving the Solvency Target at the end of the relevant Trajectory Period. The administering authority will not adopt assumptions which, in its judgement and on the basis of actuarial advice received, mean that it is less than 55% likely that the strategy will deliver funding success. Where the Probability of Funding Success is less than 65% the administering authority will not adopt assumptions which lead to a material reduction in the aggregate employer contribution rate.

Funding Target

The Funding Target is the amount of assets which the Fund needs to hold at the valuation date to pay the liabilities at that date as indicated by the chosen valuation method and assumptions. It is a product of the triennial actuarial valuation exercise and is not necessarily the same as the Solvency Target. It is instead the product of the data, chosen assumptions, and valuation method. The valuation method including the components of Funding Target, future service costs and any adjustment for the surplus or deficiency simply serve to set the level of contributions payable, which in turn dictates the chance of achieving the Solvency Target at the end of the Trajectory Period (defined below). The Funding Target will be the same as the Solvency Target only when the methods and assumptions used to set the Funding Target are the same as the appropriate funding methods and assumptions used to set the Solvency Target (see above).

Consistent with the aim of enabling employers' 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. The Projected Unit method is used in the actuarial valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period.
- For employers who no longer admit new members, the Attained Age valuation method is normally used. This means that the contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.
- For bodies closed to new entrants and other bodies whose participation in the Fund could potentially be of limited duration through known constraints or reduced covenant, the administering authority will take into account the potential for participation to cease, the potential timing of such exit, and any likely change in investment strategy regarding the assets held in respect of the admission body's liabilities at the date of exit.

Recovery and Trajectory periods

The Trajectory Period in relation to an employer is the period between the

valuation date and the date which solvency is targeted to be achieved. A Trajectory Period of 22 years has been adopted at the 2013 valuation.

When an actuarial valuation shows that the Fund is in deficiency, employers' contribution rates will be adjusted to achieve a 100% funding ratio over a period of years (the Recovery Period), while ensuring that the probability of achieving solvency over the Trajectory Period remains acceptable. In consultation with the Fund's actuary, the administering authority has set a common maximum recovery period of 30 years for all employers in the Fund. The actual recovery period within this maximum of 30 years is determined at each actuarial valuation by balancing the Fund's solvency requirements against the financial strength of the Fund's main scheduled employers.

The Fund's liabilities mostly take the form of benefit payments over long periods of time. The main scheduled employers in the Fund are financed through central and local taxation and can be viewed as very financially secure. As these employers ultimately underwrite the Fund's finances, the administering authority has agreed a recovery period of 22 years for scheduled bodies in the 2013 actuarial valuation. This is consistent with keeping employers' contribution rates as stable as possible. Were any employers to participate in the Fund for a short period only, the administering authority and Fund's actuary would be unlikely to agree to their having a recovery period longer than their remaining term of participation.

Grouping of Employers

In some circumstances it is desirable to group employers within the Fund together for funding purposes (i.e. to calculate employer contribution rates). Reasons might include reducing the volatility of contribution rates for employers, facilitating situations where employers have a common source of funding or accommodating employers who wish to share the risks related to their participation in the Fund.

Employers may be grouped entirely, such that all of the risks of participation are shared, or only partially grouped such that only specified risks are shared.

All employers in the Fund are grouped together regarding the risks associated with payment of lump sum benefits on death in service. The cost of such benefits is shared across the employers in the Fund. This is because the Fund, in view of its size, does not see it as cost effective or necessary to insure these benefits externally.

Group Funding Framework

Within the Fund there are two large groups of employers for funding purposes; the Scheduled Body Group and the Admission Body Group. Employers within a group share all risks of participation, with the exception of liability for lump sum benefits payable on death in service, with other employers in the group. A small, but increasing, number of employers sit outside of the groups.

Scheduled Body Group

The Scheduled Body Group includes:

- Scheduled bodies listed in **Part 1 of Schedule 2** of the Regulations,

excepting those employers (or category of employers) who in the view of the Administering Authority:

- Are deemed by central government to be private sector organisations, or
- Receive a significant proportion of their income from either non-government sources or otherwise are not considered to have a central or local government guarantee, or
- Are otherwise considered by the Administering Authority to be less financially secure than the principal councils to the extent that there is a perceived (or potential) covenant risk to the Fund.
- Town and Parish Council employers under **Part 2 (paragraph 2) of Schedule 2** of the Regulations who, due to their unique size and transience as active participating bodies, would benefit significantly from being able to share risks with a wider pool (and where the risk to that wider pool is deemed negligible)
- Paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations where
 - the employer was admitted to the Group before **[insert effective date of employer policy]**
 - there is a pass through arrangement with an employer which is itself a grouped scheduled body, and
 - that body and letting authority (as appropriate) adheres to any mechanisms as required by the Administering Authority to protect other grouped employers from the additional and unique risks which that body contributes to the Group.

With effect from **31 March 2016**, the following category of employers may cease to participate in the Scheduled Body Group to become ungrouped employers in the Fund:

- Bodies in the Higher Education and Further Education sector (including pre-92 Colleges and Universities)
- Admission bodies subject to a pass through arrangement where no satisfactory agreement has been reached to protect the other grouped employers from the actions of the admission body and the effect of the admission agreement being closed to new entrants.

The Administering Authority will keep under review the funding arrangements of all employers and may remove additional employers from the grouping arrangements should their situations change.

Admission Body Group

The Administering Authority views the purpose of the Admission Body Group to be primarily to smooth contributions for charities and other not-for-profit organisations which would otherwise be exposed to the potential of volatile

contributions. For historic reasons other admission bodies have participated in the Group. With effect from **31 March 2016**, the following category of employers may cease to participate in the Admission Body Group to become ungrouped employers in the Fund:

- Bodies in the Higher Education and Further Education sector (including post-92 Universities and independent schools). These bodies will become ungrouped employers, consistent with the treatment of other pre-92 Universities and colleges.
- Housing Associations. These are closed employers with no subsumption commitment.

Funding principles applying to grouped employers

Common employers' contribution rates are set for each of these groups, instead of individual contribution rates for each employer. The Administering Authority accepts that this can give rise to cross-subsidies between employers. However, employers in the Fund are required to make upfront contributions determined by the Fund's actuary to cover the costs of unreduced early retirements, which is a major distinction between employers over time. The Administering Authority and the Fund's actuary periodically review whether separate rates for individual employers or groups of employers are required.

The two large employer groups share risk according to a set of clearly defined principles which are as follows:

- The group exists to produce a common contribution rate for employers in the group
- Only the group funding target is relevant when producing a common contribution rate, and
 - An employer's cash contribution depends on its level of payroll, and any special arrangements put in place in relation to being a Relevant Scheme Employer for a grouped paragraph 1(d)(i) body admitted under Schedule 2 Part 3 of the 2013 Regulations,
 - While an employer has contributing members in the Fund, the employer will share a responsibility to contribute towards any emerging deficiency within the relevant funding group, or will benefit from an emerging surplus within the relevant funding group through a deduction against previous deficiency obligations.
- Unless it is a paragraph 1(d)(i) body admitted under Schedule 2 Part 3 of the 2013 Regulations, or as otherwise agreed between the administering authority and the employer, the employer is assumed to belong to the group indefinitely
 - As an employer can always be called upon to pay its share of any group deficiency, a flow of new entrants to the employer is required to finance this
 - Funding targets used to assess ongoing contributions at the triennial valuation are set using an ongoing actuarial basis that assumes participation is indefinite

- Employers are liable to fund deficiencies emerging at each valuation in proportion to their own payroll at the time of the valuation. Relevant Scheme Employers in relation to a grouped paragraph 1(d)(i) body admitted under Schedule 2 Part 3 of the 2013 Regulations will also be liable in respect of payroll transferred to the paragraph 1(d)(i) body, to the extent that the contributions are not fully covered by those made by the paragraph 1(d)(i) body,
- Streams of deficiency contributions, once certified at a valuation will normally remain in place for the duration of the relevant recovery period. New streams of such contributions will be certified at subsequent valuations in respect of new surplus or deficiency emerging at the relevant valuation. In certain circumstances, contribution streams set at a previous valuation may be modified at subsequent valuations if the administering authority and the Fund's actuary agree.
- Employers will pay a common future service contribution rate. Relevant Scheme Employers in relation to a grouped paragraph 1(d)(i) body will also be liable in respect of any increased rate payable in respect of the paragraph 1(d)(i) body by virtue of the admission agreement being a closed agreement,
- When employers exit the Fund they will be assumed to leave the group. The funding target adopted at that time will be assessed in light of the employer's circumstances and, in particular whether its liabilities will be subsumed (i.e. another employer or group will be responsible for the future funding of those liabilities) or will become orphan (where the Fund has no access to any future funding for those liabilities).

For most purposes, such as for the purpose of calculating an exit valuation or calculations under FRS17/IAS19, each employer in a group is assumed to have the same funding level as the group as a whole, based on the value of benefits accrued to date for the group as a whole and notional assets held in respect of the group. The funding level of the group is expressed as a percentage and calculated as:

notional assets held in respect of the group divided by value of benefits accrued to date for the group as a whole.

However, where circumstances dictate otherwise (e.g. to protect the remaining employers in a group), and it is necessary to allocate a notional value of assets to an employer in a group, this may be calculated as the value of the liabilities less the present value of the employer's stream of deficiency contributions.

Further aspects of funding strategy that may be relevant from time to time are described below:

Notional sub-funds

In order to establish contribution rates for individual employers or groups of employers it is convenient to subdivide the Fund notionally between the employers, as if each employer had its own notional sub-fund.

This subdivision is for funding purposes only. It is purely notional and does not imply any formal subdivision of assets, nor ownership of any particular assets or

groups of assets by any individual employer or group.

Roll forward of sub-funds

The notional sub-fund allocated to each employer or group will be updated allowing for all cashflows associated with that employer's or group's membership, including contribution income, benefits paid, transfers in and out and investment income allocated as set out below.

In some cases there is insufficient information to complete these calculations. In these circumstances:

- Where, in the opinion of the Fund's actuary, the unavailable cashflow data is of low materiality, estimated cashflows will be used.
- Where, in the opinion of the Fund's actuary, the unavailable cashflow data is material, the Fund's actuary will use an analysis of gains and losses to update the notional sub-fund. This method is less precise than using cashflows, and involves calculating gains and losses to the surplus or deficiency shown at the previous valuation to determine an expected surplus or deficiency at this valuation. This is compared with the liabilities evaluated at this valuation to calculate an implied notional asset holding.

Attribution of investment income

Where the Administering Authority has agreed with a scheme employer that the scheme employer will have a tailored asset portfolio notionally allocated to it, the assets notionally allocated to that employer will be credited with a rate of return appropriate to the agreed allocation.

Where the employer has not been allocated a tailored notional portfolio of assets, the assets notionally allocated to that employer will be credited with the rate of return earned by the Fund assets as a whole, adjusted for any return credited to those employers for whom a tailored notional asset portfolio exists.

Phasing in of new contribution rates

At each actuarial valuation, the Administering Authority will consider whether changes to employers' contribution rates should be payable immediately, or be phased in. The Administering Authority discusses with the Fund's actuary the risks of adopting such an approach. The current policy is to phase in over a maximum of three steps within each valuation period. However, such increases may be phased in over forthcoming and subsequent valuation periods, on a year-by-year basis, if unusual and difficult budgetary constraints make this necessary, or if other changes are expected, up to a maximum of nine steps.

Fund maturity

To protect the Fund, and individual employers, from the risk of increasing maturity producing unacceptably volatile contribution adjustments as a percentage of pay the administering authority will normally require defined capital streams from employers in respect of any disclosed funding surplus or deficiency.

In certain circumstances, for secure employers considered by the administering authority as being long term in nature, contribution adjustments to correct for any

disclosed surplus or deficiency may be set as a percentage of payroll. Such an approach carries an implicit assumption that the employer's payroll will increase at an assumed rate. If payroll fails to grow at this rate, or declines, insufficient corrective action will have been taken. To protect the Fund against this risk, the administering authority will monitor payrolls and where evidence is revealed of payrolls not increasing at the anticipated rate, the administering authority will consider requiring defined streams of capital contributions rather than percentages of payroll.

Identification of risks and counter measures

The administering authority recognises that future events and investment income cannot be predicted with certainty. Instead, there is a range of possible outcomes, and different assumed outcomes will lie at different places within that range.

The more optimistic the assumptions made, the more that outcome will sit towards the 'favourable' end of the range of possible outcomes, the lower will be the probability of events actually matching or being more favourable than the assumed events, and the lower will be the Funding Target calculated using those assumptions.

The administering authority will not adopt assumptions which, in its judgement, and on the basis of actuarial advice received, mean that it is less than 55% likely that the strategy will deliver funding success. Where the probability of funding success is less than 65% the administering authority will not adopt assumptions which lead to a material reduction in the aggregate employer contribution rate.

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 individual risk level. Risks to the Fund will be monitored and action taken to limit them as soon as possible. The main risks are as follows:

Investment risk

This covers items such as the performance of financial markets and the Fund's investment managers, asset reallocation in volatile markets, leading to the risk of investments not performing (income) or increasing in value (growth) as forecast. Examples of specific risks would be:

- assets not delivering the required return (for whatever reason, including manager underperformance)
- systemic risk with the possibility of interlinked and simultaneous financial market volatility
- insufficient funds to meet liabilities as they fall due
- inadequate, inappropriate or incomplete investment and actuarial advice is taken and acted upon
- counterparty failure

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income - yield curve, credit risks, duration risks and market risks
- alternative assets – liquidity risks, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risk
- macroeconomic risks

The administering authority reviews each investment manager's performance quarterly and annually considers the asset allocation of the Fund by carrying out an annual review meeting with its Investment Advisers, Fund Managers and Fund's actuary. The administering authority also annually reviews the effect of market movements on the Fund's overall funding position.

Employer risk

These risks arise from the ever-changing mix of employers, from short-term and ceasing employers, and the potential for a shortfall in payments and/or orphaned liabilities.

The administering authority will put in place a Funding Strategy Statement which contains sufficient detail on how funding risks are managed in respect of the main categories of employer (e.g. scheduled and admission bodies) and other pension fund stakeholders.

The administering authority maintains a knowledge base on their employers, their basis of participation and their legal status (e.g. charities, companies limited by guarantee, group/subsidiary arrangements) and uses this information to inform the Funding Strategy Statement.

Liability risk

The main risks include interest rates, pay and price inflation, life expectancy, changing retirement patterns and other demographic risks. The administering authority will make sure the Fund's actuary investigates these matters at each valuation, or more often if necessary. The Fund's actuary will report to the administering authority as appropriate. The administering authority will then agree with the Fund's actuary any necessary changes to the assumptions used in assessing solvency.

If significant liability changes become apparent between valuations, the administering authority will notify all participating employers of the likely effect on their contributions after the next full valuation, and consider whether any bonds that are in place for admission bodies require review.

Regulatory and Compliance risk

Regulatory risks relate to changes in LGPS regulations, including national pensions legislation and HM Revenue and Customs rules. The administering authority will keep abreast of all proposed changes and, whenever possible, comment on the Fund's behalf during consultation periods. The administering authority will ask the Fund's actuary to assess the effect of any changes on

employers' contribution rates.

The administering authority will then notify employers of how these rule changes are likely to affect their contribution rates at the next valuation, if they are significant.

Liquidity and maturity risk

The LGPS is going through a series of changes, each of which will impact upon the maturity profile of the LGPS and have potential cash flow implications. The increased emphasis on outsourcing and other alternative models for service delivery may result in the following:

- active members leaving the LGPS,
- transfer of responsibility between different public sector bodies,
- scheme changes which might lead to increased opt-outs
- spending cuts and its implications

All of these may result in workforce reductions that would reduce membership, reduce contributions and prematurely increase retirements in ways that may not been taken into account in previous forecasts.

The administering authority's policy is to require regular communication between itself and employers and to ensure reviews of maturity at overall Fund and employer level where material issues are identified.

Governance risk

This covers the risk of unexpected structural changes in the Fund's membership (for example, if an employer closes their scheme to new entrants or if many members withdraw or groups of staff retire), and the related risk of an employer failing to notify the administering authority promptly.

To limit this risk, the administering authority requires the other participating employers to communicate regularly with it on such matters. The administering authority also undertakes to inform the Fund's actuary promptly of any such matters.

Smoothing

The use of a smoothing adjustment to the value of the Fund's assets introduces an element of risk, in that the smoothing adjustment may not provide a correct measure of the underlying position. Any adjustment is reviewed at the end of each valuation to ensure it remains within acceptable limits.

Recovery period

Allowing surpluses or deficiencies to be eliminated over a recovery period of up to 30 years means there is a risk that too little will be done to restore solvency between successive actuarial valuations. The associated risk is reviewed with the Fund's actuary as part of the three-yearly valuation process, to ensure as far as

possible that enough is done to restore solvency. In practice, the smoothing arrangements described above deal with this.

Stepping

Increasing employers' contribution rates in annual steps rather than immediately introduces a risk that too little will be done to restore solvency in the early years of the process. The administering authority's policy is to limit the number of permitted steps to three, or, in exceptional circumstances, nine. In addition, it accepts that a slightly higher final rate may be necessary at the end of the stepping process to help make up the shortfall.

For admission bodies subject to an underwriting arrangement, up to nine steps will be permitted.

Links to investment policy set out in the Fund's Statement of Investment Principles

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 (available from Pensions, Investments and Borrowing, Corporate Services, Hampshire County Council) and is included below.

Both documents are subject to regular review.

Future monitoring

The administering authority plans to review this Statement as part of the three-yearly actuarial valuation process unless circumstances arise that require earlier action.

The administering authority and the Fund's actuary will monitor the Fund's solvency position at regular intervals between valuations. Discussions will be held with the Fund's actuary to establish whether any changes are significant enough to require further action, such as informing employers of the need for different employers' contribution rates after the next valuation.