Croydon Council

REPORT TO:	**PENSION COMMITTEE** **9 June 2015**
AGENDA ITEM:	**6**
SUBJECT:	**Contribution Policy for Academies as Employers within the Croydon Local Government Pension Scheme**
LEAD OFFICER:	**Assistant Chief Executive – Corporate Resources & s151 Officer**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Treasury**
WARDS:	**All**
CORPORATE PRIORITY/POLICY CONTEXT: Sound Financial Management: This report is to give an update to the Pension Committee on the treatment of Academies by the Actuarial Valuation Process.	
FINANCIAL SUMMARY: There are no direct financial consequences to this report; however any change in current policy will result in a reallocation of costs to Scheme employers.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	

1. RECOMMENDATIONS

The Pensions Committee are recommended to:

1.1 Agree that Academies in Croydon be consulted on a revised set of principles as detailed at Appendix A for their treatment within the actuarial valuation process such that:

a) When undertaking valuation reviews the Scheme Actuary should continue to apply the principle that Academies continue to be responsible for the same amount of pension deficit after, as before, conversion;
b) The Scheme Actuary should assess rates for Academies using a risk-adjusted approach and change the deficit recovery period from 15 years to 22 years.

1.2 Agree that Academies should be offered the option to form, on a voluntary basis, a pool, so that all members of that pool are treated as one single employer for the calculation of contributions, and any Academy not wishing to join this pool to be set up as an individual employer as per the existing approach.

1.3 Note the intention to bring a report to the September 2015 meeting for this Committee to consider the outcomes of that consultation and agree the approach for the next valuation.

2. EXECUTIVE SUMMARY

2.1 This report provides the context to a review, of the treatment of Academies by the actuarial valuation process, and summarises the recommendations of that review. The report recommends that the Council proceed to consult Academies on a number of changes to the current policy to address the concerns expressed by a number of Academies around affordability and equality.

3. DETAIL

3.1 The Pension Committee has discussed the question of how the triennial actuarial valuation treats Academies on a number of occasions, reflecting the concerns generated by this topic. This level of engagement is reflected by administering authorities across the country. In order to resolve this issue and address the genuine concerns raised by all concerned parties the Council, as administering authority for the Local Government Pension Scheme (LGPS) in Croydon, have met with representatives from many Academies and commissioned a review of the existing policy. This report provides the context to this review and sets out a series of recommendations to the Committee.

Background

3.2 A report to this Committee set out, in December, 2014, a detailed commentary on the background to the current policy position: minute A44/14 refers. This report covered the chronology of government guidance published, advice provided by the Scheme Actuary and decisions taken by previous committees, reaching back to the policy agreed in February 2012. Throughout this period the Council has been consistent in complying with all government guidance for the valuation process and the professional requirements of the Scheme's Actuary. The Council has also consistently offered a number of channels to allow individual academies to engage with the Actuary throughout the valuation process and to be consulted at each stage.

3.3 Following a period of lobbying, Hymans Robertson, the Scheme Actuary, was asked to undertake a review of funding approaches for Academies. The outcome of this review is contained in a paper appended to this report. The review revisits the principles agreed by the Committee on 29 November, 2011 which have been applied to new Academies subsequently joining the Fund. In addressing the question of cost pressures weighing on Academies the review focusses on three areas:

- Asset allocation;
- Contribution Rates; and
- Pooling.

The review makes a number of recommendations which are set out below.

3.4 A number of Academies have written to raise concerns that the current policy is inequitable, in that grant-maintained schools that are still considered notionally part of the Council seem to be treated differently from Academies and that other organisations were treated more favourably. This proved to be a misconception based on a series of misunderstandings. All grant maintained schools and indeed all Scheme employers with staff with accrued benefits within the LGPS pay a lump sum contribution towards the historic deficit funding gap – that is to say, the difference between the notional estimate of the sum of liabilities to pay pension benefits and the size of the Fund available to pay those benefits. This lump sum can be converted to a percentage of pensionable pay to allow for meaningful comparisons. All Scheme employers are treated on an equitable basis in that consistent principles guide the Actuary in calculating contribution rates. Those principles are consistent with Government guidance and comparable with the principles applied by the other LGPS Actuaries across the UK.

3.5 Differences between schools and individual Academies or groups of Academies are driven by two factors: staffing profiles and historical funding decisions. Within administering areas and across the UK employers with similar numbers of staff can have very different contribution rates. Contribution rates are sensitive to different staffing profiles and impacted by length of Scheme membership and a number of demographic factors. The Appendix to the review shows a range of different contribution rates which results from this sensitivity. The variance from the median is due to staff numbers in any one school being small. The larger the number of staff in the LGPS the likelier the calculation of contribution rates will be similar to the Council's pooled rate. Indeed the mean result shown in this Appendix is very close to the Council's pooled rate, as would be expected.

3.6 Across different administrative areas the results would be affected by a range of different historical decisions. These impact upon funding levels and deficits. Different investment strategies will also produce different results.

3.7 At the statutory deadline for receipt of contributions due under the current Local Government Pension Scheme regulations, 11 Academies had failed to pay over contributions. In total this amounts to over £380,000, including legal costs relating to outstanding sums going back three years. Interest is accruing on these balances at the rate of 1% over base rate. The Pensions Regulator, who has responsibility for the LGPS, has been notified.

3.8 The Hymans Robertson review considered alternate approaches to the existing method of allocating notional assets. The alternative approaches either disadvantage the Council by increasing the deficit left with the Council or

increases the degree of uncertainty in the allocation process. The former approach does not treat tax-payers fairly, exposing them to a greater liability that must be met ultimately through the Council Tax. The latter method possibly creates the same result and will arbitrarily generate winners and losers.

3.9 A recent Pensions Ombudsman's Determination, PO-2665, included as an appendix to this report, is relevant. The Thomas Ferens Academy complained to the Ombudsman about their administering authority's (East Riding of Yorkshire Council) approach to allocating notional assets. Their Transfer Agreement determined the assets notionally transferred to the Academy based on an assessment of the ongoing scheme funding level of active members. The Academy said that this assessment made it unjustly liable for the funding shortfall for all ex-employees of the predecessor school, even though they were never employed by the Academy. The Academy sought a Determination that East Riding, the local Scheme administrator, acted in breach of the Transfer Agreement and has acted ultra vires in imposing a transfer of the deficit. The complaint was not be upheld. The decision reached by East Riding was considered to be one which a reasonable administering authority would have reached, and it was empowered to do so. The relevance of this decision is that East Riding is advised by Hymans, and uses the same approach to deficit allocation as Croydon.

3.10 The review also addresses the issue of setting contribution rates and suggests that the Council could adopt the same risk-adjusted approach for Academies as is applied to the Council and that the recovery period could be extended to match that adopted by the Council. This would appear to be an equitable approach but would not necessarily reduce annual contributions materially and may well result in a larger contribution from the Academies over the length of the recovery period.

3.11 Finally the review looks at the current pooling arrangements. The current arrangements do not allow for Academies to be pooled with the Council. The process of conversion to Academy status is all about providing Academies with autonomy from local authority control so pooling would be perverse and contrary to this ambition. The review's recommendation is to establish a voluntary pool to accommodate Academies. This will involve a degree of cross-subsidy and will disadvantage those with low contributions to the benefit of those with above-average rates. Newly established schools will find these arrangements more expensive.

4. RECOMMENDATIONS

4.1 This report recommends consultation on a revised set of principles for the treatment of Academies within the actuarial valuation process. These are such that:

a) That the Scheme Actuary should continue to apply the principle when undertaking valuation reviews, that Academies continue to be

responsible for the same amount of deficit after as before conversion;

b) That the Scheme Actuary should assess rates for Academies using a risk-adjusted approach and change the deficit recovery period from 15 years to 22 years.

This report also recommends that Academies should be offered the option to form, on a voluntary basis, a pool and any Academy not wishing to join this pool to be set up as an individual employer as per the existing approach.

Following consultation a further report be brought back to the next meeting of this Committee, to consider responses received and a plan and timings for the transition to any new funding approach, including any amendments to the Funding Strategy Statement.

5 FINANCIAL CONSIDERATIONS

5.1 There are no further financial considerations flowing from this report.

6. OTHER CONSIDERATIONS

6.1 Other than the considerations referred to above, there are no customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report

7. COMMENTS OF THE SOLICITOR TO THE COUNCIL

7.1 The Council Solicitor comments there are no additional legal considerations arising from this report.

(Approved by: Gabriel MacGregor, Head of Corporate Law on behalf of the Council Solicitor & Monitoring Officer**)**

CONTACT OFFICER:

Nigel Cook, Head of Pensions and Treasury,
Resources Department, ext. 62552.

BACKGROUND DOCUMENTS:

APPENDICES

Appendix A Review of Funding Approach for Academies
Appendix B Ombudsman's Determination

Review of funding approach for Academies

Regulatory and legislative background

The Academies Act 2010 allows maintained schools the opportunity to become independent from the Council, and assume responsibility for their own finances.

On conversion, the new Academy assumes responsibility for the pension obligations of all active employees of the maintained school who are entitled to membership of the Fund. Responsibility for meeting any deferred or pensioner benefits for ex-employees of the maintained school remains with the Council.

The Academy is recognised as a separate employer in the Fund. The Administering Authority's role, in consultation with its actuary, is to set a starting asset position and ongoing contribution rate that reflects the risk that the Academy poses to the Fund, and which is fair to all other employers participating in the Fund.

Non-statutory joint guidance was issued by the Department for Communities and Local Government (DCLG) and the Department for Education (DfE). It contains broad principles about Academies assuming responsibility for a share of the past service deficit at conversion, and that funds should aim to set contribution rates that are similar to those payable by the Council. However the guidance is high level only – the specific approach to asset allocation and contribution rate setting for Academies is not clear. As a result, LGPS funds have adopted a wide variety of funding approaches.

On 2 July 2013, the Secretary of State for Education announced that the DfE would provide a guarantee to meet the outstanding pension liabilities of any Academy that closed. The DfE guarantee came into force on 18 July 2013. The guarantee improves the risk profile of Academies but is not watertight. For instance, it contains the words *"A reassessment will be undertaken at regular intervals to determine whether the guarantee remains affordable"*.

Finally, during October 2013, DCLG issued a consultation on "Pooling arrangements for Academies within the Local Government Pension Scheme". The outcome of this consultation has yet to be issued and no deadline has been given.

Academies in the Croydon Fund

Some Academies have raised concerns about the current funding approach, chiefly because their contribution rates are higher than those payable by maintained schools. DCLG/DfE are also concerned that too many Academies are still paying contribution rates that are significantly higher than those payable by maintained schools in the same LGPS fund.

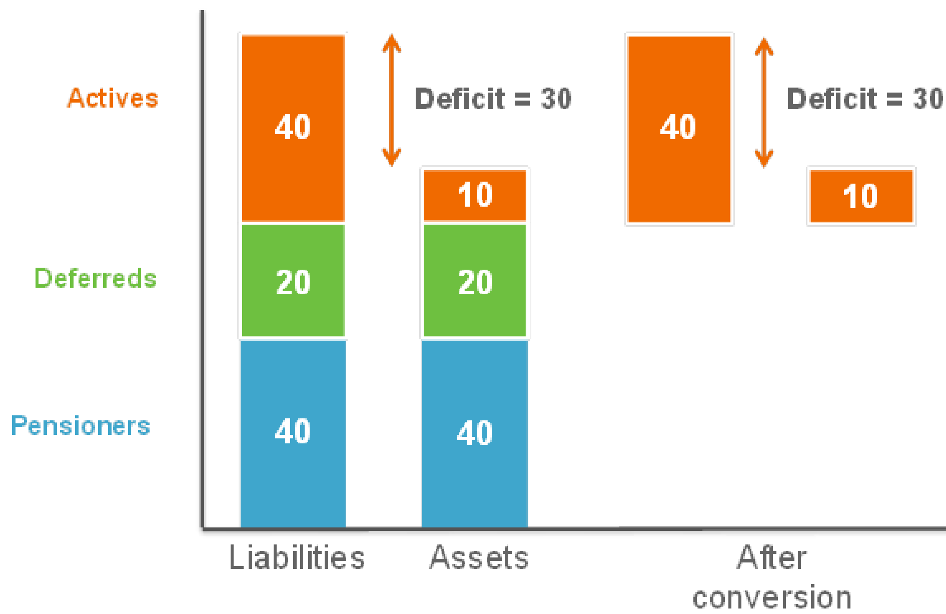
The funding approach for Academies in the LGPS has been a problematic issue for funds due to the gradually evolving guidance and government policy described above. Importantly, the LGPS Regulations are not prescriptive about the way in which contribution rates are set for any type of employer (including Academies). Each fund determines an appropriate funding strategy based on a number of factors, including the perceived risks or "strengths of covenant" of each type of employer.

Current funding approach in the Croydon Fund

The Pension Committee on 29 November 2011 agreed that the following principles would apply to future new Academies that joined the Fund:

Principle 1

An equitable split of past service deficit at conversion would be allocated to the Academies. This would be achieved by allowing for the liabilities for deferred and pensioner members that are left behind with the Council to be fully funded. The following example shows why this is equitable for both the Council and the new Academy.



In this simplified example, the maintained school has total liabilities of £100, split 40/20/40 between active, deferred and pensioner members. At the date it converts to an Academy, the Council's funding level is 70%. In other words, the Fund holds assets worth £70 to cover the £100 of liabilities. Under the Croydon deficit allocation approach described above, £60 of the assets would be used to fully fund the liabilities for deferred and pensioner members that are left behind with the Council. This leaves £10 of assets to be allocated to the new Academy, which is only responsible for the £40 worth of liabilities relating to active members.

The approach is equitable as the deficit amount is unchanged immediately before and after the school's conversion to an Academy. The pre-conversion deficit is £30 (£100 minus £70). The post-conversion deficit is also £30 (£40 minus £10). The funding level is clearly lower for the Academy (25% versus 70% as a school) but that is because the Academy no longer has responsibility for funding benefits for ex-employees.

Principle 2

The deficit recovery period would be 15 years. This was a compromise period that lay between the 22 years used for maintained schools, and the 7 years over which Academies receive guaranteed funding from the DfE.

Application of these principles generally leads to contribution rates for Academies that are higher than those of maintained schools (which pay the Council rates). There are various reasons for this including:

Different risk profiles: The Council, and therefore maintained schools, has the lowest risk profile of all employers in the Fund. The contribution rate paid by maintained schools is a 'stabilised' rate that was set at the 2013 valuation in recognition of the Council's long term and secure position in the Fund. Contribution rates for Academies are not currently 'stabilised'. Based on recent market conditions, the impact of being 'stabilised' is to dampen contribution rates. In addition, rates are naturally lower for maintained schools due to the longer deficit recovery period mentioned above.

Market conditions at conversion: These may be different from those prevailing at the date that Council rates were agreed; and

Membership profile: The Academy's profile may differ from that of the Council, and this will be reflected in the Academy's contribution rate.

Review of funding approach and options available

The Fund recognises affordability concerns for Academies. The current approach is not wrong, but other options are available that may help to alleviate cost pressures on Academies. The Fund is willing to consider options that may appease Academies as long as the overall approach keeps the Fund safe and is fair to all employers.

The options described below can be broken down into three areas, namely:

a) Asset allocation
b) Contribution rates
c) Pooling

a) Approach to asset allocation

The current approach (see Principle 1 above) ensures that the Academy continues to be responsible for the same amount of deficit that it was responsible for prior to conversion. Any alternative approach that allocates more assets to the Academy (e.g. such as a fully funded transfer) may be deemed unfair to the Council and therefore to maintained schools.

Possible alternative approaches are:

- *Use a different share of deficit approach:* the Council retains deficit in respect of the deferred and pensioner members left behind by the Academy. This reduces the starting deficit for the Academy, but increases the deficit left behind with the Council. Using the example on page 2, the assets allocated to the Academy would increase from £10 to £28 (i.e. 70% of £40).
- *Fully fund the new Academy:* the Academy starts with zero deficit. The Council would retain the entire deficit that the Academy leaves behind on conversion. This is not in line with the DCLG/DfE guidance which expects academies to be responsible for deficit at outset.
- *Ignore market conditions at the conversion date:* apply the same market conditions to all academies that join within months of each other e.g. base calculations on market conditions at the last formal valuation date. This provides greater consistency for academies but creates "winners and losers" amongst Academies. It may financially advantage or disadvantage the Council depending on actual market experience.

Recommendation by Fund officers – continue with the current approach

Reasons - fair to all employers, in line with DCLG/DfE guidance, avoids “winners and losers”

b) Setting contribution rates for Academies

Under the current approach, the contribution rate at outset is calculated to cover the expected cost of accrual of pension benefits based on market conditions at the conversion date. It includes an amount that allows for recovery of deficit over 15 years (see Principle 2 above).The contribution rate is reviewed at each triennial valuation.

Possible changes to the approach are:

- *Increase the deficit recovery period:* the current 15 years could be increased to a longer period (e.g. the Council’s recovery period of 22 years). This would reduce Academy contribution rates.
- *Apply a cap to rates:* for example, the Academy rate could be capped at the Council’s (and therefore maintained schools’) contribution rate. Alternatively a cap of the Council’s rate plus an acceptable ‘risk margin’ of say 2% to 3% of pay could be applied to reflect the weaker covenant of Academies.

- *Use a risk-adjusted approach*: similar to that used for the Council at the 2013 valuation. Rather than relying on a single set of assumptions, rates are set by using output from asset-liability modelling that allows the Fund to assess how likely an employer is to be fully funded over the longer term for a chosen contribution strategy. This may also allow a formal “contribution stability mechanism” to be agreed that protects the Fund. Under current market conditions, a risk-adjusted approach is likely to lead to lower Academy rates.

Recommendations by Fund officers – assess rates using a risk-adjusted approach, and change the deficit recovery period from 15 years to 22 years

Reasons – reflects strength of DfE guarantee, consistency of treatment with other scheduled bodies in the Fund such as the Council, in line with DCLG/DfE guidance, a risk-adjusted approach is more objective and transparent than simply capping rates

c) Pooling

Academies are currently set up as separate employers within the Fund. This differs from the treatment of maintained schools, which are pooled with the Council and pay the same contribution rate as the Council. Pooling in the LGPS tends to occur between employers that are similar in nature and/or have some form of financial interdependence. However in recent years many LGPS funds have been breaking up (rather than creating) pools due to a perceived lack of transparency and because they create cross-subsidy between employers.
Pools can be set up in different ways. This paper assumes that any pooling would be done on a “full risks” basis as per the existing Council pool i.e. each employer in the pool shares the same funding level regardless of their own specific experience. Any form of pooling goes against the autonomous nature of Academies.

There are two basic pooling options available here:

- *Pool Academies with the Council:* the Academies would pay the same contribution rate as the Council/maintained schools and so would be in line with DCLG/DfE guidance. Experience would be shared across all employers; as the biggest employer by a large margin, the Council’s experience would drive changes to the contribution rate over time. This may or may not be to the benefit of Academies depending on how their own experience compares to that of the Council. Some Academies are currently paying contribution rates below that of the Council – pooling with the Council would immediately increase costs for these Academies.
- *Set up a new Academies only pool:* this should help to keep rates more stable over time and ensures that all Academies pay the same single rate. Any shortfall in the event of an Academy closure that is not covered by the DfE guarantee would be paid for by other Academies in the pool. Pooling implies that some Academies with good experience would subsidise those with poorer experience. As above, those Academies that are currently paying a low contribution rate may face higher costs on transition to a pooled rate.

Recommendations by Fund officers – offer an “academies only pool” on a full risks basis on voluntary grounds to those Academies who wish to join. Any Academies who choose not to join would be set up as individual employers as per the existing approach.

Reasons –opportunity for Academies to share risks with each other to achieve a more stable contribution rate, voluntary nature allows Academies to maintain autonomy at their discretion, pooling is the subject of the DCLG consultation referred to on page 1

Impact on contribution rates of differing approaches

At the 2013 formal valuation it was agreed that the Council (and therefore maintained schools) would pay 23.2%, 24.2% and 25.2% of pay respectively during the three years from 1 April 2014 to 31 March 2017.

Existing Academies pay a wide range of rates, varying from newly established or Free Schools paying rates as low as 11.5% to mature, established Academies paying up to 52.7% of pay. The Appendix lists each Academy and its contribution rate for reference.

Academies come in different shapes and sizes. Broadly speaking, if we were to pool all Academies together, without any other change to the funding approach, the rate would be around 25% of pay.

The following table illustrates a very approximate range of rates for the Fund's Academies under the existing approach, the preferred approach and a 'best case' approach (from the Academy's perspective in terms of high asset allocation and low rates).

Funding approach	**Description**	**Illustrative rate (% of pay)**		
		Low	Average	High
Status quo	No change (existing approach)	11.5%	25%	52.7%
Preferred	All pooled	25%	25%	25%
	All pooled, 22 year recovery period, risk-adjusted	21%	21%	21%
	Individual rates, 22 year recovery period, risk-adjusted	10%	21%	40%
'Best case'	As per preferred but fully funded at outset (and ignores pooling)	10%	17%	24%

How are contributions paid in practice?

All of the contribution rate figures in this report, including the Appendix, are quoted as total rates expressed as a percentage of pay i.e. they cover both the cost of future service benefits and past service deficit recovery amounts. This allows rates for Academies and maintained schools to be compared more easily.

In practice however the Fund collects the cost of future service benefits as a percentage of pay, and deficit recovery amounts in the form of lump sum payments. For example, the Council's total contribution rate in 2016/17 is 25.2% of pay as stated above. In practice, this will be collected via 15.1% of pay (to cover future service benefits) and lump sum amounts totalling £11.594m (to cover deficit recovery). The £11.594m is equivalent to 10.1% of pay. Each maintained school will pay 15.1% of pay plus a proportionate share of the £11.594m based on the size of the school's payroll compared to that of the Council.

What approaches are used by other LGPS funds?

There has been no central collection of information on funding approaches since the survey of 24 funds that was carried out by CIPFA in 2011. This was reported to Croydon's Pension Committee in September 2011. However we have gathered up-to-date information from the 35 English funds advised by Hymans Robertson. The results are as follows.

Approach to asset allocation

- 28 of the 35 funds use the same deficit approach as Croydon (including 11 of 14 London Boroughs).

- The other 7 funds also use a share of deficit approach but with the Council retaining deficit in respect of the deferred and pensioner members left behind by the Academy.
- All 35 funds use the same approach as Croydon of using market conditions at the date of conversion to allocate initial assets.

Contribution rate

- 2 of the 35 funds set Academy contribution rates at the same level as the Council's contribution rate.
- 9 of the 35 funds allow the option for the Academy to choose to pay rates equal to the Council's rate.
- 4 funds set Academy contribution rates equal to the Council rate plus 1% of pay.
- One fund caps Academy contributions at 27% of pay.
- Of the remaining 19 funds, 4 use a "risk-adjusted approach" and apply a formal contribution stability mechanism to Academy rates.

Deficit recovery periods vary across the 35 funds as summarised below:

Deficit recovery period	Number of funds
<15 years	4
15-19 years	5
20 years	23
22+ years	3

Pooling contribution rates

- Of the 35 funds, no funds have Academies pooled with the Council.
- One fund has an "Academies only" pool set up.

Next steps

The Fund will shortly be undertaking a risk profiling exercise to cover all employers in the Fund. The results will feed directly into the funding approaches that are agreed for all employers at the 2016 valuation. We suggest that any changes to the funding approach for Academies takes place alongside this.

The next steps are:

- Pension Committee to review recommendations and confirm preferred funding approach for Academies;
- Fund officers to consult with Academies over preferred approach in the run up to the 2016 actuarial valuation;
- Following consultation, agree plan and timings for the transition from the existing to new funding approach; and
- Document the new funding approach in the Funding Strategy Statement (which requires review as part of the 2016 valuation)

Summary

There is nothing wrong with the existing funding approach adopted by the Croydon Fund but other options are available that may help to alleviate cost pressure on Academies. The existing approach is not out of line with other LGPS funds.

The Council's objective should be to strike the right balance between protecting the fund and ensuring the contribution rate payable by the Academy is affordable. Whatever approach is taken, the Council and the Academies need to understand the approach and its implications.

The approach preferred by Fund officers is:

- *Initial asset allocation* - continue with the current approach
- *Setting contribution rates* - use a risk-adjusted approach, and change the deficit recovery period from 15 years to 22 years
- *Pooling* - offer an "academies only pool" on a full risks basis on voluntary grounds. Academies which choose not to join would be set up as individual employers.

If any changes are made to the current approach then a transition process would need to be established. Any impact on existing academies would also have to be addressed. It is likely to be most pragmatic to apply any change as part of the 2016 valuation process and Funding Strategy Statement review, alongside any changes to funding approach for other employers in the Fund as a result of a risk profiling exercise that will be taking place in the run-up to the valuation date.

Prepared by:-

Richard Warden

Fund Actuary

22 May 2015

For and on behalf of Hymans Robertson LLP

Appendix - List of Academies participating in the Fund

Academy*	Contribution Rate 2016/2017 (% of pay)
Robert Fitzroy Academy	11.5%
Harris City Academy (Crystal Palace)	13.0%
Harris Academy South Norwood	15.8%
Paxton Academy	16.1%
Harris Invictus Academy	16.5%
Harris Haling Park	16.5%
David Livingstone Academy (STEP)	16.6%
ARK Oval Primary Academy	16.7%
Harris Primary Academy Kenley	19.0%
Castlehill Primary Academy	20.1%
Forest Academy	20.2%
St Cyprian's Greek Orthodox Primary School Academy	21.7%
Aerodrome Primary School	22.3%
Harris Academy Purley	23.2%
Atwood Primary Academy	23.5%
Applegarth School	24.0%
Gonville Academy (STEP)	24.2%
Pegasus Academy Trust	24.3%
Harris Upper Norwood Academy	24.4%
Riddlesdown Collegiate	24.7%
Norbury Manor Business and Enterprise College for Girls	24.8%
Local Authority Maintained Schools	**25.2%**
Fairchildes Primary School	25.8%
Oasis Ryelands Primary	26.1%
Oasis Academy Shirley Park	26.6%
Oasis Academy Byron	26.7%
West Thornton Primary Academy	26.7%
Woodcote High School	28.3%
Addington High School	28.8%
Harris Benson Academy	29.1%
New Valley Primary School	29.7%
Shirley High School Academy	29.9%
St Thomas Becket RC Primary	30.9%
St Marks CofE Primary	30.9%
Wolsey Junior Primary Academy	31.4%
Chipstead Valley Primary	31.4%
Broadmead Primary	32.6%
The Quest Academy	32.8%
Oasis Academy Coulsdon	32.8%
St Joseph's College	33.4%
Beulah Nursery and Infant School	33.8%
Winterbourne Junior Boys	37.7%
Rowdown Primary	38.0%
Archbishop Lanfranc	43.8%
St James the Great R.C Primary	52.7%

***Notes**

The academies highlighted in grey joined after the valuation date 31 March 2013.

The academies highlighted in yellow are newly established or Free Schools.

Pensions Ombudsman Service

Ombudsman's Determination

Applicant	Thomas Ferens Academy (the **Academy**)
Scheme	Local Government Pension Scheme
Respondent	East Riding of Yorkshire Council (**East Riding**)

Complaint Summary

The Academy was established in 2012. A Transfer Agreement determined the assets notionally transferred to the Academy based on an assessment of the ongoing scheme funding level of active members. The Academy says that this assessment has made it unjustly liable for the funding shortfall for all ex-employees of the predecessor school, even though they were never employed by the Academy. The Academy seeks a Determination that East Riding, the local Scheme administrator, acted in breach of the Transfer Agreement and has acted ultra vires in imposing a transfer of the deficit.

Summary of the Ombudsman's determination and reasons

The complaint should not be upheld. The decision reached by East Riding was one which a reasonable administering authority could have reached, and it was empowered to do so.

DETAILED DETERMINATION

Material Facts

1. East Riding is the administering authority of the East Riding Pension Fund (the **Fund**), which is part of the Scheme and is governed by the Scheme Regulations.

2. The broad background is set out in the attached Appendix 1. This is an extract from the response to the complaint from East Riding, and it is not materially in dispute.

3. The Funding Strategy Statement, to which reference is made in Appendix 1, is attached as Appendix 2.

4. HCC, to which reference is made in Appendix 1, is Hull County Council, another participating employer in the Fund. As will be seen from Appendix 1, a Commercial Transfer Agreement was concluded between the Academy and HCC.

5. East Riding says the actuarial report dated 8 June 2012 was forwarded to the Academy by HCC on 12 June. So prior to the Academy being established, it was informed that its prospective Fund contribution rate would be 43.4% of payroll (of which 24.6% of payroll was the future service contribution rate and 18.8% was the past service adjustment). The past service adjustment reflected the deficit of £1,551,000 between the liabilities for the active members of the Academy (of £1,892,000) and the notional allocation of assets attributable to the Academy (of £341,000). Despite this it was not until 18 September 2012, after the Academy commenced participation in the Fund on 1 September 2012, that it said it wished to pay employer contributions of 20%. East Riding responded immediately that the calculated contribution of 43.4% must be paid. The Academy repeated that it would pay only 20% and referred the matter to its legal advisers. The positions of the parties remained unchanged until 3 July 2013 when East Riding demanded payment of the outstanding sums within 7 days, failing which County Court proceedings might be commenced.

6. The Academy then made this complaint to this office.

7. East Riding says that all the participating academies, save for the Academy, have paid the contributions determined by the Actuary. The Academy submits that the financial demands are excessive and unlawful.

8. Specifically, the Academy seek

> "A determination that [HCC] has acted in breach of the Transfer Agreement by not agreeing with [East Riding] the transfer of the deficit on the basis set out in the Transfer Agreement and that [East Riding] has acted ultra vires in imposing a transfer of the deficit it has no power to do and in setting that basis has taken into account irrelevant factors e.g. the liabilities relating to employees the Academy has never employed."

9. It was subsequently accepted that the first part of this request cannot be investigated. Both the Academy and HCC are participating employers in the Fund (and neither is a manager/administrator) and so it is not within my jurisdiction to investigate a dispute between these parties over the terms of the Transfer Agreement.

Summary of the Academy's position

10. The Academy has been paying employer contributions of 20% pending resolution of this dispute. There is no question of a refusal to pay. It has set aside sufficient funds should the decision go against it.

11. It says it would be more than happy to pay the contributions required, provided these have been properly calculated, are proportionate to the liabilities relating to the employees that transferred to it, and are reasonable. The contributions requested meet none of these criteria.

12. East Riding had disregarded the basic reasons for the joint consultation of December 2011 (see Appendix 1, paragraph 19) which was

> "that insufficient progress had been made to ensure the long term stability of scheme costs, with some academies suffering, or at risk from, dramatic increases in employer contribution rates."

13. East Riding does not have the powers under the Scheme Regulations to set the Academy's contributions in the way it has, by taking into account deferred and pensioner member liabilities of HCC that have no connection to the Academy. East Riding has offloaded responsibility for a proportion of HCC's deferred and pensioner

liabilities onto the Academy, which did not even legally exist at the time the liabilities accrued.

14. East Riding must demonstrate that it is empowered to take the actions it has. It is insufficient for it to argue that there is nothing that prevents the actions.

15. East Riding wishes to rely on Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 for powers to adopt an Asset Allocation Policy, but it appears to the Academy that the Funding Strategy Statement in place on 1 September 2012 actually ran contrary to the Asset Allocation Policy.

16. The Academy says that, under the basic principles of public law, an administrator can only undertake actions for which it has an express power under legislation, a power that can reasonably be implied from its express power or an incidental power (under section 111 of the Local Government Act 1972). If it acts, as it submits East Riding acted, outside such powers, its actions will be ultra vires and therefore unlawful.

17. More specifically, the Scheme regulations prohibit the transfer of deferred and pensioner liabilities from one employer to another without the consent of the latter.

18. The Academy requests details of the specialist advice given to East Riding before the Asset Allocation Policy was adopted.

19. The Academy submits that the fact that no other academies may have objected to their employer contribution calculations is irrelevant to its case. It has seen documents showing that most other academies were paying lower contributions than 43.4%, and only one (out of 23) was paying more. The wide range of contribution rates (between academies and between original local education authority areas) raises questions whether the asset allocation policy was applied consistently.

20. The Academy had been seeking the intervention of the Department for Communities and Local Government (**DCLG**) and the Department for Education in this dispute. Both Departments said they had no legal powers to intervene in East Riding's actions, at which point the complaint was made to the Pensions Ombudsman.

21. Subsequent Ministerial statements and government consultation have however indicated recognition of the need to treat academies equitably when setting employer consultation rates.

22. The Academy said that it did seek further clarification from DCLG on the 2011 joint consultation. DCLG repeated that a variety of approaches to transfers have been taken, and it could not comment on individual cases as the Scheme is administered locally. The Academy says however that this reply demonstrated that there is no "DCLG approved approach" as such. The DCLG policy is that no academy pays unjustifiably higher employer pension contributions to the Scheme compared to maintained schools in the local area.

Summary of East Riding's position

23. The Academy's complaint is frivolous. The contributions demanded are lawful. That the Academy might wish East Riding had adopted a different policy in respect of the approach to determining the pension contributions to be paid by the academies is irrelevant. Its policy is justified and is one that a reasonable administering authority could adopt.

24. The Academy made the complaint immediately after being threatened by East Riding with legal action for non-payment. It would not be unreasonable to infer that this step was designed to place jurisdictional obstacles in the way of the prospective court proceedings.

25. East Riding believes that there is no dispute over the calculation of liabilities of the employees of the Academy who are members of the Fund. It understands that the dispute concerns the calculation of the deficit to be funded.

26. This involves determining what portion of the assets currently held by the Fund is to be notionally allocated to the funding of the liabilities of the employees, which is a policy decision. Until Fund assets have been allocated to the liabilities in the preceding paragraph, there is no means of calculating what the relevant deficit is.

27. East Riding interprets the essence of the Academy's case to be that East Riding acted unlawfully in demanding contributions from the Academy calculated on the

basis of a methodology involving the Actuary applying a particular form of notional asset allocation to which it (i.e. the Academy) objects.

28. More specifically, East Riding understands the Academy submits that the contribution demand is unlawful for two residual reasons (i.e. disregarding the dispute over the terms of the Transfer Agreement). These are that it is unlawful having regard to the joint departmental statement of December 2011, and it is unlawful with regard to the powers under the Scheme Regulations.

29. With regard to the first point, this statement of government policy is not binding on East Riding, but East Riding nevertheless took into account the preferences expressed in that document when adjusting its policy in respect of academies in January 2012. Nothing in the document requires East Riding to take a particular approach in respect of the notional asset allocation required in order to arrive at the deficit for which academies are taken to have funding responsibility.

30. Under the Scheme Regulations the administering authority (East Riding in this case) may set policy in respect of the proper approach to notional asset allocation. “There are numerous actuarially literate approaches and it is a matter of policy which is selected.”

31. East Riding’s chosen method involves allocation of assets to deferred and pensioner members before active members, rather than an overall share of fund method. The exercise of that choice cannot render the policy decision ultra vires. Furthermore, because East Riding acted reasonably, taking into account relevant and not irrelevant factors, there is no other ground on which to say it acted ultra vires.

32. This decision, in June 2011, followed advice given by the Fund Actuary in March 2011. Two alternative approaches were set out in that actuarial advice. The first approach was to base the asset allocation for a new academy on the ongoing funding level of active, deferred and pensioner members of a council (i.e. HCC) on the date the Actuary calculated the employer funding rate. The second approach was to base it on the ongoing funding level of active members of a council (i.e. HCC) on the date the actuary calculated the employer funding rate. In the second approach the funding level was calculated as the ratio of the active liabilities to the

remaining assets after sufficient assets had been retained to meet the deferred and pensioner liabilities of the council (i.e. HCC) in full, i.e. fully funded deferreds and pensioners, and then giving the academy a share of the remaining actives only assets.

33. East Riding chose the second approach. It said the number of schools converting to academies was unknown and it was likely that the number of employees would be a significant proportion of the active membership. This would therefore have a material impact on council employer contribution rates at the next valuation unless the second approach was adopted, given that the funding that councils were receiving from the Government, and from which the deficit would have been recovered over a number of years, had now been passed to the academies.

34. The situation was reviewed over the following few months in light of actual experience. During this time East Riding received an opinion from the Local Government Employers to the effect that its chosen method was fairer, given that a council would lose funding in respect of the provision of education services but would remain responsible for the pension liabilities of former education staff whose benefits will not transfer to an academy.

35. The Chief Finance Officers of the Fund's unitary authorities were also consulted in August 2011 on the approach adopted by the Fund.

36. East Riding submitted that the ramifications could be far-reaching and have a very significant impact on the Scheme if the Academy's position were to be accepted.

37. East Riding understands that the 22 Scheme administering authorities were split equally between a choice of the first or second approaches.

38. Powers to determine an asset allocation policy ultimately derive from Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008. This regulation requires the review, preparation and publication of a Funding Strategy Statement (**FSS**), which incorporates the asset allocation policy.

39. As the number of academies converting was an unknown quantity, measures had to be put in place to protect all Fund employers. For example it was not known what might happen to the liabilities for a failed academy. Updating of the Funding

Strategy Statement was therefore put on hold pending Government guidance, as only the new academies were affected. The new academies were all aware of the Fund's approach ahead of conversion, as they were provided with an actuarial report setting out their asset allocation and their individual employer contribution rate. The actuarial report, dated 8 June 2012, set out the reasons for the asset allocation policy and highlighted the lack of guidance on the allocation of assets and liabilities. The Academy did not provide any comments during the consultation period.

40. The Academy is wrong in submitting that deferred and pensioner liabilities are being transferred. The Fund's adopted policy does not seek to do this. The Fund first allocates assets to the deferred and pensioner members of the local authority and then the overall funding level of the active members of that authority is calculated based on the remaining assets. The assets allocated to the Academy (i.e. £341,000) are therefore based on the local authority's active members' funding level (18%) as well as the market conditions and the Academy's active Fund membership on the day prior to conversion.

41. East Riding's position relates to the funding round in operation when the Academy joined the Fund. The current funding round (concluded in 2014) is not relevant to the decision about this dispute.

42. The Academy objects to a contribution rate of 43.4%, but the employer rate of 20% it announced it would pay is lower even than the pre-conversion rate of 27.1% for a maintained school in the HCC area.

43. With regard to consultations which have taken place recently, the Academy should note the following extract from the consultation document:

> "Under the Commercial Transfer Agreement, the Local Authority retains sufficient assets in the pension fund to fully meet all the liabilities of the pensioner and deferred members as there is no future Local Authority funding for these members. The remaining assets associated with the converting school are transferred to the new Academy. An actuary acting for the administering authority calculates the amounts to be transferred according to the standards and codes of the actuarial profession."

East Riding said that this statement, albeit made at a later date, articulates the approach it has taken in allocating assets when calculating the employer contribution rates of all academies joining the Fund.

44. East Riding says that the asset allocation policy used to calculate the employer contribution rate for the academy has been applied consistently across all academy conversions in all Local Education Authorities within the Fund. There are a number of reasons for divergence between the calculated contribution rates of different academies and between academies and Local Education Authority schools. The employer contribution rate required from the Academy has to be, and has been, calculated in accordance with the Fund's actuarial advice.

45. For the avoidance of doubt, the calculation of the Academy's contribution rate is consistent with the approach set out by the Fund Actuary, and its asset allocation policy is consistent with government guidance and indeed the national policy as evidenced in the government consultation (see paragraph 33 above). It cannot therefore be considered to be ultra vires and is not contrary to any legislation or regulations made in respect of the Scheme. It is a matter for East Riding, and not anyone else, to decide what its asset allocation should be.

Conclusions

46. East Riding owes a duty to the members and to the participating employers as a whole, not to the Academy in isolation, to adopt a policy which it considers to be fair and reasonable. That alternative policies might have been adopted is irrelevant.

47. It submits that the methodology it adopted is adopted by many other local Scheme administrators. If some administrators, perhaps even a significant number, do not adopt the same policy, this would not in itself be sufficient to find that East Riding should not have done so. It also submits, and I have no reason to doubt this, that all the other academies within the Fund have complied with their contribution liabilities.

48. The Academy considers the financial demands placed on it to be unduly harsh. I am of course unaware of the detailed discussions which likely will have taken place, probably involving many interested parties, before the Academy was established.

But it was not until after it had joined the Fund that the Academy started to dispute its contribution rate. It may be the case that it did not exist as a legal entity until 1 September 2012, but in my view that would not have prevented its prospective officers from making their concerns known beforehand.

49. The Academy submits that approaches it has made to government departments may have helped set in train consultations with a view to securing more equitable treatment for academies in the setting of future employer contributions. That may be so, but what I am considering is whether East Riding acted reasonably in adopting a policy before September 2012 which resulted in the Academy's contribution rate being set as 43.4%.

50. The Academy says that East Riding must demonstrate that it has explicit powers to act as it has, rather than simply say that there is nothing preventing it from doing so. I would not expect the methodology for a highly technical exercise such as determining an asset allocation policy to be prescribed by the main Scheme Regulations (although East Riding refers me to the 2008 Administration Regulations). Rather, an administering authority has general powers under the main regulations to consult, obtain and rely on specialist advice in carrying out its obligations.

51. If the Academy's position were to be accepted, it would appear equally valid to conclude that there are no powers under which the Academy's alternative funding approach, should be adopted either.

52. I find difficulty with the Academy's argument that there is no express, implied or incidental power to adopt the Asset Allocation Policy. As I have observed in the previous paragraph, a similar argument probably could be applied to many other aspects of a Scheme administrator's duties. East Riding has general powers under the main Scheme Regulations and it has more specific powers regarding funding arrangements under the 2008 Administration Regulations. East Riding are required to keep the Funding Strategy Statement under review and in reviewing it, including revision, they must consult such persons as they consider appropriate. The Fund's Actuary would be such a person. Having adopted an Asset Allocation Policy, in my view East Riding's decision to put on hold its updating of the Funding Strategy

Statement, which the Academy submits contained provisions contrary to the Asset Allocation Policy at the time was, in the circumstances, reasonable. Further, the fact that East Riding did not immediate revise its existing and published Funding Strategy Statement does not mean decisions already reached about its revision are unlawful or ultra vires.

53. Reference has been made to s111 of the Local Government Act 1972. That statute provides that a local authority has powers to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions. But East Riding does not seek to rely on s111 in order to take steps for which it is not empowered elsewhere. Rather the Academy submits that East Riding does not have such powers and so it cannot rely on s111 to find them.

54. In conclusion I do not uphold this complaint. I find that, whilst other methodologies might have been applied, the methodology applied by East Riding to determine the Academy's contribution rate was one which a reasonable administering authority could have arrived at. East Riding acted in accordance with actuarial advice and within its legal powers in so doing.

Jane Irvine

Deputy Pensions Ombudsman
28 April 2015

Appendices

Appendix 1 - broad background extracted from the response to the complaint from East Riding (as per paragraph 2 above).

UNDERLYING BACKGROUND FACTS TO CASE

"12. The Fund is part of the Scheme. East Riding is the administering authority of the Fund. There are 142 participating employers in the Fund (as at 31 March 2013). The 4 main participating employers are the unitary authorities being HCC, East Riding itself, North Lincolnshire Council and North East Lincolnshire Council. As administering authority East Riding is responsible for the administration of the Fund, which it conducts through its Pensions Committee and appropriate delegations to officers. The main consultative body for the Fund is formed of the Chief Finance Officers of the four unitary authorities, who are the main employers participating in the fund.

13. The most recent Funding Strategy Statement is that of date 31 March 2011, published at the same time as the most recent triennial actuarial valuation of the Fund (dated 31 March 2011, containing an actuarial valuation as of 31 March 2010). Work is currently in progress in respect of the next actuarial valuation, as of 31 March 2013, due to be concluded before April 2014.

14. In the summer of 2011, after the publication of the Funding Strategy Statement and Actuarial Valuation referred to above, it became apparent that East Riding needed to take a decision as to the approach to working out what pension contributions were to be paid by academies becoming participating employers in the Fund. The policy within the Funding Strategy Statement required guarantees to be given in respect of new participating bodies, which was not going to be a condition that could sensibly be imposed in relation to academies, as government policy then stood.

15. By that time a representative of the Local Government Employers **(LGE)** had written (by letter of 18 April 2011) to the Government raising a number of pensions issues in respect of academy policy, including the lack of clarity about the appropriate approach to calculating the contributions of academies.

16. At that time stated government policy in respect of academies and pension scheme funding was that which was set out in the DfE briefing note on the LGPS dated August 2010, at paragraphs 4 and 5:

"4. The pensions authority should be asked for a calculation of the employer contribution rate for the academy. The actuarial assessment will be done by the LGPS administering authority's fund actuary but the school may wish to have their own assessment performed by an independent actuary. The employer contribution rate will be calculated on the basis of the academy's staff profile and relates only to the academy, whereas nearly all maintained schools in an LA pay the same pooled rate. This means the rate can be higher than the rate which applied to the school when maintained. There is likely to be a charge for the actuarial calculation.

5. Unlike the Teachers Pension Scheme (TPS), LGPS is a funded scheme and can be in surplus or deficit according to investment performance. Most pension funds are currently managing a deficit, and the deficit in respect of pensionable service prior to conversion transfers from the LA to the academy through the transfer agreement signed prior to conversion. The actuarial calculation of the employer contribution rate will take into account the amount needed to pay off any past service deficit and meet future accruals over a specified period, which is normally taken to be 20 years for Academies, although it is for the actuary to take a view on this. "

17. East Riding received actuarial advice on the options for how to approach the setting of contributions for academies and, after advice, decided in June 2011 that at that time (and pending more clarification from the Government as to its academies policy) a prudent policy would be adopted in respect of the determining of pension contributions to be paid by academies, the effect of which is as follows:

(1) The liabilities associated with members of the Fund who are employees of the academy in question are calculated in accordance with actuarial assumptions and the Funding Strategy Statement.

(2) In order to allocate notional assets to the academy in question (in order then to be able to calculate the applicable deficit) it is assumed the assets of the Fund are first allocated to deferred and pensioner members, and then the overall funding level across the Fund for active members is determined.

(3) A pro rata portion of the remaining assets are notionally allocated to the academy, on the basis that its own employees are to be taken as having the associated pension liabilities funded to the same level as the active members of the Fund generally.

(4) Once the deficit is calculated, a policy decision is applied in respect of the length of time over which it is intended for the deficit to be repaired (the longer the period the lower the contributions).

(5) Finally, the annual contributions can then be calculated.

18. In the absence of a clear framework for the funding of academies, and in particular (but not only) uncertainty in relation to how the failure of an academy would be accommodated, the above approach- and in particular the approach at step two by which deferred and pensioner pensions are taken to be funded first from existing assets- reflects a prudent approach to safeguard the funding position of the Fund whilst also allowing academies to participate.

19. On 4 December 2011, the DfE and DCLG made a joint statement in respect of academies policy. In the light of that joint statement, East Riding reviewed its pension funding policy in respect of academies. It was decided, after consultation with the Chief Finance Officers of the unitary authorities to maintain the existing policy save that, in recognition of the Government's preferences, the recovery period used to determine the pension contributions would be lengthened, which had the effect of reducing the pension contributions being demanded. This was agreed at a meeting on 26 January 2012.

20. It also decided that before any further changes were made to funding policy, greater clarity was needed from the Government, and a letter was written by East Riding to the government requesting clarity on a number of matters.

21. Further guidance was published by the Government in May 2012. This did not address the key outstanding issues relevant to development of policy in relation to setting contributions for academies. But the response to Question 6 does confirm that the Government expectation was that academies would make contributions in respect of deficit repair:

"**Academies as employers in the LGPS: how is the Academy Trust's LGPS employer contribution rate set?**

If the academy is not pooled, the Administering Authority's actuary will set the employer's contribution rate taking into account the number of non-teaching staff and a range of information relating to those staff e.g. pay, length of membership in the scheme etc. The resulting rate will be expressed as a percentage of pay of employees who are active members of the scheme for future service entitlements and an additional contribution towards any deficiency between assets and liabilities that may exist at the time of the calculation. The deficiency payment could be expressed as a percentage of pay or a monetary amount depending on the policy of the Fund. The contribution rate will be calculated in accordance with the LGPS (Administration) Regulations 2008. The Fund's funding strategy statement will influence the period over which the deficiency can be recouped and recovery periods can vary between different pension funds."

22. The updated guidance was considered by the East Riding Pensions Committee at its meeting on 15 June 2012. It was agreed that no further change in funding policy was appropriate at that time because no further guidance had been issued by the Government in response to the questions raised by the Fund on the calculation of the share of the funding deficit for academies and responsibility for the pension liabilities of a failed academy.

23. Negotiations between HCC and the Academy in respect of the setting up of the Thomas Ferens Academy- i.e. the Academy- were ongoing in the course of 2012. Prior to the Academy being established, the Academy was informed that, in accordance with East Riding's policy and the actuary's determinations, the pension contributions of the Academy would (on then current estimates) be 43.4%. For the avoidance of doubt, this calculation was carried out in accordance with the funding policy described above.

24. The Academy therefore was aware of the expected pension contribution prior to its commencing participation in the Fund.

25. After this level of expected pension contribution was mentioned, there were then some further negotiations concerning the point between HCC and the Academy. As to the Commercial Transfer Agreement that was ultimately concluded between HCC and the Academy:

(1) it contained the model clause providing that:
"The Company shall be responsible for any LGPS deficit relating to the Eligible Employees' membership of the LGPS referable to service up to and including the Transfer Date."

(2) What this clause makes clear is that accrued deficit associated with members of the LGPS transferring to the academy in question is to be the responsibility of the academy in question.

(3) Being a clause within a contract between HCC and the Academy, it is something that East Riding is free to take into account in determining pension contributions but it is not in any way binding on it. East Riding is not a party to the contract.

(4) In any event, this clause acknowledges that it is for the Academy to make pension contributions referable to the Scheme-related liabilities of its employees. It says nothing about the approach to be taken to the determination of those liabilities, which it is for the Actuary of the Fund to determine having regard to the Administering Authority's funding policy.

26. The Academy commenced participation in the Fund on 1 September 2012."

Appendix 2 - a copy of the East Riding Pension Fund's Funding Strategy Statement (as per paragraph 3 above)

"Funding Strategy Statement

1 Introduction

This is the Funding Strategy Statement (FSS) of the East Riding Pension Fund ("the Fund"), which is administered by East Riding of Yorkshire Council ("the Administering Authority").

The FSS is a summary of the Fund's approach to funding employers pension liabilities under the Local Government Pension Scheme.

This statement sets out how the Administering Authority has sought to balance the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the approach to funding the scheme's liabilities across the range of employers participating in the Fund.

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP and after consultation with the Fund's employers and independent adviser and is effective from 31 March 2011.

1.1 Regulatory framework

Benefits payable under the Local Government Pension Scheme are guaranteed by statute and are met by employees and employers contributions and investment returns. Members' contributions are fixed in the LGPS Regulations (Local Government Pension Scheme Benefits, Membership and Contribution Regulations 2007 (as amended)) at a level that covers only part of the cost of accruing benefits. Employers pay the balance of the cost of delivering the benefits to members (the employer contribution). The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers or pools of employers pay for their own liabilities.

The FSS forms part of a framework that includes:

- the Local Government Pension Scheme Regulations 1997 (regulations 76A and 77 are particularly relevant);
- the Local Government Pension Scheme (Administration) Regulations 2008 (regulations 35 and 36);
- the Rates and Adjustments Certificate, which can be found appended to the Fund actuary's triennial valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Statement of Investment Principles.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

In preparing the FSS, account has been taken of:

– FSS guidance produced by CIPFA

– the funds Statement of Investment Principles (SIP)

The Fund's actuary must have regard to the FSS as part of the fund valuation process.

1.2 Review of the FSS

The FSS is reviewed in detail at least every three years ahead of triennial valuations being carried out and whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

The next full review is due to be completed by 31 March 2014. More frequently, Annex A is updated to reflect any changes to employers.

In reviewing the FSS the Administering Authority will consult with all relevant interested parties involved with the Fund, before preparing and publishing the funding strategy.

The FSS is not an exhaustive statement of policy on all issues. If you have any queries please contact:-

Graham Ferry (Pensions Manager) - graham.ferry@eastriding.gov.uk

2 Purpose

2.1 Purpose of the FSS

The purpose of the FSS is to:

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

The FSS is a cohesive and comprehensive statement for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced. Whilst the position of all employers will be reflected in the FSS, the FSS must remain as a single strategy for the Administrating Authority to implement and maintain.

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered.

The Fund:

- receives contributions, transfer payments and investment income;
- invests monies held within the fund in accordance with the SIP
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The sound management of the fund relies on all interested parties exercising their duties and responsibilities conscientiously and diligently.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarised in Annex C.

2.3 Aims of the Funding policy

The objectives of the Fund's funding policy are to:

- ensure the long-term solvency of the Fund as a whole and the solvency of each of the notional sub-funds allocated to the individual employers;
- ensure that sufficient funds are available to meet all benefits as they fall due for payment;

- inform the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- help employers recognise and manage pension liabilities as they accrue with consideration to the effect on the operation of their business and to the Fund, in view of the employer's strength of covenant, where the Administering Authority considers this appropriate;
- minimise the degree of short-term change in the level of each employer's contributions by implementing a tiered stabilisation mechanism, reviewable after a 3 year period, which restricts the movement in employer contributions, where the Administering Authority considers it reasonable to do so;
- use reasonable measures, such as obtaining bonds and guarantees from employers, to reduce the risk to other employers and ultimately to the council tax payer from an employer ceasing participation or defaulting on its pension obligations;
- address the different characteristics of the disparate employers or groups of employers to the extent that this is practical and cost-effective; and
- maintain the affordability of the fund to employers as far as is reasonable over the longer term.

3 Solvency issues and target funding levels

3.1 Solvency and target funding levels

The Fund's actuary is required under Regulation 36(1) of The Local Government Pension Scheme (Administration) Regulations 2008 to report on the "solvency" of the whole fund at least every three years,

'Solvency" for ongoing employers is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund actuary's ongoing funding basis. This quantity is known as a "funding level".

The Fund actuary agrees the financial and demographic assumptions to be used for each such valuation with the Administering Authority.

The Fund operates the same target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. The time horizon of the funding target for community and transferee admission bodies will vary depending on the expected duration of their participation in the fund. The ongoing funding basis has traditionally been used for each triennial valuation for all employers in the Fund. The ongoing funding basis assumes employers in the Fund are an ongoing concern. The demographic and financial assumption used in calculating the funding level are set out at Annex A.

In the circumstances where:

- the employer is an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate within the next 5 to 10 years or lose its last active member within that timeframe,

The Administering Authority may vary the discount rate used to set the employer contribution rate. In particular contributions may be set for an employer to achieve full funding on a more prudent basis (eg using gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease.

In all cases the Administering Authority will discuss their approach with the respective employer.

3.2 Derivation of employer contributions

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the *"future service rate";* plus

b) an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, *"past service adjustment".* If there is a surplus there may be a contribution reduction; if a deficit, a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's actuary is required by the regulations to report the Common Contribution Rate1, for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit under (b) is currently spread over a period of 20 years.

The Fund's actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to an individual employer2. It is the adjusted contribution rate which individual employers are actually required to pay. The types of "peculiar" factors which are considered are set out in Section 3.7.

In effect, the Common Contribution Rate is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific spreading and phasing periods.

For some employers it may be agreed to pool contributions, see Section 3.7.9.

Annex B contains a breakdown of each employer's contributions following the 2010 valuation for the financial years 2011/12, 2012/13 and 2013/14. It also identifies which employers' contributions have been pooled with others.

Any costs of non ill-health early retirements must be paid as lump sum payments at the time of the employer's decision in addition to the contributions described above (or by instalments shortly after the decision). Instalments can be paid up to a maximum of 3 years after the decision where the Administering Authority considers this appropriate.

Employers' contributions are expressed as minima, with employers able to pay regular contributions at a higher rate. Employers should discuss with the Administering Authority before making one-off capital payments.

1 See Regulation 36(5) of LGPS (Administration) Regulations 2008
2 See Regulation 36(7) of the LGPS (Administration) Regulations 2008

3.3 Future service contribution rates

The future service element of the employer contribution rate is traditionally calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. The future service rate has been calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted.

3.3.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits that employee members earn from their service each year. Technically these rates will be derived using the Projected Unit Method with a one year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise.

3.3.2 Employers that do not admit new entrants

Certain Admission Bodies have closed the scheme to new entrants. This is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as the membership ages.

To give more long term stability to such employers' contributions, the Attained Age funding method is normally adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both funding methods are described in the Actuary's report on the valuation.

Both future service rates will include expenses of administration to the extent that they are borne by the Fund and include an allowance for benefits payable on death in service and ill health retirement.

3.4 Asset share calculations for individual employers

Adjustments to individual employer contribution rates are applied through both the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

The combined effect of these adjustments for individual employers applied by the Fund actuary relate to:

- past contributions relative to the cost of accruals of benefits to date;
- different liability profiles of employers (e.g. mix of members by age, gender, manual/non manual);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made;

over the period between the 2007 and 2010 valuation and each subsequent triennial valuation period.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

The Fund actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation [see section 3.6 below], including, but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

3.5 Asset share calculations for individual employers

The Administering Authority does not account for each employer's assets separately. The Fund's actuary is required to apportion the assets of the whole fund between the employers (or pool of employers) at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer or pool of employers. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund. The asset apportionment is capable of verification but not to audit standard.

The Administering Authority recognises the limitations in the process, but having regard to the extra administration cost of building in new protections, it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

3.6 Stability of employer contributions

3.6.1 Solvency issues and target funding levels

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of prudential strategies that the Administering Authority may deploy in order to maintain employer contribution rates at as nearly a constant rate as possible. These include:-

- capping of employer contribution rate increases I decreases within a pre-determined range ("Stabilisation").
- the use of extended deficit recovery periods.
- the phasing in of contribution increases I decreases.
- the pooling of contributions amongst employers with similar characteristics.

3.6.2 Stabilisation

There can be occasions when, despite the deployment of contribution stabilising mechanisms such as pooling, phasing and the extension of deficit recovery periods, the theoretical employer contribution rate is not affordable or achievable. This can occur in times of tight fiscal control or where budgets have been set in advance of new employer contribution rates being available.

In view of this possibility, the Administering Authority has commissioned the Fund Actuary to carry out extensive modelling to explore the long term effect on the Fund of capping future contribution increases. The results of this modelling indicate that it is justifiable to limit employer contribution rate changes from 1 April 2011 to 31 March 2014, subject to the following conditions being met:

- the Administering Authority is satisfied that the status of the employer merits adoption of a stabilised approach; and
- there were no material events up until 1 April 2011 which rendered the stabilisation unjustifiable.

The Administering Authority has adopted the following tiered stabilisation policy:

Tier 1 Employers – East Riding of Yorkshire Council
North East Lincolnshire Council
North Lincolnshire Council
Kingston Upon Hull City Council

The four Unitary Councils will have no increases to their contribution rates from 1 April 2011 to 31 March 2014. They will pay the same rate as the year ending 31 March 2011, no decrease in employers contributions will be permitted in this period e.g. if employee contributions increase

Tier 2 Employers – Town Councils
Humber Bridge Board
Small Scheduled and Resolution Bodies Pool

These employers will have no increase to their contribution rate from 1 April 2011 to 31 March 2012 and will pay the same rate as the year ending 31 March 2011. Their contribution rates will then increase by 1% of payroll per annum in the year to 31 March 2013 and a further 2% of payroll per annum in the year to 31 March 2014.

Tier 3 Employers – Universities
Colleges
Humberside Probation Trust

It has been agreed for these stable employers with no tax raising powers to reduce their deficit recovery period from 20 years to 15 years. Their contribution rate increases are to be phased in over the three year period from 1 April 2011 to 31 March 2014 using a back end loading approach.

Fund employers outwith the above three tiers will not be subject to stabilisation.

In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that the results of the modelling demonstrate that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" and are therefore paying less than their theoretical contribution rate should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

The Fund currently has a stable net cash inflow and can therefore take a medium to long term view on determining employer contribution rates to meet future liabilities through operating a fund with an investment strategy that reflects this long term view. It allows short term investment markets volatility to be managed so as not to cause volatility in employer contribution rates.

The LGPS regulations require the longer term funding objectives to be to achieve and maintain assets to meet the projected accrued liabilities. The role of the Fund Actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements. The approach to the actuarial valuation and key assumptions used at each triennial valuation form part of the consultation undertaken with the FSS.

3.6.3 Deficit recovery periods

The Administering Authority instructs the actuary to adopt specific deficit recovery periods for all employers when calculating their contributions.

The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table below:

Type of Employer	*Maximum* Length of Deficit Recovery Period
Statutory bodies with tax raising powers and Resolution bodies	a maximum period 20 years
Admission Bodies with funding guarantees	a period to be agreed with each employer not exceeding 20 years
Transferee Admission Bodies	the period from the start of the revised contributions to the end of the employer's contract
All other types of employer	A period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers

This maximum period is used in calculating each employer's minimum contributions. Employers may opt to pay higher regular contributions than these minimum rates.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2011 for 2010 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.6.4 Deficit recovery periods

For employers where stabilisation is not being applied, the deficit recovery payments for each employer covering the three year period until the next valuation will often be set as a percentage of salaries. However, the Administering Authority reserves the right to amend these rates between valuations and/or to require these payments in monetary terms instead, for instance where:

- the employer is an admitted body with a relatively large deficit recovery contribution rate (eg 15% or more), in other words its payroll is a smaller proportion of its deficit than is the case for most other employers, or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed the Fund to new entrants.

3.6.5 Surplus spreading periods

As part of the overall Funding Strategy it was agreed to adopt a 'stabilisation mechanism' that limits increases and reductions in contribution rates for public sector bodies: see 4.1 below. Therefore any emerging surplus will not reduce their contributions outside the pre-determined range.

For Transferee Admission Bodies, the aim is to be 100% funded at cessation, and so the preferred approach would be to reduce contributions by spreading the surplus over the remaining contract term, although the approach taken may be discussed and agreed with the employer associated with the body.

For any other employers deemed to be in surplus the preferred approach would be to maintain contributions at the future service level. However, reductions **may** be permitted to reduce contributions below the cost of accruing benefits, by spreading the surplus element over the maximum periods shown above for deficits in calculating their **minimum** contributions.

To help meet the stability requirement, employers outside the stabilisation mechanism may prefer not to take such reductions.

3.6.6 Phasing in of contribution rises

Transferee Admission Bodies are not eligible for phasing in of contribution rises. Other employers may be entitled to phase in contribution rises as follows:

- for employers contributing at or above its future service rate in 2010/11, phasing in the rise in employer contributions over a period of three years;
- for employers contributing at less than its future service rate in 2010/11 the employer should at least pay its future service rate in 2011/12.

3.6.7 Phasing in of contribution reductions

Any contribution reductions will be put in place with immediate effect for employers not subject to stabilisation.

3.6.8 The effect of opting for longer spreading or phasing in

Employers that are permitted and elect to use a longer deficit spreading period than was used at the 2007 valuation or to phase-in contribution changes will be assumed to incur a greater loss of investment returns on the deficit by opting to defer repayment. Thus, deferring paying contributions is expected to lead to higher contributions in the long-term (depending on the actual financial and demographic performance of the Fund relative to the valuation assumptions).

3.6.9 Pooled contributions

The Administering Authority allows smaller employers to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service.

Those employers that have been pooled are identified in Annex B.

3.7 Regular Reviews

The Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals. These intervals may be annual, in the case of Admission Bodies and/or in the last few years of the employer's contract. Such reviews may be triggered by significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions payable (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), an increased level of security or guarantee, or some combination of these.

3.8 Admission bodies ceasing

Admission Agreements for Transferee Admission Body contractors are assumed to expire at the end of the contract.
Admission Agreements for other employers are generally assumed to be open-ended but can however be terminated at any point subject to the terms of the agreement.

The Fund, however, considers any of the following as triggers for the termination of an admission agreement (notwithstanding the provisions of the agreement):

- Last active member ceasing participation in the LGPS;
- The insolvency, winding up or liquidation of the admission body;

- Any breach by the Admission Body of any of its obligations under the agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the admission body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the admission body to renew or adjust the level of the bond or indemnity or to confirm appropriate alternative guarantor as required by the Fund.

In addition either party can voluntarily terminate the admission agreement by giving the appropriate period of notice as set out in the admission agreement to the other party (or parties in the case of a Transferee Admission Body).

If an Admission Body's admission agreement is terminated, the Administering Authority instructs the Fund actuary to carry out a special valuation to determine whether there is any deficit.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

a) For Transferee Admission Bodies, the assumptions applying at the end of the contract would be those used for an ongoing valuation to be consistent with the assumptions used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

b) For admission bodies that are not Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or which triggers a cessation event, the Administering Authority must look to protect the interests of other ongoing employers. It will require the actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. In order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis" with no allowance for potential future investment outperformance and with an allowance for further future improvements in life expectancy. This approach results in a higher value being placed on the liabilities than would be the case under a valuation on the ongoing funding basis and could give rise to significant payments being required.

c) For Admission Bodies with guarantors, it is possible that any deficit could be transferred to the guarantor in which case it may be possible to simply transfer the former Admission Bodies members and assets to the guarantor, without needing to crystallise any deficit.

Under (a) and (b), any shortfall would be levied on the departing Admission Body as a capital payment.

As an alternative to (b) above, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security or guarantee to be held against any deficit, and would carry out the cessation valuation on an ongoing valuation basis: deficit recovery payments would be derived from this cessation amount. This approach would be monitored as part of each triennial valuation and the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

In the event that the Fund is not able to recover the required payment in full directly from the Admission Body or from any bond or indemnity or guarantor, then:

a) In the case of Transferee Admission Bodies the awarding authority will be liable. At its absolute discretion, the Administering Authority may agree to recover any outstanding amounts via an increase in the awarding authority's contribution rate over an agreed period.

b) In the case of admission bodies that are not Transferee Admission Bodies and have no guarantor, the unpaid amounts fall to be shared amongst all of the employers in the Fund. This will normally be reflected in contribution rates set at the formal valuation following the cessation date.

3.9 Early retirement costs

3.9.1 Non ill-health retirements

The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health. Employers are required to pay additional contributions wherever an employee retires before attaining the age at which the valuation assumes that benefits are payable.

It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire. Members receiving their pension unreduced before this age other than on ill-health grounds are deemed to have retired early.

The additional costs of premature retirement are calculated by reference to these ages.

Employers must make these additional contributions as a one off payment to the fund immediately on awarding the early retirement. Depending on the circumstances, the Administering Authority may at its absolute discretion agree to spread the payment over a period not exceeding 3 years.

3.9.2 Ill-health monitoring

The Fund monitors each employer's, or pool of employers, ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis as apply for non ill-health cases.

3.9.3 Ill-health insurance

If an employer provides satisfactory evidence to the Administering Authority of a current insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged;
- there is no need for monitoring of allowances.

The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

3.10 New admitted bodies

The Fund requires the following from any potential Admission Bodies wishing to join the Fund.

Transferee Admission Bodies will be required to have a guarantee from the transferring scheduled body and also provide a bond if requested by the Administering Authority. The bond is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the employer's contract
- allowance for the risk of asset underperformance
- allowance for the risk of a fall in gilt yields

- allowance for unpaid contributions

The employer may also be required to include their current deficit within the bond amount. The bond will be reassessed on an annual basis. This is included within the Fund's risk register.

The Administering Authority will only consider requests from Community Admission Bodies to join the Fund if they are sponsored by a scheduled body with tax raising powers, guaranteeing their liabilities and also provide a bond if requested.

This reduces the risk to the Fund of potentially having to pick up any shortfall in respect of Admission Bodies.

4 Links to investment strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the administering authority, after consultation with the employers' representatives and after taking investment advice.

4.1 Investment strategy

The investment strategy currently being pursued is described in the Fund's Statement of Investment Principles.

The investment strategy is set for the long-term, but the Fund has a policy to formally review the asset allocation, following the completion of the triennial valuation of the Fund, or perhaps more frequently to ensure that it remains appropriate to the Fund's liability profile. The Administering Authority has adopted a benchmark, which sets the proportion of assets to be invested in key asset classes such as Equities, Bonds and Cash, and Alternatives. As at 31 March 2010, the proportion held in Equities and Alternatives was 84% of the total Fund assets.

The investment strategy of lowest default or volatility risk would be one which provided cashflows which replicate the expected benefit cashflows (i.e. the liabilities). Investments in Equities and Alternatives would not be consistent with this.

The Fund's benchmark includes a significant holding in Equities and Alternatives in the pursuit of long-term higher returns than from index-linked bonds. The Administering Authority's strategy recognises the relatively immature liabilities of the Fund and the secure nature of most employers' covenants.

4.2 Consistency with funding basis

The funding policy currently adopts an asset out-performance assumption of 1.6% per annum over and above the redemption yield on fixed interest gilts. This resulted in a return on the Fund's assets of 6.1% p.a. to be adopted for the 2010 formal valuation. The Fund's investment strategy is as currently outlined in the Fund's Statement of Investment Principles. The Fund's Actuary considers that the funding basis does conform to the requirements to take a "prudent longer-term" approach to funding.
The Administering Authority has sought specific advice from the Fund's Actuary on the interaction between funding and investment strategy. In particular, the Administering Authority will consider the implications of the combined strategy on the key objectives of stability of contributions, affordability for employers, transparency of process and method, and prudence. The Administering Authority considers that its funding and investment policy appropriately balances these objectives.

The Administering Authority is aware that, in the short term - such as the three yearly assessments at formal valuations- the proportion of the Fund invested in Equities and Alternatives brings the

possibility of considerable volatility and there is a material chance that in the short term and even medium term, the asset returns will fall short of the out-performance target. The stability measures described in Section 3 will dampen down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of investments in Equities and Alternatives.

4.3 Balance between risk and reward

Prior to implementing its current investment strategy, the Administering Authority considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes like equities.

4.4 Inter-valuation monitoring of funding position

The Administering Authority monitors investment performance relative to the and measuring investment manage returns against their mandate. Where regulatory change takes place that may have a significant and detrimental effect on the funding position actuarial advice is sought on the approach that should be adopted. The Fund also reports back to employers annually at its Annual General Meeting.

5 Key risks and controls

5.1 Types of risk

The Administering Authority's has an active risk management programme in place including a Fund specific risk register. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

5.2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term	*Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.* *Analyse progress at three yearly valuations for all employers.* *Inter-valuation roll-forward of liabilities between formal valuations subject to market experience*
Inappropriate long-term investment Strategy	*Set Fund-specific benchmark, informed by Asset-Liability modelling of liabilities.* *Regular review of long-term investment strategy to ensure it remains appropriate* *Tactical asset allocation reviewed by the Pensions Committee, in light of financial market conditions, on a quarterly basis* *Detailed analysis of Fund performance on an absolute basis and relative to the actuarial rate of return and the Fund specific benchmark*
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	*Inter-valuation monitoring, as above.* Some *investment in bonds helps to mitigate this risk.*
Active investment manager under-performance relative to benchmark	*Analysis of market performance and active managers performance relative to their index benchmark on a quarterly basis*
Pay and price inflation significantly more than anticipated	*The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.* *Inter-valuation monitoring, as above, gives early warning.* Some *investment in index-linked bonds (and other inflation-linked investments) also helps to mitigate this risk.* *Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.*

Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	*Seek feedback from employers on scope to absorb short- term contribution rises.* *Mitigate impact through deficit spreading, phasing in of contribution rises and possible pooling.*

5.3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer.	*Set mortality assumptions with some allowance for future increases in life expectancy.* *Fund actuary monitors combined experience of around 50 funds to look for early warnings of lower pension amounts ceasing than assumed in funding.* *Administering Authority encourage any employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.*
Deteriorating patterns of early retirements	*Employers are charged the extra capital cost of non ill health retirements following each individual decision.* *Employer ill health retirement experience is monitored.*
A company admitted to the Fund as an admission body may become financially unviable	*A surety bond is required to cover the potential risk of the admitted body becoming insolvent and the value of this is reviewed regularly to ensure it provides adequate cover for the financial risks involved.*
Ill-health retirements significantly more than anticipated	*Monitoring of each employer's ill-health experience on an ongoing basis. The employer may be charged additional contributions if this exceeds the ill-health assumption built in.*
Reductions in payroll causing insufficient deficit recovery payments	*In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:* *For employers in the stabilisation mechanism, may be brought out of that mechanism to permit appropriate contribution increase).* *For other employers, review of contributions is permitted in general between valuations and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.*

5.4 Regulatory

Risk	Summary of Control Mechanisms
Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees	*The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.* *It considers all consultation papers issued by the CLG and comments where appropriate.* *The Administering Authority will consult employers where it considers that it is appropriate.* *In all circumstances where it appears that changes may impact on the Fund's solvency the Administrating Authority will consider seeking actuarial advice to mitigate or manage the impact of such changes.* *The results of the Hutton review are not expected to affect the Fund until after the 2013 valuation, and so will be incorporated at that time. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.*
Changes to national pension requirements and/or HM Revenue and Customs rules e.g. effect of abolition of earnings cap for post 1989 entrants from April 2006, abolition of 85 year rule, new 2008 scheme, tax simplification, budget changes for higher earners and the Hutton Review of public sector pensions.	

5.5 Governance

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e .g. large fall in employee members, large number of retirements).	*The Administering Authority monitors membership movements on a quarterly regular basis* *The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations* *Deficit contributions are expressed as monetary amounts (see Annex A).*
Administering Authority not advised of an employer closing to new entrants.	
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.	*In addition to the Administering Authority monitoring membership movements requires employers with Transferee Admission Agreements to inform it of forthcoming changes.*
An employer ceasing to exist with insufficient funding or adequacy of a bond.	*The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.*

	The risk is mitigated by: *Seeking a funding guarantee from another scheme employer, or external body, where-ever possible.* *Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.* *Vetting prospective employers before admission.* *Where permitted under the regulations requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.* *Reviewing bond or guarantor arrangements at regular intervals.* *Reviewing contributions if thought appropriate.*

Annex A- Key assumptions used in calculating the funding level

a) Demographic

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds advised by the Fund Actuary. It is acknowledged that future life expectancy and in particular, the allowance for future improvements in mortality, is uncertain. Employers should be aware that their contributions are likely to increase in future if longevity exceeds the funding assumptions. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed statutory guarantee underpinning members' benefits. The demographic assumptions vary by type of member and so reflect the different profiles of employers.

b) Investment Return

The key financial assumption is the anticipated return on the Fund's investments. The investment retun assumption makes allowance for anticipated returns from the Fund's assets in excess of gilts. There is, however, no guarantee that assets will out-perform gilts or even match the return on gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

In light of the statutory requirement for the Actuary to consider the stability of employer contributions it is therefore normally appropriate to restrict the degree of change to employers' contributions at triennial valuation dates.

Given the very long-term nature of the liabilities, a long term view of prospective returns from equities is taken. For the 2010 valuation, it is assumed that the Fund's investments will deliver an average real additional return of 1.6% a year in excess of the return available from investing in index-linked government bonds at the time of the valuation. Based on the asset allocation of the Fund as at 31 March 2010, this is equivalent to taking credit for excess returns on equities of 2% per annum over and above the gross redemptions yield on index-linked gilts on the valuation date and for excess returns of 0.4% per annum on the non-equity assets.

c) Salary Growth

Pay for public sector employees will be frozen by Government until 2012, with a flat increase of £250 being applied to all those earning less than £21 ,000 pa. Although this "pay freeze" does not officially apply to local government employers, it has been suggested that they are expected to show similar restraint in respect of pay awards. Based on an analysis of the membership in LGPS funds, the average expected increase in pensionable pay across all employees should be around 1% pa for the next two years. Therefore the salary increase assumption at the 2010 valuation has been set to 1% pa for 2010/11 and 2011/12. After this point, the assumption will revert back to RPI plus 1.5% pa, as adopted for the previous valuation.

d) Pension Increases

The Chancellor of the Exchequer announced in his Emergency Budget on 22 June 2010 that the consumer prices index (CPI) rather than the retail prices index (RPI) will be the basis for future increases to public sector pensions in deferment and in payment. This proposed change has been allowed for in the valuation calculations as at 31 March 2010.

At the previous valuation, we derived our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. At this valuation, we propose to adjust this market-derived rate downwards by 0.5% pa to allow for the "formula effect" of the difference between RPI and CPI. Basing pension increases on CPI rather than RPI will serve to reduce the value placed on the Fund's liabilities.

e) General

The same financial assumptions are adopted for all ongoing employers. All employers have the same asset allocation. Demographic assumptions vary by member characteristics and so reflect the different profiles of the employers.

Annex B - Rates and adjustments certificate

In accordance with regulation 36(1) of the Administration Regulations I have made an assessment of the contributions that should be paid into the Fund by participating employers for the period 1 April 2011 to 31 March 2014 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in the current Funding Strategy Statement and my report on the actuarial valuation dated March 2011.

The required minimum contribution rates are set out in the table below.

Signature:

Date: 31 March 2011

Name: Bryan T Chalmers

Qualification: Fellow of the Institute and Faculty of Actuaries

Firm: Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

Statement to the rates and adjustments certificate

The Common Rate of Contribution payable by each employing authority under regulation 36(4)(a) of the Administration Regulations for the period 1 April 2011 to 31 March 2014 is 25.8% p.a. of pensionable pay (as defined in Appendix B).

Individual Adjustments are required under regulation 36(4)(b) of the Administration Regulations for the period 1 April 2011 to 31 March 2014 resulting in Minimum Total Contribution Rates expressed as a percentage of pensionable pay are as set out below:

Employer Code	Employer name as at 31 March 2010	Minimum Contributions for the Year Ending		
		31 March 2012	31 March 2013	31 March 2014
		% of pay	% of pay	% of pay
EAST RIDING OF YORKSHIRE POOL				
80	East Riding of Yorkshire Council	15.3%[1]	15.3%[1]	15.3%[1]
NORTH EAST LINCOLNSHIRE POOL				
81	North East Lincolnshire Council	21.8%[2]	21.8%[2]	21.8%[2]
NORTH LINCOLNSHIRE POOL				
82	North Lincolnshire Council	22.3%	22.3%	22.3%
KINGSTON UPON HULL CITY COUNCIL POOL				
7	Kingston Upon Hull City Council	27.1%	27.1%	27.1%
INDIVIDUAL EMPLOYERS				
14	National Probation Service - Humberside	22.8%	24.1%	25.4%
21	Humber Bridge Board	25.1%	26.1%	27.1%
29	North Eastern Inshore Fisheries and Conservation Authority	18.8%	18.8%	18.8%
31	Pocklington School	23.5%[3]	23.5%[3]	23.5%[3]
40	Hornsea Town Council	22.3%	23.3%	24.3%
44	Humberside International Airport Limited	21.2%[4]	21.2%[4]	21.2%[4]
45	Withernsea Town Council	18.2%	19.2%	20.2%
46	University of Lincoln	20.4%	23.3%	26.3%
49	Humberside Independent Care Association	29.9%[5]	29.9%[5]	29.9%[5]
52	Bishop Burton College	18.8%	21.3%	23.9%
54	Grimsby Institute of Further and Higher Education	17.6%	19.2%	20.7%
55	Hull College	16.9%	19.2%	21.6%
56	North Lindsey	17.7%	19.4%	21.1%
63	Goole Town Council	19.6%	20.0%	21.0%
67	Humberside Police	17.3%	18.1%	19.0%
71	Humberside Fire Authority	20.7%	20.7%	20.7%
74	Hull and East Yorkshire Community Foundation Ltd	13.5%	13.5%	13.5%
75	Humbercare Limited	25.5%[6]	25.5%[6]	25.5%[6]
91	Sports and Leisure Management Limited	21.0%	21.0%	21.0%
101	Yorkshire & Humberside Grid for Learning	16.0%	16.0%	16.0%
104	Shoreline Housing Partnership Limited	26.2%	26.2%	26.2%
106	Arvato Government Services (ERYC) Limited	22.5%	22.5%	22.5%
107	Brigg Town Council	16.5%	16.5%	16.5%
109	North Lincolnshire Homes Limited	18.6%	21.1%	23.7%

Employer Code	Employer name as at 31 March 2010	Minimum Contributions for the Year Ending		
		31 March 2012	31 March 2013	31 March 2014
		% of pay	% of pay	% of pay
110	Kier Support Services Limited	18.1%	20.1%	23.2%
112	Kingstown Works Limited	16.8%	16.8%	16.8%
113	Havelock Academy	19.4%	19.4%	19.4%
115	Immingham Academy	17.3%	17.3%	17.3%
116	Wintringham Academy	15.1%	15.1%	15.1%
117	Care Trust Plus	19.1%[7]	19.1%[7]	19.1%[7]
125	Archbishop Sentamu Academy	14.7%	14.7%	14.7%
126	St Lawrence Academy	20.6%	20.6%	20.6%
127	NPS Humber Ltd	19.8%	19.8%	19.8%
129	Reel Cinemas (UK) Ltd	21.1%	21.1%	21.1%
130	Sirus Academy (Pickering)	20.7%	20.7%	20.7%
SMALL SCHEDULED & RESOLUTION BODIES POOL				
23	Immingham Town Council	21.8%	22.8%	23.8%
25	Lower Ouse Internal Drainage Board	21.8%	22.8%	23.8%
26	Market Weighton Internal Drainage Board	21.8%	22.8%	23.8%
27	Market Weighton Town Council	21.8%	22.8%	23.8%
72	Driffield Town Council	21.8%	22.8%	23.8%
76	Elloughton Cum Brough Parish Council	21.8%	22.8%	23.8%
77	Beverley Town Council	21.8%	22.8%	23.8%
83	Burton Upon Stather Parish Council	21.8%	22.8%	23.8%
84	Bottesford Town Council	21.8%	22.8%	23.8%
87	Bridlington Town Council	21.8%	22.8%	23.8%
89	Barton Upon Humber Town Council	21.8%	22.8%	23.8%
97	Hedon Town Council	21.8%	22.8%	23.8%
98	Beverley & North Holdsrness Internal Drainage Board	21.8%	22.8%	23.8%
SMALL ADMISSION BODIES POOL				
20	Hull and Goole Port Health Authority	22.8%	22.8%	22.8%
37	Hull Young People's Christian & Literary Institute	22.8%	22.8%	22.8%
47	Pickering and Ferens Homes	22.8%	22.8%	22.8%
48	Hull Resettlement Project Limited	22.8%	22.8%	22.8%
69	Hull Charterhouse Trustees	22.8%	22.8%	22.8%
79	The Deep (EMIH Ltd)	22.8%	22.8%	22.8%
EAST RIDING COLLEGES POOL				
90	East Riding College	17.8%	20.8%	23.7%
SMALL COLLEGES POOL				
57	Franklin College	17.9%	19.9%	21.08%
58	Wilberforce College	17.9%	19.9%	21.08%
59	Wyke College	17.9%	19.9%	21.08%
60	John Leggott College	17.9%	19.9%	21.08%

Further comments

Stabilisation

The following employers have had their contribution rates stabilised following a separate modelling exercise that I carried out on their behalf:

- East Riding of Yorkshire Council
- Kingston Upon Hull City Council
- North East Lincolnshire Council
- North Lincolnshire Council

Notes

Contributions expressed as a percentage should be paid into East Riding of Yorkshire Pension Fund {'the Fund') at a frequency in accordance with the requirements of the Regulations.

Further sums should be paid to the Fund to meet the costs of any early retirements and/or augmentation using methods and factors issued by me from time to time.

Further sums may be required to be paid to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those included within my assumptions.

The certified contribution rates represent the minimum level of contributions to be paid. Employing authorities may pay further amounts at any time and future periodic contributions may be adjusted on a basis approved by the Fund actuary.

1. East Riding of Yorkshire Council will pay the pooled Future Service Rate of 15.3%. The deficit of the pool will be paid by the Council and will be recovered by means of monetary amounts. The required monetary amounts for the period of 1 April 2011 to 31 March 2014 are as follows;

   2011/2012 £5.967m 2012/2013 £6.027m 2013/2014 £6.087m

2. In addition to their certified minimum contribution rate as stated in the Rates and adjustments certificate, North East Lincolnshire Council are required to pay monetary lump sum amounts for the period of 1 April 2011 to 31 March 2014 as follows;

   2011/2012 £530k 2012/2013 £536k 2013/2014 £541 k

3. The certified minimum contribution rate as stated in the Rates and adjustments certificate for Pocklington School is 23.5%. Where the total deduction of 23.5% of pensionable pay at the end of each financial year is less than £225k then the employer must pay a lump sum to make up the difference so that the total employer pension contributions for each financial year is a minimum of £225k. The lump sum must be paid by the end of the financial year that it relates to.

4. In addition to their certified minimum contribution rate as stated in the Rates and adjustments certificate, Humberside International Airport Limited are required to pay monetary lump sum amounts for the period of 1 April 2011 to 31 March 2014 as follows;

   2011/2012 £107k 2012/2013 £113k 2013/2014 £119k

5. The certified minimum contribution rate as stated in the Rates and adjustments certificate for Humberside Independent Care Association is 29.9%. Where the total deduction of 29.9% of pensionable pay at the end of each financial year is less than £190k then the employer must pay a lump sum to make up the difference so that the total employer pension contributions for each financial year is a minimum of £190k. The lump sum must be paid by the end of the financial year that it relates to.

6. In addition to their certified minimum contribution rate as stated in the Rates and adjustments certificate, Humbercare Limited are required to pay monetary lump sum amounts for the period of 1 April 2011 to 31 March 2014 as follows;

   2011/2012 £26k 2012/2013 £26k 2013/2014 £26k

7. In addition to their certified minimum contribution rate as stated in the Rates and adjustments certificate, Care Trust Plus are required to pay monetary lump sum amounts for the period of 1 April 2011 to 31 March 2014 as follows;

2011/2012	£32k	2012/2013	£34k	2013/2014	£36k

Annex C - Responsibilities of the key parties

The **Administering Authority** will:

- collect, account and reconcile employer and employee contributions from the employer bodies;
- receive monies due from all sources including contributions, investment, income and transfer values
- invest monies not required for the immediate payment of benefits, transfers and administration costs in accordance with the Investment Regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process and bulk transfers in consultation with the Fund's Actuary;
- prepare and maintain an FSS and a SIP, both after due consultation, with interested parties; and
- monitor all aspects of the Fund's performance and funding and amend FSS/SIP as required
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses

The **Individual Employer** will:

- deduct contributions from employees' pay correctly.
- pay all contributions (employees and employers), including their own as determined by the actuary, promptly by the due date;
- exercise discretions within the regulatory framework and inform the Administering Authority of their individual policies on discretions;
- make additional contributions in accordance with agreed arrangements, for example, augmentation of scheme benefits, early retirement strain;
- notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding;
- engage with the Administering Authority in all required consultation processes; and
- comply with the valuation timetable where required and respond to communications as necessary to complete the process.

The **Fund actuary** will:

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS;
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters; and

The **Pensions Committee** will:-

- carry out statutory functions relating to local government pensions under regulations made under Sections 7, 12 and 24 of the Superannuation Act 1972. Broadly this enables them to oversee the general framework within which the Fund is managed;
- monitor investment and administration performance;
- carry out regular reviews of investments and investment strategy;
- determine and keep under constant review, an overall asset allocation policy for the Fund, including appointment and termination of fund managers;
- consider appropriate professional advice on all matters with a material impact on the Fund;
- approve significant internal decisions and documents for the Fund including the valuation, Annual Report and Accounts and the FSS; and
- determine and keep under constant review, all policies and strategies of the Fund."