Nottinghamshire County Council

Nottinghamshire Pension Fund

April 2018

FUNDING STRATEGY STATEMENT

Introduction

1. This is the Funding Strategy Statement (FSS) for the Nottinghamshire County Council Pension Fund. It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 ("the Regulations") and describes Nottinghamshire County Council's strategy, in its capacity as Administering Authority, for the funding of the Nottinghamshire County Council Pension Fund ("the Fund").

2. This statement has regard to the guidance set out in the document "Preparing and Maintaining a Funding Strategy Statement" published by CIPFA in February 2016. The statement also has regard to the Investment Strategy Statement published by the Administering Authority in March 2017.

3. The Statement describes a single strategy for the Fund as a whole. The Fund Actuary, Barnett Waddingham LLP, has been consulted on the contents of this Statement.

Purpose of the Funding Strategy Statement

4. The purpose of this Funding Strategy Statement is to explain the funding objectives of the Fund and in particular:

- How the costs of the benefits provided under the Local Government Pension Scheme (the "Scheme") are met through the Fund
- The objectives in setting employer contribution rates
- The funding strategy that is adopted to meet these objectives.

Aims and Purpose of the Fund

5. The aims of the Fund are to:

- Manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due
- Achieve and maintain Fund solvency and long-term cost efficiency at reasonable cost to taxpayers, scheduled, resolution and admitted bodies, and enable contribution rates to be kept as nearly constant as possible where practical
- Seek returns on investment within reasonable risk parameters

6. The purpose of the Fund is to:

- Pay pensions, lump sums and other benefits provided under the Regulations
- Meet the costs associated in administering the Fund
- Receive contributions, transfer values and investment income.

Key Parties

7. The key parties involved in the funding process and their responsibilities are as follows.

The Administering Authority

8. The Administering Authority for the Pension Fund is Nottinghamshire County Council. The main responsibilities of the Administering Authority are to:

- Collect employee and employer contributions
- Invest the Fund's assets, while ensuring cash is available to meet liabilities as and when they fall due
- Pay the benefits due to Scheme members
- Take measures to safeguard the Fund against the consequences of employer default
- Manage the actuarial valuation process in conjunction with the Fund Actuary, and enable the Local Pensions Board to review the valuation process as they see fit
- Prepare and maintain this FSS and the Investment Strategy Statement (ISS) after consultation with other interested parties as appropriate
- Monitor all aspects of the Fund's performance and funding
- Effectively manage any potential conflicts of interest arising from its dual role as both Administering Authority and Scheme employer

Scheme Employers

9. In addition to the Administering Authority, a number of other Scheme Employers, including Admission Bodies, participate in the Fund. The responsibilities of each Scheme Employer that participates in the Fund, including the Administering Authority, are to:

- Collect employee contributions and pay these together with their own employer contributions certified by the Fund Actuary to the Administering Authority within the statutory timescales, including any exit payments on ceasing participation in the Fund
- Notify the Administering Authority of any new Scheme members and any other membership changes promptly
- Develop a policy on certain discretions and exercise those discretions as permitted under the Regulations
- Meet the costs of any augmentations or other additional costs in accordance with agreed policies and procedures
- Notify the Administering Authority of significant changes in the employer's structure or membership.

Fund Actuary

10. The Fund Actuary for the Pension Fund is Barnett Waddingham LLP. The main responsibilities of the Fund Actuary are to:

- Advise interested parties on funding strategy and completion of actuarial valuations in accordance with the FSS and the Regulations, and in particular, set contribution rates in order to secure the Fund's solvency and long-term cost efficiency, having regard to the desirability of maintaining as nearly constant a primary contribution rate as possible.
- Advise on other actuarial matters affecting the financial position of the Fund, including bulk transfers, employer exit valuations, etc.

- 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 Fund.

Solvency Issues, Target Funding Levels and Long-term Cost Efficiency

Funding Objectives

11. The funding objectives are to:
- Set levels of employer contribution that will build up a fund of assets that will be sufficient to meet all future benefit payments from the Fund as they fall due
- Ensure the solvency and long-term cost efficiency of the Fund, while having regard to the desirability of maintaining as nearly constant employer contribution rates where practical
- Set contributions to target a 100% funding level over an appropriate time period using appropriate actuarial assumptions

Funding Strategy

12. The factors affecting the Fund's finances are constantly changing, so it is necessary for its financial position and the contributions payable to be reviewed from time to time by means of an actuarial valuation to check that the funding objectives are being met.

13. The actuarial valuation involves a projection of future cash flows to and from the Fund. The main purpose of the valuation is to determine the level of employers' contributions that should be paid to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund.

14. The last actuarial valuation was carried out as at 31 March 2016 with the assets of the Fund found to be 87% of the accrued liabilities of the Fund.

Funding Method

15. The key objective in determining employer's contribution rates is to establish a funding target and then set levels of employer contribution to meet that target over an agreed period.

16. The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund. The funding target may, however, depend on certain employer circumstances and in particular, whether an employer is an "open" employer – one which allows new staff access to the Fund, or a "closed" employer which no longer permits new staff access to the Fund. The expected period of participation by an employer in the Fund may also affect the chosen funding target.

17. For open employers, the actuarial funding method that is adopted is known as the Projected Unit Funding Method which considers separately the benefits in respect of service completed before the valuation date ("past service") and benefits in respect of service expected to be completed after the valuation date ("future service"). This approach focuses on:
- The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service. It makes allowance for future increases to members' pay for pensions in payment. A funding level in excess of 100 per cent indicates a

surplus of assets over liabilities; while a funding level of less than 100 per cent indicates a deficit
- The future service funding rate which is the level of contributions required from the individual employers which, in combination with employee contributions, is expected to support the cost of benefits accruing in future.

18. The key feature of this method is that, in assessing the future service cost, the contribution rate represents the cost of one year's benefit accrual.

19. For closed employers, the funding method adopted is known as the Attained Age Method. The key difference between this method and the Projected Unit Method is that the Attained Age Method assesses the average cost of the benefits that will accrue over the remaining expected working lifetime of active members.

Valuation Assumptions and Funding Model

20. In completing the actuarial valuation it is necessary to formulate assumptions about the factors affecting the Fund's future finances such as inflation, pay increases, investment returns, rates of mortality, early retirement and staff turnover.

21. The assumptions adopted at the valuation can therefore be considered as:
- The statistical assumptions which are essentially estimates of the likelihood of benefits and contributions being paid
- The financial assumptions which will determine the estimates of the amount of benefits and contributions payable and their current or present value. The base market statistics used for the financial assumptions are smoothed around the valuation date so that the market conditions used are the average of the daily observations over the three months before and the three months after the valuation date.

22. A summary of the key assumptions is included in the following table and can be found in the actuarial valuation report as at 31 March 2016. Further details regarding the derivation of these assumptions can be found in the Fund Actuary's initial results and assumptions advice to the Fund dated 5 October 2016.

Assumption	Derivation	Value at 31 March 2016
Future Price Inflation (RPI)	Smoothed 20 year point on the Bank of England implied Retail Price Index inflation curve as at 31 March 2016	3.3% p.a.
Future Price Inflation (CPI)	RPI less 0.9% per annum to reflect the differences in the indices	2.4% p.a.
Salary increases	Assumed to be in line with CPI until 31 March 2020 and then CPI plus 1.5% p.a. thereafter	2.4% p.a. until 31 March 2020 then 3.9% p.a.

Discount rate	Based on the long-term investment strategy of the Fund, with deductions for expenses and prudence	5.4% p.a.
Post-retirement mortality	S2PA tables with a multiplier of 100% for males and 90% for females, projected into the future with the 2015 CMI Model with a long-term rate of improvement of 1.5% p.a.	n/a

Future Investment Returns/Discount Rate

23. To determine the value of accrued liabilities and derive future contribution requirements it is necessary to discount future payments to and from the Fund to present day values. The discount rate that is adopted will depend on the funding target adopted for each employer.

24. For open employers, the discount rate that is applied to all projected liabilities reflects a prudent estimate of the rate of investment return that is expected to be earned from the underlying investment strategy by considering average market yields in the six months straddling the valuation date. The discount rate so determined may be referred to as the "ongoing" discount rate.

25. For closed employers, an adjustment may be made to the discount rate in relation to the remaining liabilities, once all active members are assumed to have retired if at that time (the projected "termination date"), the employer becomes an exiting employer under Regulation 64. The Fund Actuary may incorporate such an adjustment after consultation with the Administering Authority.

26. The adjustment to the discount rate for closed employers is to set a higher funding target at the projected termination date, so that there are sufficient assets to fund the remaining liabilities on a "minimum risk" rather than on an ongoing basis. The aim is to minimise the risk of deficits arising after the termination date.

Asset Valuation

27. For the purposes of the valuation, the asset value used is the market value of the accumulated Fund at the valuation date adjusted to reflect average market conditions during the six months straddling the valuation date.

Deficit Recovery/Surplus Amortisation Periods

28. Whilst one of the funding objectives is to build up sufficient assets to meet the cost of benefits as they accrue, it is recognised that at any particular point in time, the value of the accumulated assets will be different from the value of accrued liabilities, depending on how the

actual experience of the Fund differs from the actuarial assumptions. Accordingly the Fund will normally either be in surplus or in deficit.

29. Where the actuarial valuation reveals a deficit in respect to a particular employer then the levels of required employer contributions will include an adjustment to fund the deficit over a specified period. Each employer’s recovery period is considered individually, unless they are part of a pool (see Pooling of Individual Employers). Past service deficit contributions are generally paid as monetary amounts but may be paid as a percentage of payroll, subject to the Administering Authority agreeing this approach.

30. At the 2016 actuarial valuation, no employers’ deficit recovery periods were greater than 20 years.

31. Where an employer’s funding position has improved in the inter-valuation period, but the employer is still in deficit, the employer may be required to maintain the previous total contribution level so that the expected deficit recovery period reduces.

32. Incremental phasing-in (stepping) of contribution increases may be considered for some employer types where proposed increases are large, with target rates to be achieved in no later than 3 years. Where stepping is agreed to, employers are instructed that the difference between the employer contributions with stepping and the employer contributions without stepping will need to be repaid later in the recovery period.

33. Employers in surplus on their funding method will generally pay the future service rate although the surplus may be released back to the employer through an adjustment to their contribution rate. The Fund Actuary will consider each employer separately when deciding whether surplus amortisation is appropriate.

Pooling of Individual Employers

34. The general policy of the Fund is that each individual employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly, contribution rates are set for individual employers to reflect their own particular circumstances.

35. However, certain groups of individual employers are pooled for the purposes of determining contribution rates to recognise common characteristics or where the number of Scheme members is small.

36. The main purpose of pooling is to produce more stable employer contribution levels in the longer term whilst recognising that ultimately there will be some level of cross-subsidy of pension cost amongst pooled employers.

37. Currently, other than Scheme employers that are already legally connected, there are the following pools:

- Small Scheduled Bodies pool
- Grouped Admission Bodies pool
- Fund Academies pool

Cessation Valuations

38. On the cessation of an employer's participation in the Scheme, the Fund Actuary will be asked to make a termination assessment, as required by the Regulations. Any deficit in the Fund in respect of the employer will be due to the Fund as a termination contribution, unless it is agreed by the Administering Authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Fund to another participating employer.

39. In assessing the financial position on termination, the Fund Actuary may adopt a discount rate based on gilt yields and adopt different assumptions from those used at the previous valuation in order to protect the other employers in the Fund from having to fund any future deficits which may arise from the liabilities that will remain in the Fund.

Links to Investment Policy

40. The investment strategy and the funding strategy are linked by the strategic asset allocation of the Fund, which has been set following advice from the Fund's investment adviser and with regard, amongst other considerations, the maturity profile of the Fund.

41. The actuarial valuation involves a projection of future cashflows from the Fund and these cashflows are discounted to the current time, using the discount rate, to obtain a single figure for the value of the past service liabilities. This figure is the amount of money, which if invested now, would be sufficient to make those payments in future provided that the assumptions made during the valuation were borne out in practice (in particular, if the future investment return was equal to the discount rate used).

42. The discount rate is based on the expected long-term future investment return, using the long-term strategic allocation set out in the Investment Strategy Statement, with a deduction for expenses and for prudence.

Risks and Counter Measures

43. Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of employer contributions, it is recognised that there are risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.

44. The major risks to the funding strategy are financial, although there are other external factors including demographic risks, regulatory risks and governance risks.

Financial Risks

45. The main financial risk is that the actual investment strategy fails to produce the expected rate of investment return (in real terms) that underlies the funding strategy. This could be due to a number of factors, including market returns being less than expected and/or the fund managers who are employed to implement the chosen investment strategy failing to achieve their performance targets.

46. The valuation results are most sensitive to the real discount rate. Broadly speaking an increase/decrease of 0.1% per annum in the real discount rate will decrease/increase the valuation of the liabilities by 2%, and decrease/increase the required employer contribution by around 1% of payroll.

47. However, the Pension Fund Committee regularly monitors the investment returns achieved by the fund managers and receives advice from officers and independent advisers on investment strategy.

48. The Committee may also seek advice from the Fund Actuary on valuation related matters. In addition, the Fund Actuary may provide funding updates between valuations to check whether the funding strategy continues to meet the funding objectives.

Demographic Risks

49. Allowance is made in the funding strategy via the actuarial assumptions for a continuing improvement in life expectancy. However, the main demographic risk to the funding strategy is that it might underestimate the continuing improvement in longevity. For example, an increase of one year to life expectancy of all members in the Fund will reduce the funding level by approximately 1%.

50. The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review.

51. The liabilities of the Fund can also increase by more than has been planned as a result of early retirements. However, the Administering Authority monitors the incidence of early retirements and procedures are in place that require individual employers to pay additional amounts into the Fund to meet any additional costs arising from early retirements.

Regulatory Risks

52. The benefits provided by the Scheme and employee contribution levels are set out in Regulations determined by central Government. Regulations also place certain limitations on how the assets can be invested. The tax status of the invested assets is also determined by the Government.

53. The funding strategy is therefore exposed to the risks of changes in the Regulations governing the Scheme and changes to the tax regime which may affect the cost to individual employers participating in the Scheme.

54. However, the Administering Authority participates in any consultation process of any proposed changes in Regulations and seeks advice from the Fund Actuary on the financial implications of any proposed changes.

Employer Risks

55. Many different employers participate in the Fund. Accordingly, it is recognised that a number of employer-specific events could impact on the funding strategy including:

- Structural changes in an individual employer's membership
- An individual employer deciding to close the Scheme to new employees
- An employer ceasing to exist without having fully funded their pension liabilities.

56. The Administering Authority monitors the position of employers participating in the Fund, particularly those which may be susceptible to the events outlined, and takes advice from the Fund Actuary when required.
57. In addition, the Administering Authority keeps in close touch with all individual employers participating in the Fund to ensure that, as Administering Authority, it has the most up to date information available on individual employer situations. It also keeps individual employers briefed on funding and related issues.

Monitoring and Review

58. This FSS is reviewed formally, in consultation with the key parties as appropriate, at least every three years to tie in with the triennial actuarial valuation process.

59. The Administering Authority also monitors the financial position of the Fund between actuarial valuations and may review the FSS more frequently if necessary.