WIRRAL COUNCIL

PENSIONS COMMITTEE

21 MARCH 2017

SUBJECT:	**FUNDING STRATEGY STATEMENT**
WARD/S AFFECTED:	**ALL**
REPORT OF:	**MANAGING DIRECTOR FOR DELIVERY**
RESPONSIBLE PORTFOLIO HOLDER:	
KEY DECISION?	**NO**

1.0 EXECUTIVE SUMMARY

1.1 This report presents Members with the final version of the Funding Strategy Statement (FSS) following committee's previous consideration of the draft assumptions and policy document at its meeting of 15 November 2016 (minute 131 refers)

1.2 As members are aware, the refinement and finalisation of the FSS was delegated to officers subsequent to the completion of an open consultation process with constituent employers. The aim of the consultation was to encourage employer engagement to the process, with a view to implementing a funding plan which balances the Fund's solvency and long term cost efficiency against affordable employer contributions

1 3 An updated draft FSS is attached as Appendix 1, which following due consideration of the comments received, incorporates measures to permit alternative phasing patterns for specific financial periods; to align with employer budget constraints and provide an easement from the upward pressure on cash contributions.

1.4 The 2013 FSS has been updated to incorporate the full suite of discretionary policies that impact on funding and risk management. This action has improved the transparency of funding by presenting the individual synergistic policies in one document.

1.5 Subject to member approval of the FSS, the Fund Actuary (Mercer) will produce the Rates and Adjustment Certificate confirming the individual employer contributions for the financial period 1 April 2017 to 31 March 2020.

2.0 BACKGROUND AND KEY ISSUES

Principal Objective of the Funding Strategy Statement

2.1 The principal objective of the FSS is to secure the long term solvency of the Fund by achieving and maintaining sufficient assets to cover 100% of projected accrued liabilities, as assessed on an ongoing basis, including an allowance for projected final pay.

2.2 The FSS defines the parameters and actuarial assumptions to determine the valuation of the funds liabilities and the appropriate plan for making up any shortfall if assets are less than liabilities. It also has a direct impact on the setting of individual employer contributions required to cover the cost of the benefits that active members will build up in the future.

Actuarial Assumptions

2.3 The most significant actuarial assumptions are around:

a) **Financials** - expected investment returns, discount rates for liabilities, projected salary growth, pension increases

b) **Demographics** - mortality, ill health retirements, commutation rates

c) **Funding strategy** - length of recovery period, phasing of contributions, and segmentation and strength of employer covenant.

2.4 A synopsis of the assumptions used to complete the 2016 Triennial Valuation are presented within the separate Actuarial Valuation report on today's agenda and are also documented within Appendix A of the FSS.

Governance & Employer Engagement

2.5 The Fund has promoted employer engagement with the decision making process by arranging a number of employer forums and asked specifically for comments on:

- the appropriateness of the assumptions and in particular those that relate to pay and expectations of short term pay increases;
- the requirement for employers to at least maintain the same level of deficit recovery contributions as per the 2013 valuation where an employer is carrying a deficit;
- whether the level of detail was sufficient and the need for further explanations or meetings to understand the financial implications;
- whether they would be interested in ill health captive insurance.

2.6 In general, the respondents were supportive of the approach being applied and the transparency of the process, with all comments highlighting concerns about affordability giving the economic environment; with particular focus on their own organisation's financial constraints and budget forecasts for short and long term salary progression.

2.7 In recognition of employer budget pressures and the direct impact of increases to employer contributions on front line services, affordability will be taken into consideration when setting individual employer plans, with a number of flexible funding models incorporated within the FSS.

Ill Health Captive Insurance

2.8 A number of smaller employers also responded to support the introduction of an internal captive insurance arrangement to insure against employee ill health strain costs. This will be introduced from 1 April 2017 for Academies, Community related Admitted Bodies and Resolution Bodies.

2.9 The rationale for the change in policy is that whilst ill health retirements are reasonably rare, when they occur they can generate a significant cost to the employer. This potential funding cost is becoming a significant concern for a number of the Fund's smaller employers and a risk to the Fund.

2.10 A captive type arrangement within the Fund would smooth out the effect on ill health retirements for those employers covered by the arrangement and give greater certainty of cost. Compared to third party insurance, this approach would essentially remove any element of profit being passed outside the Fund as all premiums and costs would effectively be kept within the Scheme.

2.11 The captive arrangement operates as follows:

- in lieu of an ill health allowance incorporated within the contribution rate, premiums will be paid by the employer into the captive arrangement, which is tracked separately by the Fund Actuary in the valuation calculations. The premiums are included in the employer's primary rate. The premium for 2017-2020 is 1% p.a.

- the captive fund is then used to effectively meet strain costs emerging from ill-health retirements e.g. no impact on funding position for employers within the captive arrangement.

- the premium is set with the expectation that they will be sufficient to cover the costs in the three years following the valuation date. If any excess premiums over costs are built up in the captive arrangement, these will be used to offset future adverse experience and/or lower premiums at the discretion of the administering authority based on the advice of the actuary.

- premiums payable are subject to review at each triennial valuation.

Risk Management – Investment Buckets

2.12 The FSS has been revised to include two alternative "investment" buckets which exhibit lower investment risk and lower expected investment return characteristics than the whole fund strategy

2.13 The investment strategies are currently being finalised and will be implemented from 1 April 2017 in the form of three "investment buckets", each offering a different exposure to investment risk and expected return.

- **A higher risk bucket** - this is in line with the Fund's existing investment strategy which is broadly an 80% allocation to growth assets and a 20% allocation to defensive assets.

- **A medium risk bucket** – this has been designed to give an option to reduce exposure to riskier growth assets in order to help keep pension contributions stable. The medium risk bucket's initial investment strategy will be a 65% allocation to growth assets and a 35% allocation to defensive assets. The growth and defensive assets in this bucket are the same as the higher risk bucket but in the different proportions noted.

Under this bucket an employer will be giving up some potential higher investment return in order to protect some of the downside risk of deficit contributions needing to increase in the future. It therefore may be appropriate for employers who currently have a high funding level or are in surplus.

- **A lower risk bucket** - this bucket has been designed to hold lower risk, income generating assets such as bonds, property and infrastructure. The lower risk bucket will target a minimum investment return above CPI inflation. The intention is that those "orphaned" liabilities in respect of employers who have terminated the Fund will be backed by this bucket.

  This "bucket" may also be suitable for those employers that are planning to exit the Fund in the short term or for employers that want to "lock in" their funding position and remove a significant level of volatility in the funding position; in exchange for higher and more stable contribution requirements.

2.14 As part of the implementation of the investment buckets the Fund has been analysing the different employers in the Fund (in terms of the type of employer, the current funding position, strength of covenant and security in place) with a view to targeting which employers may be more suitable for each investment bucket.

The Fund does have the right to move an employer between the medium or lower risk strategy buckets if there are any concerns over employer covenant, which means there is an unacceptable level of risk to tax payers. However, the Fund will discuss this with the relevant employers before making this decision.

2.15 The regulatory framework underpinning the triennial actuarial valuation requires the FSS to be approved by the Committee prior to the Fund Actuary finalising the actuary report.

RELEVANT RISKS

3.0 It is imperative that the Administering Authority takes a prudent view when negotiating the financial and demographic assumptions for the FSS in order to secure the long term solvency of the Scheme to avoid the risk of an increase to the deficit.

The maximum recovery period for all employers has been reduced by three years. Advice provided states that it would be imprudent to maintain the recovery period at the 2013 rate. This is on the basis that not reducing the maximum recovery period would be detrimental to an employer's long term funding as it would further delay repayment of the principal debt and the opportunity of gaining of gaining investment returns on contributions.

4.0 OTHER OPTIONS CONSIDERED

4.1 Not relevant for this report.

5.0 CONSULTATION

5.1 Not relevant for this report.

6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS

6.1 None associated with the subject matter.

7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 There none associated with the subject matter

8.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

8.1 The revised financial and demographic assumptions within the FSS will have a direct impact on funding levels and the employer contributions certified for the financial period 1 April 2017 to 31 March 2020.

8.2 Whilst approximately 58% of the Fund's employer base by number would be covered by the captive insurance arrangement this represents approximately 9% of the Fund's liabilities as at 31 March 2016. The impact of adopting this differential approach on the non-captive employers in terms of ill health allowance would be minimal as it only relates to a small part of the payroll.

9.0 LEGAL IMPLICATIONS

9.1 There are none arising from this report

10.0 EQUALITIES IMPLICATIONS

10.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

The differing characteristics and financial strength of employers have been reviewed to ensure that appropriate contribution easements have been applied equitably across all employers to prevent adverse risk falling on any individual employer.

11.0 CARBON REDUCTION AND ENVIRONMENTAL IMPLICATIONS

11.1 There are none arising from this report

12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising from this report

13.0 RECOMMENDATION

13.1 Members are recommended to approve the Funding Strategy Statement along with the implementation of the alternative invest strategies and internal ill health captive insurance arrangement.

14.0 REASON/S FOR RECOMMENDATION/S

14.1 There is a requirement for Members of the Pension Committee to be kept up to date with legislative developments as part of their decision making role.

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APPENDICES

Appendix 1 Funding Strategy Statement

BACKGROUND PAPERS/REFERENCE MATERIAL

None

BRIEFING NOTES HISTORY

Briefing Note	Date
FUNDING STRATEGY STATEMENT **FUNDING STRATEGY STATEMENT**	**15 NOVEMBER 2016** **19 NOVEMBER 2013**