Nottinghamshire County Council Pension Funds
Funding Strategy Statement

March 2011

This Statement has been prepared by Nottinghamshire County Council (the Administering Authority) to set out the funding strategy for the Nottinghamshire County Council Pension Fund (the Scheme), in accordance with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2007 (as amended) and the guidance paper issued in March 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.

1. Introduction

1.1 The Local Government Pension Scheme Regulations 2007, as amended ("the Regulations"), provide the statutory framework under 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:

- 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 Scheme published under Regulation 9A of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended)
    - consult such persons as it considers appropriate.
- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles

1.2 Benefits payable under the Scheme are guaranteed by statute and thereby 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 Regulations. The required levels of employee contributions are also specified in the Regulations.

1.3 Employer contributions are determined in accordance with the Regulations (principally Regulation 36) which require that an actuarial valuation is completed every three years by the actuary, including provision of a rates and adjustments certificate. Contributions to each Scheme 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

2.1 Funding is 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 of 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.

2.2 **The purpose of this Funding Strategy Statement 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
- 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 Scheme as a whole, recognising that there will be conflicting objectives which 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 Pension Fund

3.1 **The aims of the fund are to:**

- enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies
- manage employers' liabilities effectively
- ensure that sufficient resources are available to meet all liabilities as they fall due
- maximise the returns from investments within reasonable risk parameters

3.2 **The purpose of the fund is to:**

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

as defined in the Local Government Pension Scheme Regulations 2007 (as amended) and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

4. Responsibilities of the Key Parties

4.1 **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 actuary
- prepare and maintain an FSS and SIP, both after due consultation with interested parties
- monitor all aspects of the Scheme's performance and funding and amend FSS/SIP.

4.2 **The Individual Employer should:**

- deduct contributions from employees' pay correctly
- pay all contributions, including their own as determined by the 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
- notify the Administering Authority promptly of all changes to membership, actual or proposed which may affect future funding.

4.3 **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
- advise on the preparation of the FSS.

5. Solvency Issues and Target Funding Levels

5.1 To meet the requirements of the Regulations the Administering Authority's long term funding objective is for the Funds to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the "funding target") assessed on an ongoing basis including allowance for projected final pay.

5.2 The principal method and assumptions to be used in the calculation of the funding target are set out in Appendix A. Underlying these assumptions are the following two tenets:

- that the Scheme and the major employers are expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

5.3 As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer (or employer grouping), following a principle of no cross-subsidy between the various employers in each of the Scheme.

5.4 In attributing the overall investment performances obtained on the assets of the Scheme to each employer, a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole. However, under exceptional circumstances the Administering Authority may agree an alternative approach with a particular employer.

5.5 The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates:

a. Employer groupings will be adopted for certain employers with small numbers of members in the Fund, specifically Small Scheduled Bodies and the Grouped Admission Bodies.

b. A maximum deficit recovery period of 20 years will apply Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan below).

c. Any significant increases in employer contributions following an actuarial valuation may be phased in over an agreed period depending upon each employer's circumstances.

d. The Administering Authority may agree an alternative pattern of contribution rates in a particular case, where appropriate to the employer in question.

e. Nottinghamshire County Council is responsible for surpluses and deficits arising in respect of the former employees of certain bodies in the Admission Agreement Etc Fund. The treatment of such surpluses and deficits is agreed between the Administering Authority and the Fund actuary at each triennial valuation.

f. 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 will be due to the Scheme 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 Scheme to another participating employer. In assessing the deficit on termination, the actuary may adopt a discount rate based on gilt yields and adopt different assumptions from those used at the previous valuation to protect the other employers in the Fund from having to fund any future deficits from the liabilities that will remain in the Fund.

5.6 In determining the above objectives the Administering Authority has had regard to:

- relevant guidance issued by the CIPFA Pensions Panel
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose,
- the Government's aims as regards increases in local authority pension costs
- the Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.

5.7 If the assets within the appropriate scheme relating to a particular employer are less than the funding target at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall. Additional contributions will be expressed as a level percentage of pensionable payroll, unless arrangements are made otherwise in relation to any particular employer(s).

5.8 In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of the employer;
- the assessment of the financial covenant of the Employer;
- any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.

5.9 In addition to any contributions required to rectify a shortfall of assets below the funding target contributions will be required to meet the cost of future accrual of benefits for members after the valuation date. The method and assumptions for assessing these contributions are also set out in Appendix A.

5.10 All costs in relation to non-ill health early retirement costs will be funded as they occur. Employers may however meet the cost of the early payment strain element in 3 payments over a 2 year period from the date of retirement. These costs will be assessed on the basis of the actuary's advice.

6. Link to Investment Policy

6.1 The investment policy of the funds is set out in the Statement of Investment Principles (SIP). In assessing the value of the Scheme's liabilities in the valuation, the funding basis sets the discount rate to value the liabilities as the expected investment return from the agreed investment strategy taking into account the investment strategy adopted by the Scheme, as set out in the SIP.

6.2 The results of the 2010 valuation in respect of the Nottinghamshire County Council Pension Fund show the liabilities to be 84% covered by the current assets, with the funding deficit of 16% being covered by future deficit contributions. .

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

Equities	55% - 75%
Property	5% - 25%
Bonds	10% - 25%
Cash	0% - 10%

6.3 The Fund will be invested on a core/satellite approach, with approximately 40% of the fund managed in-house on an enhanced index-tracking basis, and the balance with specialist managers who are given targets for out-performance against benchmarks.

7. Identification of Risks and Counter-measures

7.1 The funding of defined benefits is by its nature uncertain. Funding of the Scheme 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 assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

7.2 **Financial Risks**

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets in the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- Effect of possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies

7.3 **Demographic Risks**

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements

7.4 **Regulatory Risk**

- Changes to Regulations, e.g. more favourable benefits package, potential new entrants to the Scheme, e.g. part-time employees
- Changes to national pension requirements and/or Inland Revenue rules

7.5 **Governance Risks**

- Administering Authority unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements)
- Administering Authority not advised of an employer closing to new entrants
- An employer ceasing to exist with insufficient funding or adequacy of a bond
- Meetings by the Administering Authority taking place infrequently
- Insufficient training being provided to members
- Inadequate procedures for taking and recording decisions
- Lack of continuity of membership of the Pensions Committee and its Sub-Committees

8. Monitoring and Review

8.1 The Administering Authority has taken advice from the actuary in preparing this Statement.

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

8.3 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 the Scheme's 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

- if there have been any significant special contributions paid into the Scheme.

Actuarial Valuation as at 31 March 2010

Method and assumptions used in calculating the funding target and recovery plan

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 ageing and decline of the current closed membership group.

Financial assumptions

Investment return (discount rate)

The discount rate adopted at the 2010 valuation represented the expected investment return from the agreed investment strategy. In nominal terms this resulted in a discount rate of 6.9% per annum. Further details can be found in the 2010 valuation report.

Inflation (Retail Prices Index)

The inflation assumption will be taken to be the investment market's expectation for inflation, adjusted to reflect possible distortion in the UK government index-linked gilt market arising from supply/demand issues. This is derived by taking 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, and reducing it by 0.25% p.a. The assumption adopted was 3.5% per annum.

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. An additional allowance has been made for promotional increases. However in anticipation of Government policy it has been assumed that there will be a short term "pay freeze" for 2 years for those earning over £21,000 per annum.

Pension increases

Previously, pension increases were assumed to be in line with retail price increases. The 2010 Emergency Budget announced that in future, the pension increase orders will be linked to the CPI rather than RPI. It was assumed that pension increases will be 0.5% less than the price inflation assumption. i.e. 3.0% per annum.

Mortality

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 S1PA Heavy tables allowing for medium cohort projection, with a minimum 1% improvement and a multiplier of 105%.
Members who retire on the grounds of ill heath are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 5 years older.

Commutation

It has been assumed that members on retirement will commute pension to provide a lump sum of 50% of the standard lump sum and the maximum allowed at a rate of £12 cash for each £1 p.a. of pension given up.