Agenda Item	**8**
Report No	**PC/8/24**

HIGHLAND COUNCIL

Committee: Pensions Committee

Date: 22 February 2024

Report Title: **Funding Strategy Statement**

Report By: Head of Corporate Finance

1 Purpose/Executive Summary

1.1 The purpose of this report is to provide information to members on the 2023 Actuarial Valuation process and seek approval of the funding approach outlined in the Funding Strategy Statement.

2 Recommendations

2.1 Members are invited to.

i. note the overall whole Fund valuation as at 31 March 2023 included in Report on the Actuarial Valuation as at 31 March 2023 (Appendix 1).

ii. agree the funding approach outlined in the Funding Strategy Statement including the assumptions used in the calculation of the Fund liabilities for the triennial valuation as at 31 March 2023 (Appendix 2)

3 Implications

3.1 Resource – resource implications are a key consideration in the Valuation process as the process requires assessing future assets and liabilities and calculating employer rates in respect of this to ensure funding objectives are met (Appendix 1). Resource implications are also considered in section 2 of Funding Strategy Statement (Appendix 2) as part of the methodology to calculated contribution rates and the assumptions used.

3.2 Legal – the Fund is required under the Local Government Pension Scheme (Scotland) Regulations 2018, to complete a triennial valuation (Regulation 60), publish a Funding Strategy Statement and consult with all participating employers and the Pensions Committee around the funding approach for the triennial valuation (Regulation 56). The valuation is to be completed and signed off by the scheme actuary by 31 March 2024. Information on the LGPS regulations is included in section 4 of this report and in the Funding Strategy Statement (Appendix 2) at Appendix A, Regulatory Framework.

3.3 Community (Equality, Poverty, Rural and Island) – there are no specific community implications for this report.

3.4 Climate Change / Carbon Clever – in section 3.4 of the Report on the Actuarial Valuation as at 31 March 2023 (Appendix 1), as part of the sensitivity and risk analysis, climate change risks are evaluated. The effects of possible asset underperformance as a result of climate change are also considered in the risk assessment in the Funding Strategy Statement (Appendix 2) at Appendix C, Risks and controls.

3.5 Health and Safety (risks arising from changes to plant, equipment, or people) – there are no Health and Safety (risks arising from changes to plant, equipment, or people) considerations to be included in the report.

3.6 Risk – risks are considered in the sensitivity and risk analysis in Report on the Actuarial Valuation as at 31 March 2023 (Appendix 1) and the Funding Strategy Statement (Appendix 2) at Appendix C, Risks and controls.

3.7 Gaelic – there were no Gaelic implications to be considered in the report.

4 Introduction

4.1 The Highland Council is the Administering Authority for the Highland Council Pension Fund.

4.2 The Actuarial Valuation process is a key part of the LGPS risk management framework. The process ensures there is a continual “health check” on Fund solvency and provides the opportunity to analyse actual experience compared to actuarial assumptions.

4.3 The completion of the Actuarial Valuation is a regulatory requirement and in compliance with The Local Government Pension Scheme (Scotland) Regulations 2018 (Regulation 60), an Administering Authority must obtain:

1) an actuarial valuation of the assets and liabilities of each of its pension funds as at 31 March 2020 and on 31 March in every third year afterwards;
2) a report by an actuary in respect of the valuation; and
3) a rates and adjustments certificate prepared by an actuary which sets out employer contribution rates.

4.2 As part of the Actuarial Valuation process, The Local Government Pension Regulations 2018 require Administering Authorities to formulate, consult and publish a Funding Strategy Statement (FSS). The Funding Strategy Statement (Appendix 2) is produced in accordance with the Chartered Institute of Public Finance & Accountancy (CIPFA) revised statutory guidance "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme (LGPS) 2016", which affirms the FSS as being a key part of a pension fund's risk management framework.

4.3 The objectives of the (FSS) are to:

- take a prudent long-term view to secure the regulatory requirement for long-term solvency, with sufficient funds to pay benefits to members and their dependants
- use a balanced investment strategy to minimise long-term cash contributions from employers and meet the regulatory requirement for long-term cost efficiency
- where appropriate, ensure stable employer contribution rates
- reflect different employers' characteristics to set their contribution rates, using a transparent funding strategy
- use reasonable measures to reduce the risk of an employer defaulting on its pension obligations

4.4 The Highland Council Pension Fund FSS was developed with support from the Council's Actuaries.

5. Report on the Actuarial Valuation as at 31 March 2023 (Appendix 1)

5.1 Ms Laura McInroy from the Fund's Actuary, Hymans Robertson will be in attendance to provide a presentation on the Actuarial Valuation as at 31 March 2023 (Appendix 1), the purpose of which is to inform members on the Actuarial Valuation process and results.

5.2 The Report on the Actuarial Valuation as at 31 March 2023 sets out the Approach to the Valuation, the Valuation Results and includes a Sensitivity and risk analysis.

5.3 In terms of the Valuation results, key points to note are that the funding position for The Highland Council Pension Fund has increased from 100% at the 2020 Valuation to 136% at the 2023 Valuation and the employer primary contribution rate will reduce from 21.2% at the 2020 Valuation to 17.8% at the 2023 Valuation.

6 Highland Council Pension Fund Funding Strategy Statement (Appendix 2)

6.1 The Funding Strategy Statement is at Appendix 2 and covers the following key areas:

- method the Fund uses to calculate employer contributions
- circumstances in which additional contributions may be payable
- how the Fund calculates assets and liabilities
- process when an employer joins the Fund
- policy on bulk transfer of staff to the Fund
- policy on employer leaving the Fund.
- statutory reporting requirements

6.2 A key change compared to the previous Funding Strategy Statement, is the Policy on employers leaving the fund (Appendix 1, Policy on Cessations Appendix G) and how valuations will now be calculated when an employer ceases to be in the Fund (cessation valuation). The amendment to the cessation valuation approach is to use a cessation corridor approach rather than using the previous government bond yield approach.

This has the following two major benefits to both the Fund and its employers:

1. **Reflects how assets are invested in practice** – When an employer ceases participation in the Fund, the Fund does not purchase government bonds to match that employer's liabilities. Instead, the employer's assets remain invested in the Fund's investment strategy which aims to achieve returns over and above the yield available on long-dated government bonds. Adopting the corridor approach aligns the cessation methodology with actual Fund practice, whilst enabling the Fund to set the level of prudence within the cessation calculations (something that was not possible under the government bond yield approach)
2. **Stability in cessation valuations** – The current economic environment has led to significant volatility in government bonds yields and, as a result, volatility in employers' cessation positions. Market volatility makes exit planning difficult for employers as changes in the government bond yield can swing a cessation surplus to a cessation deficit relatively quickly. The corridor approach helps reduce the volatility in cessation positions by providing a range of acceptable positions as opposed to a providing single value for the employer's liabilities on a given date.

6.3 In the Policy on Cessations Appendix G, there is also new section on Deferred Debt Agreements. This follows following changes to the LGPS (Scotland) 2018 Regulations in June 2022 that provided Funds with the flexibility to defer the debt (the "exit payment") that employers owed when their last employee left the LGPS.

7 Consultation

7.1 As per the Regulations a draft copy of the FSS was issued to employers on 19 December 2024 requesting comments by 19 January 2024.

7.2 Meetings were held with three employer bodies to discuss the individual employer rates but no requests were made to change the FSS.

8 Training and governance

8.1 Pensions Committee and Board members attended a training session on 24 January 2024 which provided an overview of the actuarial valuation, initial results compared to previous valuations, the process for setting employer rates and the Member's role in the valuation process and approving the Funding Strategy Statement.

Designation: Head of Corporate Finance

Date: 14 February 2024

Author: Brian Porter, Head of Corporate Finance

Background Papers: LGPS regulations, Integra Financial reporting

APPENDIX 1

HYMANS ROBERTSON

The Highland Council Pension Fund

Report on the actuarial valuation as at 31 March 2023

February 2024

Robert Bilton FFA

Laura McInroy FFA

For and on behalf of Hymans Robertson LLP

Hymans Robertson LLP

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Report on the actuarial valuation as at 31 March 2023

1) Executive summary

We have been commissioned by The Highland Council ("the Administering Authority") to carry out a valuation of The Highland Council Pension Fund ("the Fund") as at 31 March 2023. This fulfils Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018. This report is a summary of the valuation.

1. Contribution rates

The contribution rates for individual employers set at this valuation can be found in the Rates and Adjustments certificate. Table 1 shows the combined individual employer rates set at this valuation and the last valuation.

	31 March 2023		31 March 2020	
Primary rate	17.8% of pay		21.2% of pay	
Secondary rate	2024/25	-£814,000	2021/22	-£4,581,000
	2025/26	-£769,000	2022/23	-£4,671,000
	2026/27	-£794,000	2023/24	-£4,772,000

Table 1: Whole fund contribution rates compared with the previous valuation

The overall contribution rate, expressed as a percentage of pay, has reduced due to both an improvement in the past service funding position and higher assumed future investment returns at 2023 compared to 2020.

2. Funding position

At 31 March 2023, the past service funding position has improved from the last valuation at 31 March 2020. Table 2 shows the single reported funding position at this valuation and the last valuation.

	31 March 2023	31 March 2020
	(£m)	(£m)
Employees	674	782
Deferred Pensioners	276	301
Pensioners	823	803
Total liabilities	**1,773**	**1,887**
Assets	**2,406**	**1,892**
Surplus (Deficit)	**633**	**6**
Fund level	**136%**	**100%**

Table 2: Single reported funding position compared with the previous valuation

The required investment return to be 100% funded is c.3.0% p.a. (3.2% at 2020). The likelihood of the Fund's investment strategy achieving the required return is 93% (75% at 2020).

1 Approach to the valuation

1.1 Valuation purpose

The triennial actuarial valuation is an important part of the Fund's risk management framework. Its main purpose is to ensure the Fund continues to have a contribution plan and investment strategy that will achieve the objectives set out in the Funding Strategy Statement.

This report marks the culmination of the valuation process and contains its two key outcomes:

1. Employer contribution rates for the period 1 April 2024 to 31 March 2027
2. The funding level of the whole Fund at 31 March 2023.

Further information on the valuation process, methodology and strategy is set out in the publicly available Funding Strategy Statement, Statement of Investment Principles and published papers of the Fund's Pensions Committee. Additional material is also contained in Hymans Robertson's LGPS 2023 valuation toolkit.

1.2 Setting employer contribution rates

Employer contributions need to be set at a level which ensures the Fund has a reasonable likelihood of having enough money to pay members' benefits. Identifying the amount of benefits that may be paid is complex, as benefits earned today may only start being paid in 50 years' time. Over that period, there is significant uncertainty over factors which affect the cost of benefits e.g. inflation and investment returns. These uncertainties are allowed for by taking a risk-based approach to setting employer contribution rates. This approach is built around three key funding decisions set by the Fund.

1.2.1 Key funding decisions

Decision 1: What is the funding target for each employer?
Consider: Will the employer remain in the Fund for the long-term or exit at some point?

Decision 2: What is the funding time horizon?
Consider: How long will the employer participate in the Fund?

Decision 3: What is the required likelihood of success?
Consider: How much prudence can the employer's covenant support in its funding plan?

1.2.2 Modelling approach

Asset-liability modelling is used to project each employer's assets and benefit payments into the future using 5,000 different economic scenarios. These are generated using Hymans Robertson's Economic Scenario Service (ESS). Further information on this can be found in Appendix 2.

A contribution rate is set for each employer which has (at least) the required likelihood of meeting the funding target over the relevant funding time horizon. The 5,000 projections of the employer's assets and benefits from the asset-liability model are used to quantify the likelihood that a given contribution rate will meet this target.

1.3 Measuring the funding level

The past service funding level is measured at the valuation date. While it is limited in providing insight into a funding plan, it is a useful high-level summary statistic. A market-related approach is taken to calculate both the assets and the liabilities to ensure they are consistent with one another:

1. The market value of the Fund's assets at the valuation date has been used.
2. The liabilities have been valued using assumptions based on market indicators at the valuation date (these assumptions are detailed in Appendix 2).

1.3.1 Calculating the liabilities

The liabilities are the value of all future payments to members based on all benefits earned up to the valuation date, expressed in today's money.

Chart 1 shows the projected payments for all members in the Fund at the valuation date. The projections are based on the membership data provided for the valuation (Appendix 1), the assumptions (Appendix 2), and our understanding of the LGPS benefit structure as at 31 March 2023 (details at www.scotlgpsregs.org).

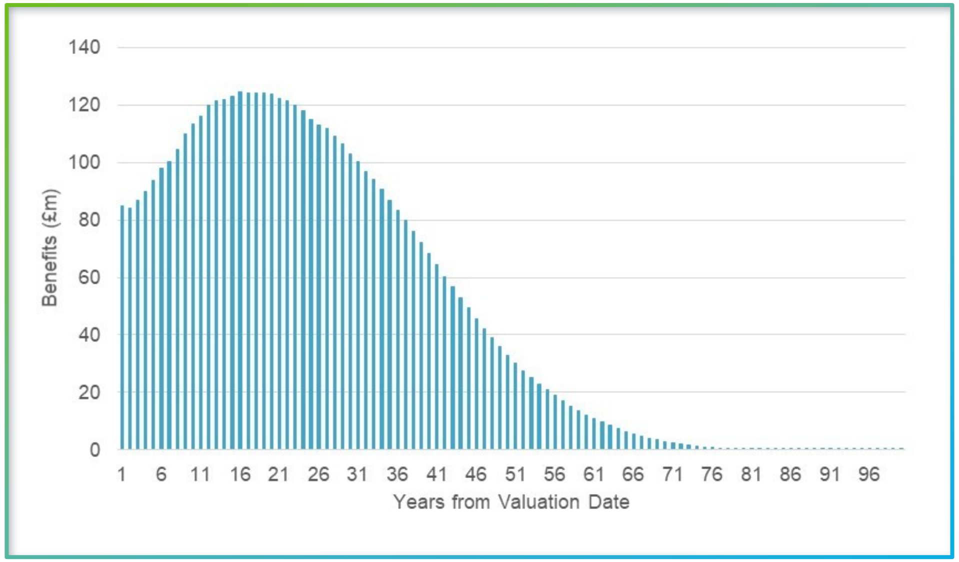

Chart 1: Projected benefit payments for all service earned up to 31 March 2023

To express the future payments in today's money, each projected payment is discounted back to the valuation date in line with an assumed rate of future investment return (known as the discount rate').

2 Valuation results

2.1 Employer contribution rates

The primary objective of the Fund is to set employer contribution rates that will enable it to pay members' benefits. A secondary objective is to ensure the rates are as stable as possible. The risk-based approach detailed earlier is used to meet both those objectives.

The employer contribution rate is made up of two components.

1. **A primary rate:** the level sufficient to cover benefits that will be accrued in the future.
2. **A secondary rate:** the costs associated with sufficiently funding benefits accrued up to the valuation date.

Each employer has a contribution rate which is appropriate to their circumstances, and these can be found in the Rates & Adjustments Certificate (Appendix 5).

Broadly, contribution rates have reduced at this valuation due to both an improvement in the past service funding position and higher assumed future investment returns at 2023 compared to 2020.

However, all employers will be different, and the contribution rate will reflect the membership and experience of each employer.

Table 3 shows the total of all employer contribution rates to be paid into the Fund over the period 1 April 2024 to 31 March 2027.

	31 March 2023		31 March 2020	
Primary rate	17.8% of pay		21.2% of pay	
Secondary rate	2024/25	-£814,000	2021/22	-£4,581,000
	2025/26	-£769,000	2022/23	-£4,671,000
	2026/27	-£794,000	2023/24	-£4,772,000

Table 3: Whole fund contribution rates compared with the previous valuation

The primary rate includes an allowance of 0.7% of pensionable pay for the Fund's expenses (0.7% of pay at the last valuation).

Employees pay a contribution to the Fund in addition to these rates. These rates are set by the LGPS Regulations. The average employee contribution rate at 31 March 2023 is 6.0% of pay (6.1% at 31 March 2020).

2.2 Funding level

The funding level is the ratio of assets to liabilities. The market value of the assets at the valuation date is known. The value (in 'today's money') of the future benefit payments is uncertain given that the level of future investment returns is unknown.

To help understand funding risk, the liabilities and therefore the funding level has been calculated across a range of different assumptions for future investment returns (also known as 'discount rates'). The likelihood of the Fund's investment strategy (detailed in Appendix 1) achieving those levels of return has also been calculated.

Chart 2 shows how the funding level varies with different future investment return assumptions at 31 March 2023 (blue line). The green line shows the same analysis at 31 March 2020.

- The funding position at 2023 is stronger than it was in 2020.
- The funding level at 2023 will be 100% if future returns are around 3.0% pa. The likelihood of the Fund's assets yielding at least this return is around 93%.
- The comparator at 2020 was a return of 3.2% pa which had a likelihood of 75%.
- There is a 50% likelihood of an investment return of 8.0% pa, so the "best estimate" funding level is 198% at 31 March 2023 (137% at 2020).

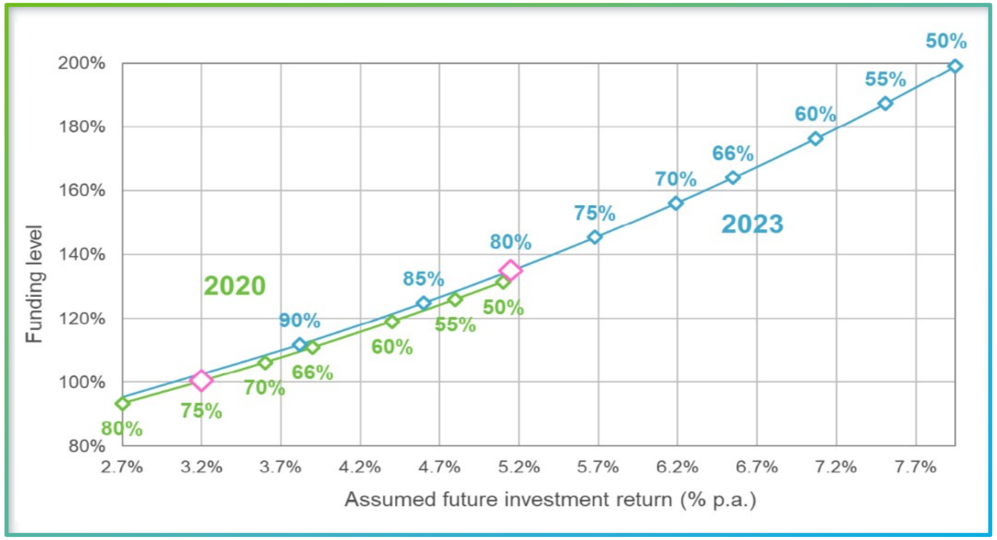

Chart 2: Funding level across a range of future investment returns.

Figures on each line show the likelihood of the Fund's assets exceeding the level of return over the next 20 years.

2.3 Single funding level as at 31 March 2023

Whilst Chart 2 provides a better understanding of the past service funding position, there is still a requirement to report a single funding level at 31 March 2023.

To report a single funding level and funding surplus/deficit for the 2023 valuation, an assumed future investment return of 5.2% pa has been used. There is an 80% likelihood associated with this level of future investment return.

Table 4 sets out the assets and liabilities at the valuation date. The results at the 2020 valuation are shown for comparison.

The funding level and surplus/deficit figures provide a high-level snapshot of the funding position as at 31 March 2023, but there are limitations:

- The liabilities are calculated using a single set of assumptions about the future and so are very sensitive to the choice of assumptions.
- The market value of assets held by the Fund will change daily.

The future progression of the funding position is uncertain. If the financial and demographic assumptions made at this valuation occur in practice, employers pay contributions in line with the R&A certificate, and there are no other changes in the financial or demographic environment, we project that the funding level at the next valuation (31 March 2026) will stay approximately the same at 136%.

	31 March 2023	31 March 2020
	(£m)	(£m)
Employees	674	782
Deferred pensioners	276	301
Pensioners	823	803
Total liabilities	**1,773**	**1,887**
Assets	**2,406**	**1,892**
Surplus/(Deficit)	**633**	**6**
Funding level	**136%**	**100%**

Table 4: Single reported funding position compared with the previous valuation

The reported funding level does not directly drive the contribution rates for employers. The contribution rates take into consideration how assets and liabilities will evolve over time in different economic scenarios. They also reflect each employer’s funding profile and covenant.

2.4 Changes since the last valuation

2.4.1 Events between 2020 and 2023

The most significant external event to occur since the last valuation has been the Covid-19 pandemic. However, the analysis below shows that mortality experience was broadly as expected over the period with minimal impact on the funding position.

A significant factor which has affected the funding strategy is better than expected investment returns. This has had a material positive impact on the funding position.

Financial

	Expected	Actual	Difference	Impact on funding position
Investment returns				
3-year period	9.9%	27.8%	17.9%	+£340m
Annual	3.2% pa	8.5% pa	5.3% pa	

Table 5: Analysis of investment return experience between 2020 and 2023 valuations

Membership

	Expected	Actual	Difference	Impact on funding position
Pre-retirement				
Early leavers	3,107	4,804	1,697	+£6m
Ill-health retirements	186	155	-31	+£4m
Salary increases	3.1% pa	6.0% pa	2.9% pa	-£43m
Post-retirement				
Benefit increases	1.7% pa	4.5% pa	2.8% pa	-£152m
Pension ceasing	£4.2m	£4.0m	-£0.2m	-£4m

Table 6: Analysis of membership experience between 2020 and 2023 valuations

2.4.2 Outlook for the future

Expectations about the future, which inform the assumptions used to value the liabilities, have changed since the last valuation. The most significant changes are:

Future inflation: this is expected to be on average higher than at 2020 due to the current high level of inflation.

Investment returns: due to changes in financial markets, future investment returns are now expected to be higher than at the last valuation.

Factor	What does it affect?	What's changed?	Impact on liabilities
Future investment returns	The rate at which you discount back future benefits payments (also known as the discount rate assumption)	Future investment returns are anticipated to be higher than at 2020.	Decrease of £674m
Inflation	The rate at which pensions (both in payment and deferment) and CARE pots increase.	Significant increase in short-term future inflation expectations.	Increase of £236m
Salary increases	The rate at which future salaries will increase. This affects benefits that are still linked to final salary, i.e. accrued before 1 April 2015.	No material change since last valuation given competing factors, eg tighter budgetary conditions vs. strong job market and pressure from National Living Wage increases.	Neutral
Current life expectancy	How long we expect most people to live for based on today's current observed mortality rates.	Slight reduction in life expectancy (not allowing for Covid-related excess deaths)	Decrease of £2m
Future improvements in life expectancy	How we expect life expectancies to change (increase) in the future.	Updated model of future improvements to the most recent model available, including allowance for some recent mortality experience related to the excess deaths from the Covid 19 pandemic.	Decrease of £45m

Table 7: Summary of change in outlook

2.5 Reconciling the overall change in funding position

Tables 8 & 9 provide insight into the funding position change between 31 March 2020 and 31 March 2023. Firstly, the changes expected to happen (Table 8), which relate mostly to assets. Then the impact of actual experience (Table 9), which affects mainly the liabilities.

2.5.1 Expected development

	Surplus/deficit
	£m
31 March 2020 valuation	**6**
Cash flows	
Employer contributions paid in	148
Employee contributions paid in	46
Benefits paid out	-
Net transfers into/out of the Fund	*
Other cash flows (e.g. expenses)	(9)
Expected changes	
Expected investment returns	189
Interest on benefits already accrued	(189)
Accrual of new benefits	(241)
Expected position at 31 March 2023	**(50)**

Table 8: Expected development of funding position between 2020 and 2023 valuations.

* We have insufficient data to accurately value the impact on the liabilities from transfers in/out. This has instead been combined with "Other cash flows"

2.5.2 Impact of actual events

	Surplus/deficit
	£m
Expected position at 31 March 2023	**(50)**
Events between 2020 and 2023	
Salary increases greater than expected	(43)
Benefit increases greater than expected	(152)
Early retirement strain (and contributions)	1
Ill health retirement strain	4
Early leavers more than expected	6
Pensioner mortality less than expected	(4)
Other membership experience	(9)
Higher than expected investment returns	340
Changes in future expectations	
Investment returns	674
Inflation	(236)
Salary increases	0
Longevity	46
Other demographic assumptions	56
Actual position at 31 March 2023	**633**

Table 9: Impact of actual events on the funding position at 31 March 2023

Numbers may not sum due to rounding.

3 Sensitivity and risk analysis

Funding benefits that are going to be paid in the future involves risk and uncertainty. The Fund therefore maintains a risk register which is regularly reviewed. Additionally, as part of the valuation, the Fund reviews sources of risk that may impact its funding position and the contribution rates payable by employers.

This section discusses some of the most significant sources of funding risk (assumptions, regulatory, administration and governance, and climate change). Further information about the Fund's approach to funding risk management, including monitoring, mitigation, and management, is set out in the Funding Strategy Statement.

The valuation results depend on the actual assumptions made about the future. By their nature, these assumptions are uncertain which means it's important to understand their sensitivity and risk levels.

3.1 Contribution rates

The risk-based approach to setting employer contribution rates mitigates the limitation of relying on one set of assumptions. Therefore, there is no need to carry out additional analysis of the sensitivity of contribution rates to changes in financial assumptions, but they are sensitive to changes in demographic assumptions. The results in this section in relation to the funding position can be broadly applied to the contribution rates.

3.2 Funding level

3.2.1 Financial assumptions

In Section 3.2 we have already set out how the results vary with the assumed future investment return. Here we consider inflation.

CPI assumption	Surplus/Deficit	Funding level
	£m	%
2.1% pa	661	138%
2.3% pa	633	136%
2.5% pa	571	132%

Table 10: Sensitivity of funding position to inflation assumption

3.2.2 Demographic assumptions

The main area of demographic risk is if people live longer than expected. Table 11 shows the impact of longer-term longevity rates improving at a faster pace (1.75% pa vs 1.5% pa used in the headline results).

Long-term rate of improvement	Surplus/Deficit	Funding level
	£m	%
1.50% pa	633	136%
1.75% pa	622	135%

Table 11: Sensitivity of the funding to longevity assumption

3.3 Other risks

3.3.1 Regulatory, Administration and Governance risks

Potential risks in this area include change in central government legislation, which alters the future cost of the LGPS, and failures in administration processes leading to incorrect data and inaccuracies in actuarial calculations. At this valuation, specific risks include:

McCloud

Benefits accrued by certain members between 2015 and 2022 may increase following the McCloud case, which ruled that transitional protections introduced in 2015 for older members were discriminatory. We've made an allowance for the cost of these potential improvements, based on the guidance issued by the Scottish Public Pensions Agency on 28 April 2023. Details are set out in guide 12 of Hymans Robertson's LGPS 2023 valuation toolkit.

Cost sharing mechanism

Benefits could change because of the 2020 cost cap valuation; the outcome is currently unknown. We have assumed that there will be no changes required to the benefit structure due to the cost cap.

Goodwin

As the remedy to this issue is still uncertain, it is difficult to identify who it would apply to. Given its impact is estimated to be very small for an LGPS fund, we have made no allowance for this change at the 2023 valuation.

GMP Indexation

It is assumed that all increases on GMPs for members reaching State Pension age after 6 April 2016 will be paid for by LGPS employers in the Fund. This is the same approach that was taken for the 2020 valuation.

3.3.2 Post valuation events

Since 31 March 2023, there has been continued volatility in financial markets and rises in interest rates by central banks. These events affect the value of the Fund's assets and liabilities.

- The Fund's investment return since 31 March 2023 is estimated to be somewhere between 5% and 10%.
- Liability valuations are likely to be lower now than at 31 March 2023 due to rises in expected future investment returns and a reduction in long-term inflation expectations.

As an open scheme, with a strong covenant, the Fund takes a long-term view when considering the funding impact of such events. For employers who have a very short time horizon recent volatility may be more immediately impactful, and the Fund has engaged with these employers as appropriate.

No explicit allowance has been made for this volatility in the valuation results or contribution rates detailed in the Rates & Adjustments Certificate. The Fund will continue to monitor changes in the financial and demographic environment as part of its ongoing risk management approach.

3.4 Climate change

3.4.1 Background

Climate change is a major source of uncertainty which could affect future investment returns, inflation, and life expectancies. Therefore, the Fund has explicitly explored the resilience of its funding and investment strategy to future potential climate change outcomes.

It is impossible to confidently quantify the effect of climate risk given the significant uncertainty over the impact of different possible climate outcomes. Instead, three different climate change scenarios have been considered as a stress test (instead of trying to predict how climate change affects the funding level in the future).

All the scenarios assume that there will be a period of disruption linked either to the response to climate risk (transition risks) or the effect of it (physical risks). This disruption will lead to high volatility in financial markets, and the later the disruption, the more pronounced it will be.

More information about the scenarios detailed below can be found in guide 10 of Hymans Robertson's LGPS 2023 valuation toolkit.

3.4.2 Outcome of analysis

The Fund has set its funding and investment strategy using asset-liability modelling and considering two main risk metrics.

- **Likelihood of success** – the chance of being fully funded in 20 years' time.
- **Downside risk** – the average worst 5% of funding levels in 20 years' time.

When exploring the potential impact of climate change, the Fund has compared how these risk metrics change under each climate change scenario (against the 'core' model used when setting the funding and investment strategy). The stress-test results for the Fund are shown in Table 12. All results are in absolute terms.

Scenario	Likelihood of success	Downside risk
In comparison to 'core' modelling results		
Green revolution	1% lower	4% lower
Delayed transition	2% lower	1% higher
Head in the sand	2% lower	6% higher

Table12: Modelling results with additional climate risk testing

The 'likelihood of success' is worse in the climate scenarios. This is to be expected given that they are purposefully stress tests, and all the scenarios are bad outcomes. The 'downside risk' measure is better in the 'green revolution' scenario and worse in the 'delayed transition' and 'head in the sand' scenarios which highlights the importance of monitoring this risk and how it may evolve.

The climate risk results are not materially different to the 'core' modelling results, and not enough to suggest that the funding strategy is unduly exposed to climate change risk. The Fund will continue to monitor this risk as more information emerges and climate change modelling techniques evolve.

4 Final comments

The Fund's valuation operates within a broader framework, and this document should be considered alongside the following:

- The Funding Strategy Statement, which in particular highlights how different employers in different circumstances have their contributions calculated.
- The Statement of Investment Principles, which sets out the investment strategy for the Fund.
- The general governance of the Fund, including meetings of the Pensions Committee and Local Pensions Board, decisions delegated to officers, the Fund's business plan, etc.

4.1 New employers joining the Fund

Any new employers or admission bodies joining the Fund should be referred to the Fund Actuary to assess the required level of contribution. Depending on the number of transferring members the ceding employer's rate may also need to be reviewed.

4.2 Cessation and bulk transfers

Any employer who ceases to participate in the Fund should be referred to the Fund Actuary in accordance with Regulation 61 of the LGPS regulations.

Any bulk movement of scheme members:

- involving 10 or more scheme members being transferred from or to another LGPS fund.
- involving 2 or more scheme members being transferred from or to a non-LGPS pension arrangement.

should be referred to the Fund Actuary to consider the impact on the Fund.

4.3 Valuation frequency

Under the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2026 where contribution rates payable from 1 April 2027 will be set.

Robert Bilton FFA   Laura McInroy FFA

February 2024

For and on behalf of Hymans Robertson LLP

Appendices

Appendix 1: Data

Membership data

A summary of the membership data provided by the Fund for the 2023 valuation is set out in Table 13. The corresponding membership data from the previous valuation is also shown for reference.

The results of the valuation are dependent on the quality of the data used. We have carried out a series of validation checks on the data supplied to us by the Administering Authority to ensure that it is fit for purpose.

More information on how we verify the quality of the data used in the valuation has been shared with the Administering Authority in our report ' Data Report for the 2023 Valuation, dated 24 January 2024.

Asset data

To check the membership data and derive employer asset values, we have used asset and accounting data and employer level cash flow data provided by the Fund.

Whole Fund membership data	31 March 2023	31 March 2019
Employee members		
Number	13,182	12,617
Total actual pay (£000)	268,582	227,515
Total accrued pension (£000)	54,004	44,551
Average age (liability weighted)	55.0	53.0
Future working lifetime (years)	7.6	8.7
Deferred pensioners (including undecideds)		
Number	14,045	11,918
Total accrued pension (£000)	21,613	16,848
Average age (liability weighted)	53.5	51.8
Pensioners and dependants		
Number	12,026	10,497
Total pensions in payment (£000)	61,944	49,396
Average age (liability weighted)	69.2	67.9

Table 13: Whole Fund membership data at this valuation compared with the previous valuation

Investment strategy

A summary of the investment strategy allocation used for the calculation of employer contribution rates and to derive the future investment return is set out in Table 14.

This information was provided by Fund Officers.

Asset class	Allocation
Overseas equities	56%
Private equity	5%
Infrastructure equity	5%
Total growth assets	**66%**
Index-linked gilts	1%
Fixed interest gifts	4%
DGF Low Beta	5%
BBB Credit	4%
Total protection assets	**14%**
Mult-asset credit	3%
Private lending	7%
Property	10%
Total income generating assets	**20%**
Total	**100%**

Table 14: Investment strategy allocation used for the calculation of employer contribution rates.

Appendix 2: Assumptions

To set and agree assumptions for the valuation, the Fund carried out an in-depth analysis and review in August 2023 with the final set noted by the Pensions Committee on 21 September 2023.

Financial assumptions

Setting employer contribution rates

An asset-liability model was used to set employer contributions at the 2023 valuation. This model relies on Hymans Robertson's proprietary economic model, the Economic Scenario Service (ESS). The ESS reflects the uncertainty associated with future levels of inflation and asset returns and the interactions and correlations between different asset classes and wider economic variables. In the short term (first few years), the models are fitted with current financial market expectations. Over the longer term, models are built around views of fundamental economic parameters, for example equity risk premium, credit spreads and long-term inflation. The table below shows the calibration of the ESS at 31 March 2023. Further information on the assumptions used for contribution rate setting is included in the Funding Strategy Statement.

Time period	Percentile	Asset class annualised total returns											Inflation/Yields		
		Cash	Developed World ex UK Equity	Private equity	Infrastructure equity	IL Gilts (Medium)	FI Gilts (Medium)	Diversified Growth Fund (Low Beta)	Corporate Debt BBB (Medium)	Multi Asset Credit	Private Lending	Property	Inflation (CPI)	17 year real yield (CPI)	17 year yield
10 years	16th	2.5%	1.1%	0.5%	2.4%	0.8%	2.4%	3.2%	2.8%	4.0%	4.8%	1.2%	0.9%	-0.3%	2.7%
	50th	3.6%	7.3%	11.4%	7.8%	2.8%	3.7%	5.1%	4.7%	5.9%	7.6%	6.2%	2.5%	0.9%	4.1%
	84th	4.7%	13.6%	22.3%	13.2%	5.1%	4.9%	7.0%	6.4%	7.7%	10.3%	11.5%	4.1%	2.2%	5.9%
20 years	16th	2.3%	2.8%	3.7%	3.9%	1.0%	3.3%	3.4%	3.8%	4.7%	5.7%	2.7%	0.7%	-0.5%	1.4%
	50th	3.7%	7.4%	11.4%	7.9%	2.7%	4.1%	5.2%	5.1%	6.3%	7.8%	6.4%	2.3%	1.3%	3.4%
	84th	5.4%	12.2%	19.2%	12.0%	4.5%	4.8%	7.2%	6.3%	7.9%	9.8%	10.3%	3.9%	2.9%	5.9%
40 years	16th	1.8%	3.7%	5.4%	4.5%	1.0%	2.9%	3.2%	3.6%	4.5%	5.7%	3.2%	0.6%	-0.6%	1.2%
	50th	3.5%	7.2%	11.0%	7.7%	2.7%	3.7%	5.0%	4.8%	6.1%	7.6%	6.2%	2.0%	1.3%	3.3%
	84th	5.7%	10.9%	16.8%	11.1%	4.6%	4.9%	7.3%	6.3%	8.1%	9.7%	9.5%	3.5%	3.2%	6.1%
	Volatility (5yr)	2%	18%	30%	15%	7%	5%	5%	7%	6%	9%	15%	3%	-	-

Table 15: ESS individual asset class return distributions at 31 March 2023

Calculating the funding level

Table 16 summarises the assumptions used to calculate the funding level at 31 March 2023, along with a comparison at the last valuation.

Assumption	31 March 2023	Required for	31 March 2020
Discount rate	5.2% pa	To place a 'today's money' value on all the benefits promised to scheme members at the valuation date. The Fund's assets are estimated to have a 80% likelihood of achieving a return that is at least equal the discount rate.	3.2% pa (based on 75% likelihood)
Benefit increases/CARE revaluation	2.3% pa	To determine the size of future benefit payments.	1.7% pa
Salary increases	3.1% pa*	To determine the size of future final-salary linked benefit payments.	2.5% pa*

Table 16: Summary of assumptions used for measuring the funding level, compared to last valuation

*plus a promotional salary scale

Demographic assumptions

The same demographic assumptions are used to set contribution rates and assess the current funding level.

Longevity

	31 March 2023	31 March 2020
Baseline assumptions	VitaCurves based on member-level lifestyle factors	VitaCurves based on member-level lifestyle factors
Future improvements	**CMI 2022 model** Initial addition = **0.25% (both Male and Female)** Smoothing factor = **7.0** Weighting = **0%** (2020 & 2021 data), **25%** (2022 data) **1.5% pa** long-term rate	**CMI 2019 model** Initial addition = **0.5% (both Male and Female)** Smoothing factor = **7.0** **1.5% pa** long-term rate of improvement

Table 17: Summary of longevity assumptions at this valuation compared with the previous valuation

Other demographic assumptions

Death in service	See sample rates in Table 19
Retirements in ill health	See sample rates in Table 19
Withdrawals	See sample rates in Table 19
Promotional salary increases	See sample rates in Table 19
Commutation	65% of future retirements elect to exchange pension for additional tax-free cash up to HMRC limits
50:50 option	0.5% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option
Retirement age	The earliest age at which a member can retire with their benefits unreduced
Proportion married	A varying proportion of members are assumed to have a dependant at retirement or on earlier death. For example, at age 60 this is assumed to be 85% for males and 60% for females. The dependant of a male member is assumed to be 2 years younger than him and the dependant of a female member is assumed to be 3.5 years older than her.

Table 18: Summary of other demographic assumptions

Sample rates for demographic assumptions

Males

Age	Salary scale	Death before retirement	Withdrawals		Ill health Tier 1		Ill health Tier 1	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.21	390.20	578.87	0	0	0	0
25	117	0.21	257.74	382.37	0.11	0.02	0.13	0.02
30	131	0.26	182.82	271.22	0.21	0.03	0.23	0.03
35	144	0.30	142.82	211.87	0.41	0.14	0.46	0.15
40	154	0.51	114.92	170.49	0.62	0.26	0.69	0.24
45	164	0.86	67.17	139.50	0.99	0.51	1.09	0.49
50	174	1.37	52.03	108.06	1.86	1.31	2.59	1.45
55	179	2.15	49.98	103.80	5.83	4.52	4.67	3.11
60	184	3.86	44.51	92.45	9.91	6.97	3.87	2.65
65	185	6.44	0	0	18.92	13.49	0	0

Females

Age	Salary scale	Death before retirement	Withdrawals		Ill health Tier 1		Ill health Tier 1	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.11	308.39	406.55	0	0	0	0
25	117	0.11	207.45	273.48	0.16	0.13	0.09	0.10
30	131	0.16	173.85	229.19	0.21	0.18	0.12	0.13
35	144	0.27	107.10	197.67	0.41	0.34	0.24	0.25
40	154	0.44	89.08	164.40	0.61	0.51	0.36	0.37
45	164	0.71	73.33	135.34	0.82	0.68	0.48	0.50
50	174	1.04	55.36	103.12	1.50	1.23	1.11	1.13
55	179	1.37	52.27	96.47	5.47	4.43	2.32	2.35
60	184	1.75	42.03	77.56	11.52	9.30	2.38	2.40
65	185	2.25	0	0	20.73	16.76	0	0

Table 19: Sample rates of male and female demographic assumptions.

Figures are incidence rates per 1,000 members except salary scale.
FT and PT denoted full-time and part-time members respectively.

Appendix 3: Reliances & limitations

We have been commissioned by The Highland Council ('the Administering Authority') to carry out a full actuarial valuation of The Highland Council Pension Fund ('the Fund') at 31 March 2023, as required under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018 ('the Regulations').

This report is addressed to the Administering Authority. It has been prepared by us as actuaries to the Fund and is solely for the purpose of summarising the main outcomes of the 2023 actuarial valuation. It has not been prepared for any other third party or for any other purpose. We make no representation or warranties to any third party as to the accuracy or completeness of this report, no reliance should be placed on this report by any third party and we accept no responsibility or liability to any third party in respect of it.

This summary report is the culmination of other communications in relation to the valuation, in particular:

- our 2023 valuation toolkit which sets out the methodology used when reviewing funding plans
- our paper to dated 24 January 2024 which discusses the funding strategy for the Fund's stabilised employers
- our paper dated 24 January 2024 which discusses the valuation assumptions.
- our initial results report dated 24 January 2024 which outlines the whole Fund results and inter-valuation experience
- our data report dated 24 January 2024 which summarises the data used for the valuation, the approach to ensuring it is fit for purpose and any adjustments made to it during the course of the valuation
- the Funding Strategy Statement which details the approach taken to adequately fund the current and future benefits due to members.

The totality of our advice complies with the Regulations as they relate to actuarial valuations.

The following Technical Actuarial Standards apply to this advice, and have been complied with where material and to a proportionate degree. They are:

- TAS100 – Principles for technical actuarial work
- TAS300 – Pensions

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Appendix 4: Glossary

Term	Explanation
50:50 option	An option for LGPS members to pay half contributions and earn half the retirement benefit (pre-retirement protection benefits are unreduced).
Asset-liability modelling	An approach to modelling and understanding risk for a pension fund. The assets and liabilities are projected forwards into the future under many different future scenarios of inflation, investment returns and interest rates. The future scenarios are then analysed to understand the risk associated with a particular combination of contribution rates and investment strategy. Different combinations of contribution rates and/or investment strategies may be tested.
Baseline longevity	The rates of death (by age and sex) in a given group of people based on current observed data.
Club Vita	A firm of longevity experts who Hymans Roberston partner with for longevity analysis. They combine data from thousands of pension schemes and use it to create detailed baseline longevity assumptions at member-level, as well as insights on general longevity trends and future improvements.
Commutation	The option for members to exchange part of their annual pension for a one-off lump sum at retirement. In the LGPS, every £1 of pension exchanged gives the member £12 of lump sum. The amounts that members commute is heavily influenced by tax rules which set an upper limit on how much lump sum can be taken tax-free.
CPI inflation	The annual rate of change of the Consumer Prices Index (CPI). The CPI is the UK government's preferred measure of inflation and is the measure used to increase LGPS (and all other public sector pension scheme) benefits each year.
Deferred pensioner	A former employee who has left employment (or opted out of the pension fund) but is not yet in receipt of their benefits from the fund.
Demographic assumptions	Assumptions concerned with member and employer choices rather than macroeconomic or financial factors. For example, retirement age or promotional salary scales. Demographic assumptions typically determine the timing of benefit payments.

Term	Explanation
Discount rate	An assumption for the annual rate of future investment return. Used to place a single 'today's money' value on a stream of future payments.
Employee members	Members who are currently employed by employers who participate in the Fund and are paying contributions into the Fund.
ESS	Economic Scenario Service - Hymans Robertson's proprietary economic scenario generator used to create thousands of simulations of future inflation, asset class returns and interest rates.
Funding position	The extent to which the assets held by the Fund at 31 March 2023 cover the accrued benefits ie the liabilities. The two measures of the funding position are: • the funding level - the ratio of assets to liabilities; and • the funding surplus/deficit - the difference between the asset and liabilities values.
Inflation	Prices tend to increase over time, which is called inflation. Inflation is measured in different ways, using a different 'basket' of goods and mathematical formulas.
Liabilities	An employer's liability value is the single value at a given point in time of all the benefit payments expected to be made in future to all members. Benefit payments are projected using demographic and financial assumptions and the liability is calculated using a discount rate.
Longevity improvements	An assumption about how rates of death will change in future. Typically, we assume that death rates will fall and life expectancies will improve over time, continuing the long-running trend.
Pensioner	A former employee who is in receipt of their benefits from the fund. This category includes eligible dependants of the former employee.
Primary rate	The estimated cost of future benefits, expressed in percentage of pay terms. The primary rate will include an allowance to cover the Fund's expenses.

Term	Explanation
Prudence	To be prudent means to err on the side of caution in the overall set of assumptions. We build prudence into the choice of discount rate by choosing an assumption with a prudence level of more than 50%. All other assumptions aim to be best estimate.
Prudence level	A percentage indicating the likelihood that the assumed rate of investment return will be achieved in practice, based on the ESS model. The higher the prudence level, the more prudent the assumed rate of investment return.
Secondary rate	An adjustment to the primary rate, generally to reflect costs associated with benefits that have already been earned up to the valuation date. This may be expressed as a percentage of pay and/or monetary amount.
Withdrawal	Refers to members leaving the scheme before retirement. These members retain an entitlement to an LGPS pension when they retire but are no longer earning new benefits.

Appendix 5: Rates and Adjustments Certificate

In accordance with Regulation 60(4) of the Regulations, we have assessed the contributions that should be paid into the Fund by participating employers for the period 1 April 2024 to 31 March 2027 to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in this Rates and Adjustments Certificate are detailed in the Funding Strategy Statement dated February 2024 and in Appendix 2 of the report on the actuarial valuation dated 7 February 2024. These assumptions underpin our estimate of the number of members who will become entitled to a payment of pensions under the provisions of the LGPS and the amount of liabilities arising in respect of such members.

The table below summarises the whole Fund primary and secondary contribution rates for the period 1 April 2024 to 31 March 2027. The primary rate is the payroll weighted average of the underlying individual employer primary rates and the secondary rate is the total of the underlying individual employer secondary rates, calculated in accordance with the LGPS regulations and CIPFA guidance. The secondary rate has been shown both as a monetary amount and an equivalent percentage of the projected pensionable pay.

Robert Bilton FFA

Laura McInroy FFA

February 2024

For and on behalf of Hymans Robertson LLP

This valuation (31 March 2023)		
Primary rate	17.8% of pay	
Secondary rate	**Monetary amount**	**Equivalent to % of payroll**
2024/25	-£814,000	-0.3%
2025/26	-£769,000	-0.3%
2026/27	-£794,000	-0.3%

Table 20: Whole fund primary and secondary contribution rates from 1 April 2024 to 31 March 2027

The required minimum contribution rates for each employer in the Fund are set out in the remainder of this certificate.

Employer code	Employer name	Primary rate (% of pay)	Secondary rate (% of pay and monetary amount)			Total contributions (Primary rate plus secondary rate)			Notes
			2024/25	2025/26	2026/27	2024/25	2025/26	2026/27	
	The Highland Council Pool								
40	The Highland Council	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
2	Comhairle Nan Eilean Siar	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
11	Stornoway Port Authority	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
13	Cromarty Firth Port Authority	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
18	Highland and Western Isles Valuation Joint Board (Assessors)	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
59	Bord Na Gaidhlig	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
60	Sight Action (formerly VISH)	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
61	Highland Blindcraft	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
72	An Comunn Gaidhealach	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
73	Highlife Highland	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	
76	NHS Highland	17.7%	-0.2%	-0.2%	-0.2%	17.5%	17.5%	17.5%	

Employer code	Employer name	Primary rate (% of pay)	Secondary rate (% of pay and monetary amount)			Total contributions (Primary rate plus secondary rate)			Notes
			2024/25	2025/26	2026/27	2024/25	2025/26	2026/27	
	Scottish Police Authority								
78	Scottish Police Authority (former Northern Joint Police Board staff)	18.0%	-2.1%	-2.1%	-2.1%	15.9%	15.9%	15.9%	
	Scottish Fire & Rescue Service								
79	Scottish Fire & Rescue Service (former Highlands & Islands Fire Board Staff)	17.7%	1.3%	1.3%	1.3%	19.0%	19.0%	19.0%	
	UHI North, West & Hebrides								
	UHI North, West & Hebrides	17.5%	0.1%	0.1%	0.1%	17.6%	17.6%	17.6%	
	HIE/LEC								
68	HIE (former LECS)	23.8%	-	-	-	23.8%	23.8%	23.8%	
	SDS								
69	SDS (former Careers Scot)	38.8%	-	-	-	38.8%	38.8%	38.8%	

Employer code	Employer name	Primary rate (% of pay)	Secondary rate (% of pay and monetary amount)			Total contributions (Primary rate plus secondary rate)			Notes
			2024/25	2025/26	2026/27	2024/25	2025/26	2026/27	
	Individual Employers								
14	Inverness Harbour Trust	39.1%	£21,000	£21,000	£21,000	39.1% plus £21,000	39.1% plus £21,000	39.1% plus £21,000	
27	Governors of Eden Court Theatre	36.4%	-36.4%	-	-	-	36.4%	36.4%	
34	Inverness College	17.5%	-0.4%	-0.4%	-0.4%	17.1%	17.1%	17.1%	
41	UHI	19.3%	-	-	-	19.3%	19.3%	19.3%	
63	High Trans Initative (HITRANS)	16.0%	-	-	-	16.0%	16.0%	16.0%	
64	Hebridean Housing Partnership	17.6%	-	-	-	17.6%	17.6%	17.6%	
66	Morrisons FM	23.9%	-23.9%	-23.9%	-23.9%	-	-	-	
75	Forth & Oban (FES Ltd)	28.0%	-28.0%	-28.0%	-28.0%	-	-	-	
80	WIPRO	30.8%	-30.8%	-30.8%	-30.8%	-	-	-	

Notes to the Rates & Adjustments Certificate

- Contributions expressed as a percentage of payroll should be paid into 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 augmentations using methods and factors issued by us from time to time or as otherwise agreed.
- Payments may be required to be made to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those allowed for within our assumptions. If an employer has ill health liability insurance in place with a suitable insurer and provides satisfactory evidence to the Administering Authority, then their certified contribution rate may be reduced by the value of their insurance premium, for the period the insurance is in place.
- 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.
- The monetary contributions set out in the certificate above can be prepaid in advance with appropriate adjustments for interest as and when agreed with the Administering Authority. Under these circumstances a revised Rates and Adjustments certificate may be issued reflecting any advance payment.

Appendix 6: Section 13 dashboard (draft)

Metric	Unit	2023 Valuation
2023 funding position – local funding basis		
Funding level (assets/liabilities)	%	136%
Funding level (change since previous valuation)	%	36% increase
Asset value used at the valuation	£m	2,406
Value of liabilities (including McCloud liability)	£m	1,773
Surplus (deficit)	£m	633
Discount rate (past service)	% pa	5.2%
Discount rate (future service)	% pa	Past service and future service are consistently valued with the same underlying assumptions, methodologies, and models regarding future expected levels of inflation, interest rates and investment returns.
Assumed pension increase (CPI)	% pa	2.3%
Method of derivation of discount rate, plus any changes since previous valuation		There is an 80% likelihood that the Fund's assets will return at least 5.2% over the 20 following the 2023 valuation date. The same methodology was used for the 2020 valuation with a 75% likelihood

Metric	Unit	2023 Valuation
Assumed life expectancy at age 65		
Life expectancy for current pensioners – men age 65	Years	20.7
Life expectancy for current pensioners – women age 65	Years	23.5
Life expectancy for future pensioners – men age 45	Years	21.6
Life expectancy for future pensioners – women age 45	Years	25.1
Past service funding position – SAB basis (for comparison purposes only)		
Market value of assets	£m	2,406
Value of liabilities	£m	2,011
Funding level on SAB basis (assets/liabilities)	%	120%
Funding level on SAB basis (change since last valuation)	%	3% increase

Metric	Unit	2023 Valuation	2020 Valuation
Contribution rates payable			
Primary contribution rate	% of pay	17.8%	21.2%
Secondary contribution rate (cash amounts in each year in line with CIPFA guidance)			
1st year of rates and adjustments certificate	£m	-0.814	-4.581
2nd year of rates and adjustments certificate	£m	-0.769	-4.671
3rd year of rates and adjustments certificate	£m	-0.794	-4.772
Giving total expected contributions			
1st year (£ figure based on assumed payroll)	£m	49.438	46.132
2nd year (£ figure based on assumed payroll)	£m	51.049	47.330
3rd year (£ figure based on assumed payroll)	£m	52.640	48.549
Assumed payroll (cash amounts in each year)			
1st year rates and adjustments certificate	£m	281.758	239.214
2nd year rates and adjustments certificate	£m	290.545	245.287
3rd year rates and adjustments certificate	£m	299.605	251.515
Three-year average	% of pay	17.6%	19.3%
Average employee contribution	% of pay	6.0%	6.1%
Employee contribution rate (£ figure based on assumed payroll of £281.758m)	£m pa	17.0	14.6

Metric	Unit	2023 Valuation	2020 Valuation
Deficit recovery and surplus spending plan			
Latest deficit recovery period end date, where this methodology is used by the fund's actuarial advisor.	Year	Methodology not used	Methodology not used
Earliest surplus spreading period end date, where this methodology is used by the fund's actuarial advisor.	Year	Methodology not used	Methodology not used
The time horizon end date, where this methodology is used by the fund's actuarial advisor	Year	2043	2040
The funding plan's likelihood of success, where this methodology is used by the fund's actuarial advisor.	%	75%	67%
Percentage of liabilities relating to employers with deficit recovery periods of longer than 20 years	%	0%	0%
Additional information			
Percentage of total liabilities that are in respect of Tier 3 employers	%	TBC	8%
Included climate change analysis/comments in the 2023 valuation report		Yes	Not applicable
Value of McCloud liability in the 2023 valuation report (on local funding basis)	£m	TBC	Not applicable

The Highland Council Pension Fund
Draft Funding Strategy Statement

Effective from 1 April 2024 (proposed)

Contents

Appendices

1 Welcome to The Highland Council Pension Fund's Funding Strategy Statement

This document sets out the Funding Strategy Statement (FSS) for The Highland Council Pension Fund.

The Highland Council Pension Fund is administered by Highland Council, known as the Administering Authority. Highland Council worked with the Fund's actuary, Hymans Robertson, to prepare this FSS which is effective from 1 April 2024.

There's a regulatory requirement for Highland Council to prepare an FSS. You can find out more about the regulatory framework in Appendix A. If you have any queries about the FSS, contact pensions.section@highland.gov.uk

1.1 What is the Highland Council Pension Fund?

The Highland Council Pension Fund is part of the Scottish Local Government Pension Scheme (LGPS). You can find more information about the LGPS at www.scotlgpsmember.org. The Administering Authority runs the fund on behalf of participating employers, their employees and current and future pensioners. You can find out more about roles and responsibilities in Appendix B.

1.2 What are the funding strategy objectives?

The funding strategy objectives are to:

- take a prudent long-term view to secure the regulatory requirement for long-term solvency, with sufficient funds to pay benefits to members and their dependants
- use a balanced investment strategy to minimise long-term cash contributions from employers and meet the regulatory requirement for long-term cost efficiency
- where appropriate, ensure stable employer contribution rates
- reflect different employers' characteristics to set their contribution rates, using a transparent funding strategy
- use reasonable measures to reduce the risk of an employer defaulting on its pension obligations

1.3 Who is the FSS for?

The FSS is mainly for employers participating in the fund, because it sets out how money will be collected from them to meet the fund's obligations to pay members' benefits.

Different types of employers participate in the fund:

Scheduled bodies
Employers who are specified in a schedule to the LGPS regulations, including councils and employers like further education establishments. Scheduled bodies must give employees access to the LGPS if they can't accrue benefits in another pension scheme, such as another public service pension scheme.

Admission bodies
Other employers can join through an admission agreement. The fund can set participation criteria for them and can refuse entry if the requirements aren't met. This type of employer includes contractors providing outsourced services like cleaning or catering to a scheduled body.

Some existing employers may be referred to as **community admission bodies** (CABs). CABs are employers with a community of interest with another scheme employer. Others may be called **transferee admission bodies** (TABs), that provide services for scheme employers. These terms aren't defined under current regulations but remain in common use from previous regulations.

1.4 How does the funding strategy link to the investment strategy?

The funding strategy sets out how money will be collected from employers to meet the fund's obligations. Contributions, assets and other income are then invested according to an investment strategy set by the Administering Authority. The investment strategy is set out in the Fund's Statement of Investment Principles which can be found on the Fund's website.

The funding and investment strategies are closely linked. The fund must be able to pay benefits when they are due – those payments are met from a combination of contributions (through the funding strategy) and asset returns and income (through the investment strategy). If investment returns or income fall short the fund won't be able to pay benefits, so higher contributions would be required from employers.

1.5 Does the funding strategy reflect the investment strategy?

The funding policy is consistent with the investment strategy contained within the Statement of Investment Principles. Future investment return expectations are set with reference to the investment strategy, including a margin for prudence which is consistent with the regulatory requirement that funds take a 'prudent longer-term view' of funding liabilities (see Appendix A)

1.6 How is the funding strategy specific to The Highland Council Pension Fund?

The funding strategy reflects the specific characteristics of the fund employers and its own investment strategy.

2 How does the Fund calculate employer contributions?

2.1 Calculating contribution rates

Employee contribution rates are set by the LGPS regulations as they apply in Scotland.

Employer contributions are made up of two elements:

1) the primary contribution rate – contributions payable towards future benefits (also includes an allowance for the fund's expenses)

2) the secondary contribution rate – the difference between the primary rate and the total employer contribution

The fund actuary uses a model to project each employer's asset share over a range of future economic scenarios. The contribution rate takes each employer's assets into account as well as the projected benefits due to their members. The value of the projected benefits is worked out using employer membership data and the assumptions in Appendix D.

The total contribution rate for each employer is then based on:

- **the funding target** – how much money the fund aims to hold for each employer
- **the time horizon** – the time over which the employer aims to achieve the funding target
- **the likelihood of success** – the proportion of modelled scenarios where the funding target is met.

This approach takes into account the maturing profile of the membership when setting employer contribution rates.

2.2 The contribution rate calculation

Table 1: contribution rate calculation for individual or pooled employers

Type of employer	Scheduled bodies	CABs		TABs*
Sub-type	**Local authorities, police, fire, colleges & other similar employers**	**Open to new entrants**	**Closed to new entrants**	**(all)**
Funding target*	Ongoing	Ongoing	Low-risk exit	Ongoing
Minimum likelihood of success	75%	Low risk: 75% Medium risk: 80% High risk: 85%	70%	Low risk: 75% Medium risk: 80% High risk: 85%
Maximum time horizon	20 years	20 years	20 years or average future working lifetime, if less	Outstanding contract term
Primary rate approach	The contributions must be sufficient to meet the cost of benefits earned in the future with the required likelihood of success at the end of the time horizon			
Secondary rate	% of payroll	% of payroll	Monetary amount	% of payroll
Stabilised contribution rate?	Yes	No	No	No
Treatment of surplus	Covered by stabilisation arrangement. Preferred approach: contributions kept at primary rate. Reductions may be permitted by the Administering Authority.	Preferred approach: contributions kept at primary rate. Reductions may be permitted by the Administering Authority		Reduce contributions by spreading the surplus over the remaining contract term

** Employers participating in the fund under a fixed contribution rate agreement between a letting authority and a contractor, will pay a contribution rate as agreed between the contractor and letting authority.*
*** See Appendix D for further information on funding targets.*

2.3 Making contribution rates stable

Making employer contribution rates reasonably stable is an important funding objective. Where appropriate, contributions are set with this objective in mind. The Fund adopts a formal stabilisation mechanism to setting contributions for some individual employers, which keeps contribution variations within a pre-determined range of 0.5% of pay each year.

Eligibility to participate in the stabilisation mechanism and the range for contribution variations are reviewed during the valuation process. The fund may change the pace of increases or decreases in contributions where required. The Administering Authority also may review the variation ranges and eligibility between valuations to respond to membership or employer changes.

2.4 Reviewing contributions between valuations

The fund may amend contribution rates between formal valuations, in line with LGPS regulations. The purpose of any review is to establish the most appropriate contributions. A review may lead to an increase or decrease in contributions.

The Fund's policy on contribution reviews is set out in Appendix E.

2.5 What is pooling?

The Administering Authority operates contribution rate pools for some types of employers. Contribution rates can be volatile for smaller employers that are more sensitive to individual membership changes – pooling across a group of employers minimises this. In a contribution rate pool, contributions are set to target full funding for the pool as a whole, rather than for individual employers.

Employers in a pool maintain their individual funding positions, tracked by the fund actuary. That means some employers may be better funded or more poorly funded than the pool average. If pooled employers used stand-alone funding rather than pooling, their contribution rates could be higher or lower than the pool rate. Setting contributions in this way means that while the fund receives the contributions required, the risk that employers develop a surplus or deficit increases.

Pooled employers are identified in the rates and adjustments certificate and only have their pooled contributions certified. Individual contribution rates aren't disclosed to pooled employers, unless agreed by the Administering Authority.

CABs that are closed to new entrants aren't usually allowed to enter a pool.

If an employer leaves the fund, the required contributions are based on their own funding position rather than the pool average. Cessation terms also apply, which means higher contributions may be required at that point.

2.6 What are the current contribution pools?

The Highland Council Pool includes all councils, local authority funded schools and smaller related employers and certain ceased contractor arrangements.

2.7 Administering Authority discretion

Individual employers may be affected by circumstances not easily managed within the FSS rules and policies. If this happens, the Administering Authority may adopt alternative funding approaches on a case-by-case basis.

Additionally, the Administering Authority may allow greater flexibility to the employer's contributions if added security is provided or there are other justifiable factors. Flexibility could include things like a reduced contribution rate, extended time horizon, or permission to join a pool. Added security may include a suitable bond, a legally binding guarantee from an appropriate third party, or security over an asset.

The Fund may consider prepayment of employer contributions in specific circumstances.

3 What additional contributions may be payable?

3.1 Pension costs – awarding additional pension and early retirement on non ill-health grounds

If an employer awards additional pension as an annual benefit amount, they pay an additional contribution to the fund as a single lump sum. The amount is set by guidance issued by the Government Actuary's Department and updated from time to time.

If an employee retires before their normal retirement age on unreduced benefits, employers may be asked to pay additional contributions called strain payments.

Employers typically make strain payments as a single lump sum, though strain payments may be spread if the Administering Authority agrees as follows:

Scheme employers	up to 5 years
Community Admission Bodies	up to 3 years
Transferee Admission Bodies	payable immediately

3.2 Pension costs – early retirement on ill-health grounds

If a member retires early because of ill-health, their employer must pay a funding strain, which may result in a large change to their funding position. Such strains are currently met by each employer, although individual employers may elect to take external insurance (see 3.3 below).

3.3 External ill health insurance

If an employer provides satisfactory evidence to the Administering Authority of a current external insurance policy covering ill health early retirement strains, then the employer's contribution to the Fund each year may be reduced by the amount of the insurance premium. This is at the sole discretion of the Administering Authority.

4 How does the fund calculate assets and liabilities?

4.1 How are employer asset shares calculated?

The fund adopts a cashflow approach to track individual employer assets.

Each fund employer has a notional share of the fund's assets, which is assessed yearly by the actuary. The actuary starts with assets from the previous year-end, adding cashflows paid in/out and investment returns to give a new year-end asset value. The fund actuary makes a simplifying assumption, that all cashflow and investment returns have been paid uniformly over the year. This assumption means that the sum of all employers' asset values is slightly different from the whole fund asset total over time. This minimal difference is split between employers in proportion to their asset shares at each valuation.

If an employee moves from one employer to another within the fund, assets equal to the cash equivalent transfer value (CETV) will move from the original employer to the receiving employer's asset share.

Alternatively, if employees move when an outsourced contract begins, the fund actuary will calculate assets linked to the value of the liabilities transferring (see section 5).

4.2 How are employer liabilities calculated?

The fund holds membership data for all active, deferred and pensioner members. Based on this data and the assumptions in Appendix D, the fund actuary projects the expected benefits for all members into the future. This is expressed as a single value – the liabilities – by allowing for expected future investment returns.

Each employer's liabilities reflect the experience of their own employees and ex-employees.

4.3 What is a funding level?

An employer's funding level is the ratio of the market value of asset share against liabilities. If this is less than 100%, the employer has a shortfall: the employer's deficit. If it is more than 100%, the employer is in surplus. The amount of deficit or surplus is the difference between the asset value and the liabilities value.

Funding levels and deficit/surplus values measure a particular point in time, based on a particular set of future assumptions. While this measure is of interest, for most employers the main issue is the level of contributions payable. The funding level does not directly drive contribution rates. See section 2 for further information on rates.

5 What happens when an employer joins the fund?

5.1 When can an employer join the fund

Employers can join the fund if they are a new scheduled body or a new admission body.

On joining, the fund will determine the assets and liabilities for that employer within the fund. The calculation will depend on the type of employer and the circumstances of joining.

A contribution rate will also be set. This will be set in accordance with the calculation set out in Section 2, unless alternative arrangements apply (for example, the employer has agreed a pass-through arrangement or some other form of risk sharing).

5.2 New admission bodies as a result of outsourcing services

New admission bodies usually join the fund because an existing employer (usually a scheduled body like a council) outsources a service to another organisation (a contractor). This involves TUPE transfers of staff from the letting employer to the contractor. The contractor becomes a new participating fund employer for the duration of the contract and transferring employees remain eligible for LGPS membership. At the end of the contract, employees typically revert to the letting employer or a replacement contractor.

Liabilities for transferring active members will be calculated by the fund actuary on the day before the outsourcing occurs.

New contractors will be allocated an asset share equal to the value of the transferring liabilities. The admission agreement may set a different initial asset allocation, depending on contract-specific circumstances.

There is flexibility for outsourcing employers when it comes to pension risk potentially taken on by the contractor. The Fund may consider how they may be reflected in the contribution rate payable and asset allocation for the new contractor. It is the responsibility of the letting authority and contractor to notify the Administering Authority about the existence of any specific pension risk sharing clauses for the outsourcing.

5.3 Other new employers

There may be other circumstances that lead to a new admission body entering the fund, e.g. set up of a wholly owned subsidiary company by a Local Authority. Calculation of assets and liabilities on joining and a contribution rate will be carried out allowing for the circumstances of the new employer.

5.4 Risk assessment for new admission bodies

A new admission body must assess the risks it poses to the fund if the admission agreement ends early, for example if the admission body becomes insolvent or goes out of business. In practice, the fund actuary assesses this because the assessment must be carried out to the Administering Authority's satisfaction.

After considering the assessment, the Administering Authority may decide the admission body must provide security, such as a guarantee from the letting employer, an indemnity or a bond.

This must cover some or all of the:

- strain costs of any early retirements, if employees are made redundant when a contract ends prematurely,
- allowance for the risk of assets performing less well than expected,
- allowance for the risk of liabilities being greater than expected,
- allowance for the possible non-payment of employer and member contributions,
- admission body's existing deficit.

6 What happens if an employer has a bulk transfer of staff?

Bulk transfer cases will be looked at individually, but generally:

- Where only active members transfer out, the Fund will not pay bulk transfers greater than the value of the members' liabilities had they opted to transfer on an individual basis (i.e. Cash Equivalent Transfer Values);
- Where the entire membership of the employer (i.e. active, deferred and pensioner members) transfers out, the Fund will not pay a bulk transfer greater than the asset share of the transferring employer.
- The fund won't grant added benefits to members bringing in entitlements from another fund, unless the asset transfer is enough to meet the added liabilities.
- The fund may permit shortfalls on bulk transfers if the employer has a suitable covenant and commits to meeting the shortfall in an appropriate period, which may require increased contributions between valuations.

The Fund's full policy on bulk transfers is set out in Appendix F.

7 What happens when an employer leaves the fund?

7.1 What is a cessation event?

Triggers for considering cessation from the fund are:

- the last active member stops participation in the fund. The Administering Authority, at their discretion, can defer acting for up to three years by issuing a suspension notice. That means cessation won't be triggered if the employer takes on one or more active members during the agreed time
- insolvency, winding up or liquidation of the admission body
- a breach of the agreement obligations that isn't remedied to the fund's satisfaction
- failure to pay any sums due within the period required
- failure to renew or adjust the level of a bond or indemnity, or to confirm an appropriate alternative guarantor
- termination of a deferred debt arrangement (DDA).

If no DDA exists, the Administering Authority will instruct the fund actuary to carry out a cessation valuation to calculate if there is a surplus or a deficit when the employer leaves the fund.

7.2 What happens on cessation?

The Administering Authority must protect the interests of the remaining fund employers when an employer leaves the fund. The actuary aims to protect remaining employers from the risk of future loss. The funding target adopted for the cessation calculation is below. These are defined in Appendix D.

(a) Where there is no guarantor, cessation liabilities and a final surplus/deficit will usually be calculated using the Fund's risk-based cessation approach, outlined in Appendix G.

(b) Where there is a guarantor, the guarantee will be considered before the cessation valuation. Where the guarantor is a guarantor of last resort, this will have no effect on the cessation valuation. If this isn't the case, cessation may be calculated using the same basis that was used to calculate liabilities (and the corresponding asset share) on joining the fund.

(c) Depending on the guarantee, it may be possible to transfer the employer's liabilities and assets to the guarantor without crystallising deficits or surplus.

If the fund can't recover the required payment in full, unpaid amounts will be paid by the related letting authority (in the case of a ceased admission body) or guarantor, or, if no authority/guarantor exists, shared between the other fund employers. This may require an immediate revision to the rates and adjustments certificate or be reflected in the contribution rates set at the next formal valuation.

The Fund's cessation policy is set out in Appendix G.

7.3 What happens if there is a surplus?

If the cessation valuation shows the exiting employer has more assets than liabilities – an exit credit – the Administering Authority will obtain a revised rates and adjustments certificate showing the exit credit payable to the exiting employer.

Full details of the Fund's approach to cessation valuations can be found in the Fund's cessation policy (in Appendix G).

7.4 How do employers repay cessation debts?

If there is a deficit, full payment will usually be expected in a single lump sum or:

- spread over an agreed period, if the employer enters into a deferred spreading agreement
- if an exiting employer enters into a deferred debt agreement, it stays in the fund and pays contributions until the cessation debt is repaid. Payments are reassessed at each formal valuation.

More detail of the flexibilities available to employers on exit can be found in the Fund's cessation policy (See Appendix G).

7.5 What if an employer has no active members?

When employers leave the fund because their last active member has left, they may pay a cessation debt, receive an exit credit or enter a Deferred Debt Agreement (DDA)/DSA (Deferred Spreading Arrangement). Beyond this they have no further obligation to the fund and either:

a) their asset share runs out before all ex-employees' benefits have been paid. The other fund employers will be required to contribute to the remaining benefits. The fund actuary will portion the liabilities on a pro-rata basis at successive formal valuations.

b) the last ex-employee or dependant dies before the employer's asset share is fully run down. The fund actuary will apportion the remaining assets to the other fund employers on a pro-rata basis.

8 What are the statutory reporting requirements?

8.1 Reporting regulations

The Public Service Pensions Act 2013 requires that the Government Actuary's Department must report to the Scottish Public Pensions Agency (SPPA) acting on behalf of Scottish Ministers on each of the LGPS Funds in Scotland. This report is usually called a section 13 report. The report should include confirmation that employer contributions are set at the right level to ensure the fund's solvency and long-term cost efficiency.

8.2 Solvency

Employer contributions are set at an appropriate solvency level if the rate of contribution targets a funding level of 100% over an appropriate time, using appropriate assumptions compared to other funds. Either:

(a) employers collectively can increase their contributions, or the fund can realise contingencies to target a 100% funding level

or

(b) there is an appropriate plan in place if there is, or is expected to be, a reduction in employers' ability to increase contributions as needed.

8.3 Long-term cost efficiency

Employer contributions are set at an appropriate long-term cost efficiency level if the contribution rate makes provision for the cost of current benefit accrual, with an appropriate adjustment for any surplus or deficit.

To assess this, the Administering Authority may consider absolute and relative factors.

Relative factors include:

1. comparing LGPS funds with each other
2. the implied deficit recovery period
3. the investment return required to achieve full funding after 20 years.

Absolute factors include:

1. comparing funds with an objective benchmark
2. the extent to which contributions will cover the cost of current benefit accrual and interest on any deficit
3. how the required investment return under relative considerations compares to the estimated future return targeted by the investment strategy

4. the extent to which contributions paid are in line with expected contributions, based on the rates and adjustment certificate
5. how any new deficit recovery plan reconciles with, and can be a continuation of, any previous deficit recovery plan, allowing for fund experience.

These metrics may be assessed by GAD and SPPA on a standardised market-related basis where the fund’s actuarial bases don’t offer straightforward comparisons.

Appendices

Appendix A – The regulatory framework

A1 Why do funds need a funding strategy statement?

The Local Government Pension Scheme (LGPS) regulations require funds to maintain and publish a funding strategy statement (FSS). The purpose of the FSS is to document the processes the Administering Authority uses to:

- *establish a **clear and transparent fund-specific strategy** identifying how employers' pension liabilities are best met going forward*
- *support the regulatory framework to maintain **as nearly constant employer contribution rates as possible***
- *ensure the fund meets its **solvency and long-term cost efficiency** objectives*
- *take a **prudent longer-term view** of funding those liabilities.*

To prepare this FSS, the Administering Authority has used guidance by the Chartered Institute of Public Finance and Accountancy (CIPFA).

A2 Consultation

Both the LGPS regulations and most recent CIPFA guidance state the FSS should be prepared in consultation with "*persons the authority considers appropriate*". This should include '*meaningful dialogue… with council tax raising authorities and representatives of other participating employers*'.

The consultation process included issuing a draft version of the FSS for comments or questions to all participating employers.

A3 How is the FSS published?

The FSS is:

- Published on the Fund's website
- Published as part of Pensions Committee Agendas
- Available freely on request

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the valuation. Amendments may be made before then if there are regulatory or operational changes. Any amendments will be consulted on, agreed by the Pensions Committee and included in the Committee meeting minutes.

A5 How does the FSS fit into the overall fund documentation?

The FSS is a summary of the fund’s approach to funding liabilities. It isn’t exhaustive – the fund publishes other statements like the statement of investment principles, governance policy, administration strategy and communications policy. The fund’s annual report and accounts also includes up-to-date fund information.

You can see all Fund documentation at www.highlandpensionfund.org.

Appendix B – Roles and responsibilities

B1 The Administering Authority:

1 operates the fund and follows all LGPS (Scotland) regulations

2 manages any conflicts of interest from its dual role as Administering Authority and a fund employer

3 collects employer and employee contributions, investment income and other amounts due

4 ensures cash is available to meet benefit payments when due

5 pays all benefits and entitlements

6 invests surplus money like contributions and income which isn't needed to pay immediate benefits, in line with regulation and the Statement of Investment Principles (SIP)

7 communicates with employers so they understand their obligations

8 safeguards the fund against employer default

9 works with the fund actuary to manage the valuation process

10 provides information to the Government Actuary's Department so they can carry out their statutory obligations

11 consults on, prepares and maintains the funding and investment strategy statements

12 tells the actuary about changes which could affect funding

13 monitors the fund's performance and funding, amending the strategy statements as necessary

14 enables the local pension board to review the valuation process

B2 Individual employers:

1 deduct the correct contributions from employees' pay

2 pay all contributions by the due date

3 have appropriate policies in place to work within the regulatory framework

4 make additional contributions as agreed, for example to augment scheme benefits or early retirement strain

5 tell the Administering Authority promptly about any changes to circumstances, prospects or membership which could affect future funding

6 make any required exit payments when leaving the fund

B3 The fund actuary:

1. prepares valuations, including setting employers' contribution rates, agreeing assumptions, working within FSS and LGPS regulations and appropriately targeting fund solvency and long-term cost efficiency
2. provides information to the Government Actuary Department so they can carry out their statutory obligations
3. advises on fund employers, including giving advice about and monitoring bonds or other security
4. prepares advice and calculations around bulk transfers and individual benefits
5. assists the Administering Authority to consider changes to employer contributions between formal valuations
6. advises on terminating employers' participation in the fund
7. fully reflects actuarial professional guidance and requirements in all advice

B4 Other parties:

1. internal and external investment advisers ensure the Statement of Investment Principles (SIP) is consistent with the funding strategy statement
2. investment managers, custodians and bankers play their part in the effective investment and dis-investment of fund assets in line with the Statement of Investment Principles
3. auditors comply with standards, ensure fund compliance with requirements, monitor and advise on fraud detection, and sign-off annual reports and financial statements
4. governance advisers may be asked to advise the Administering Authority on processes and working methods
5. internal and external legal advisers ensure the fund complies with all regulations and broader local government requirements, including the Administering Authority's own procedures
6. the SPPA/Scottish Ministers (assisted by the Government Actuary's Department) and the Scottish LGPS Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements

Appendix C – Risks and controls

C1 Managing risks

The Administering Authority has a risk management programme to identify and control financial, demographic, regulatory and governance risks.

The role of the local pension board is set out in the board's constitution which is available in the Fund's governance policy at available at www.highlandpensionfund.org

Details of the key fund-specific risks and controls are set out below.

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities and contribution rates over the long-term.	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc. Analyse progress at three yearly valuations for all employers. Inter-valuation monitoring of liabilities between valuations at whole Fund level.
Inappropriate long-term investment strategy.	Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure key outcomes. Chosen option considered to provide the best balance; reviewed at least every three years.
Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.
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.

Risk	Summary of Control Mechanisms
	Some investment in bonds also helps to mitigate this risk. Employers pay for their own salary awards and should be mindful 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	An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions.
Orphaned employers give rise to added costs for the Fund	The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future. If it occurs, the additional cost will be met by the Fund's remaining employers.
Effect of possible asset underperformance as a result of climate change	The Fund actively considers this risk when allocating assets and appointing fund managers

C3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.

Risk	Summary of Control Mechanisms
Deteriorating patterns of early retirements	Employers are charged the extra cost of non ill-health retirements following each individual decision. Employer ill health retirement experience can be monitored, and external insurance is an option for employers.
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: Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases. 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.

C4 Regulatory risks

Risk	Summary of Control Mechanisms
Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.
Time, cost and/or reputational risks associated with any SPPA/Scottish Ministers intervention triggered by the Section 13 analysis.	Take advice from Fund Actuary on proposed valuation approach relative to anticipated Section 13 analysis.

Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.

C5 Governance risks

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) or not advised of an employer closing to new entrants.	The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data. The Actuary may revise the Rates and Adjustments Certificate to increase an employer's contributions between triennial valuations Deficit contributions may be expressed as monetary amounts.
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way	The Administering Authority maintains close contact with its specialist advisers. Advice is delivered via formal meetings involving Elected Members, and recorded appropriately. Actuarial advice is subject to professional requirements such as peer review.
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.	The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes. Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.

Risk	**Summary of Control Mechanisms**
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 Fund from various risks. Requiring new Community Admission Bodies to have a guarantor. Reviewing bond or guarantor arrangements at regular intervals. Reviewing contributions well ahead of cessation if thought appropriate.
An employer ceasing to exist resulting in an exit credit being payable by the Fund	The Administering Authority monitors admission bodies coming up to cessation. The Administering Authority invests in liquid assets to ensure that exit credits can be paid when required.

C6 Employer covenant assessment and monitoring

Many of the employers participating in the fund, such as admitted bodies (including TABs and CABs), have no local tax-raising powers. The fund assesses and monitors the long-term financial health of these employers to assess an appropriate level of risk for each employer's funding strategy.

Type of employer	Assessment	Monitoring
Local Authority, Police, Fire, Colleges	Tax-raising or government-backed, no individual assessment required	n/a
Admission bodies (including TABs & CABs)	Covenant assessment carried out by Fund Officers to assign employers a risk rating of 'high risk', 'medium risk' or 'low risk'	The Fund will review employers periodically or when a significant event occurs

C7 Climate risk and TCFD reporting

The Fund has considered climate-related risks as part of the 2023 valuation when setting the funding strategy. To consider the resilience of the strategy the Fund has considered climate scenario stress testing as part of an asset-liability modelling exercise. The modelling results under the stress tests were within risk tolerance levels, particularly given the severity of the stresses applied. The results provide assurance that the modelling approach does not significantly underestimate the potential impact of climate change and that the funding strategy is resilient to climate risks. The results of these stress tests may be used in future to assist with disclosures prepared in line with Task Force on Climate-Related Financial Disclosures (TCFD) principles.

The modelling was carried out at whole fund level. Given that the same underlying model is used for all employers when setting contribution rates, applying the stress tests to all employers was not deemed proportionate at this stage and would not be expected to result in any changes to the agreed contribution plans.

The Fund has a Responsible Investment Policy which is available on the Fund's website.

Appendix D – Actuarial assumptions

The fund's actuary uses a set of assumptions to determine the strategy, and so assumptions are a fundamental part of the Funding Strategy Statement.

D1 What are assumptions?

Assumptions are used to estimate the benefits due to be paid to members. Financial assumptions determine the amount of benefit to be paid to each member, and the expected investment return on the assets held to meet those benefits. Demographic assumptions are used to work out when benefit payments are made and for how long.

The funding target is the money the fund aims to hold to meet the benefits earned to date.

Any change in the assumptions will affect the funding target and contribution rate, but different assumptions don't affect the actual benefits the fund will pay in future.

D2 What assumptions are used to set the contribution rate?

The fund doesn't rely on a single set of assumptions when setting contribution rates, instead using Hymans Robertson's Economic Scenario Service (ESS) to project each employer's assets, benefits and cashflows to the end of the funding time horizon.

ESS projects future benefit payments, contributions and investment returns under 5,000 possible economic scenarios, using variables for future inflation and investment returns for each asset class, rather than a single fixed value.

For any projection, the fund actuary can assess if the funding target is satisfied at the end of the time horizon.

Table: Summary of assumptions underlying the ESS, 31 March 2023

Time period	Percentile	Asset class annualised total returns											Inflation/Yields		
		Cash	Developed World ex UK Equity	Private equity	Infrastructure equity	IL Gilts (Medium)	FI Gilts (Medium)	Diversified Growth Fund (Low Beta)	Corporate Debt BBB (Medium)	Multi Asset Credit	Private Lending	Property	Inflation (CPI)	17 year real yield (CPI)	17 year yield
10 years	16th	2.5%	1.1%	0.5%	2.4%	0.8%	2.4%	3.2%	2.8%	4.0%	4.8%	1.2%	0.9%	-0.3%	2.7%
	50th	3.6%	7.3%	11.4%	7.8%	2.8%	3.7%	5.1%	4.7%	5.9%	7.6%	6.2%	2.5%	0.9%	4.1%
	84th	4.7%	13.6%	22.3%	13.2%	5.1%	4.9%	7.0%	6.4%	7.7%	10.3%	11.5%	4.1%	2.2%	5.9%
20 years	16th	2.3%	2.8%	3.7%	3.9%	1.0%	3.3%	3.4%	3.8%	4.7%	5.7%	2.7%	0.7%	-0.5%	1.4%
	50th	3.7%	7.4%	11.4%	7.9%	2.7%	4.1%	5.2%	5.1%	6.3%	7.8%	6.4%	2.3%	1.3%	3.4%
	84th	5.4%	12.2%	19.2%	12.0%	4.5%	4.8%	7.2%	6.3%	7.9%	9.8%	10.3%	3.9%	2.9%	5.9%
40 years	16th	1.8%	3.7%	5.4%	4.5%	1.0%	2.9%	3.2%	3.6%	4.5%	5.7%	3.2%	0.6%	-0.6%	1.2%
	50th	3.5%	7.2%	11.0%	7.7%	2.7%	3.7%	5.0%	4.8%	6.1%	7.6%	6.2%	2.0%	1.3%	3.3%
	84th	5.7%	10.9%	16.8%	11.1%	4.6%	4.9%	7.3%	6.3%	8.1%	9.7%	9.5%	3.5%	3.2%	6.1%
Volatility (5yr)		2%	18%	30%	15%	7%	5%	5%	7%	6%	9%	15%	3%	-	-

ESS assumptions are calibrated at each month end. Contribution rate assessments carried out after 31 March 2023 (for new employers joining the Fund) will use the most up to date calibration of the ESS.

D3 What financial assumptions are used?

Future investment returns and discount rate

The fund uses a risk-based approach to generate assumptions about future investment returns over the funding time horizon, based on the investment strategy.

The discount rate is the annual rate of future investment return assumed to be earned on assets after the end of the funding time horizon. The discount rate assumption is set as a margin above the risk-free rate.

Assumptions for future investment returns depend on the funding objective.

	Employer type	Margin above risk-free rate
Ongoing basis	All employers except closed community admission bodies	2.0%
Low-risk exit basis	Community admission bodies closed to new entrants	0%

Discount rate (for funding level calculation as at 31 March 2023 only)

For the purpose of calculating a funding level at the 2023 valuation, a discount rate of 5.2% pa applies. This is based on a prudent estimate of investment returns, specifically, that there is an 80% likelihood that the fund's assets will future investment returns of 5.2% pa over the 20 years following the 2023 valuation date.

Pension increases and CARE revaluation

Increases to pensions in payment, deferred benefits and revaluation of CARE benefits are in line with the Consumer Price Index (CPI) and determined by the regulations.

The CPI assumption is based on Hymans Robertson's ESS model.

For funding level calculations, the CPI assumption is based on the median value from the ESS model over a time horizon consistent with that used to derive the discount rate. The median value of CPI inflation from the ESS was 2.3% pa on 31 March 2023.

Salary growth

The salary increase assumption at the latest valuation has been set to 0.8% above CPI pa plus a promotional salary scale.

D4 What demographic assumptions were used?

Demographic assumptions are best estimates of future experience. The fund uses advice from Club Vita to set demographic assumptions, as well as analysis and judgement based on the fund's experience.

Demographic assumptions vary by type of member, so each employer's own membership profile is reflected in their results.

Life expectancy

The longevity assumptions are a bespoke set of Vita Curves produced by detailed analysis and tailored to fit the fund's membership profile.

Allowance has been made for future improvements to mortality, in line with the 2022 version of the continuous mortality investigation (CMI) published by the actuarial profession. The starting point (A parameter) has been adjusted by +0.25% to reflect the difference between the population-wide data used in the CMI and LGPS membership. A long-term rate of mortality improvements of 1.5% pa applies. The smoothing parameter used in the CMI model is 7.0.

A weighting of 0% has been applied to 2020 and 2021 data within the model to avoid overstating the impact of the Covid-19 pandemic on future life expectancy. However, a weighting of 25% has been applied for 2022 data reflecting emerging data on the longer term impact of the pandemic and a wider slowdown in life expectancy improvements.

Other demographic assumptions

Retirement in normal health	Members are assumed to retire at the earliest age possible with no pension reduction.
Promotional salary increases	Sample increases below
Death in service	Sample rates below
Withdrawals	Sample rates below
Retirement in ill health	Sample rates below
Family details	A varying proportion of members are assumed to have a dependant partner at retirement or on earlier death. For example, at age 60 this is assumed to be 85% for males and 60% for females. Beyond retirement the proportion is adjusted for assumed dependant mortality. Male (female) pensioners are assumed to be 2 years older (3.5 years younger) than their partner dependant who are assumed to be opposite sex to members.
Commutation	65% of maximum tax-free cash
50:50 option	0.5% of members will choose the 50:50 option.

D3 Rates for demographic assumptions

Males

Incidence per 1000 active members per year								
Age	Salary scale	Death before retirement	Withdrawals		Ill-health tier 1		Ill-health tier 2	
		FT &PT	FT	PT	FT	PT	FT	PT
20	105	0.21	390.20	578.87	0.00	0.00	0.00	0.00
25	117	0.21	257.74	382.37	0.11	0.02	0.13	0.02
30	131	0.26	182.82	271.22	0.21	0.03	0.23	0.03
35	144	0.30	142.82	211.87	0.41	0.14	0.46	0.15
40	154	0.51	114.92	170.49	0.62	0.26	0.69	0.24
45	164	0.86	67.17	139.50	0.99	0.51	1.09	0.49
50	174	1.37	52.03	108.06	1.86	1.31	2.59	1.45
55	179	2.15	49.98	103.80	5.83	4.52	4.67	3.11
60	184	3.86	44.51	92.45	9.91	6.97	3.87	2.65
65	185	6.44	0	0	18.92	13.49	0	0

Females

Incidence per 1000 active members per year								
Age	Salary scale	Death before retirement	Withdrawals		Ill-health tier 1		Ill-health tier 2	
		FT &PT	FT	PT	FT	PT	FT	PT
20	105	0.11	308.39	406.65	0.00	0.00	0.00	0.00
25	117	0.11	207.45	273.48	0.16	0.13	0.09	0.1
30	131	0.16	173.85	229.19	0.21	0.18	0.12	0.13
35	144	0.27	107.10	197.67	0.41	0.34	0.24	0.25
40	154	0.44	89.08	164.40	0.61	0.51	0.36	0.37
45	164	0.71	73.33	135.34	0.82	0.68	0.48	0.5
50	174	1.04	55.88	103.12	1.5	1.23	1.11	1.13
55	179	1.37	52.27	96.47	5.47	4.43	2.32	2.35
60	184	1.75	42.03	77.56	11.52	9.3	2.38	2.4
65	185	2.25	0	0	20.73	16.76	0	0

D5 What assumptions apply in a cessation valuation following an employer's exit from the fund?

Please refer to the fund's cessation policy in Appendix G for further information.

Appendix E – Policy on contribution reviews

Effective date of policy	1 April 2024
Date approved	tbc
Next review	tbc

Introduction

The purpose of this policy is to set out the Administering Authority's approach to reviewing contribution rates between triennial valuations.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

E1 Aims and objectives

The Administering Authority's aims and objectives related to this policy are as follows:

- To provide employers with clarity around the circumstances where contribution rates may be reviewed between valuations.
- To outline specific circumstances where contribution rates will not be reviewed.

E2 Background

The Fund may amend contribution rates between valuations for 'significant change' to the liabilities or covenant of an employer.

Such reviews may be instigated by the fund or at the request of a participating employer.

Any review may lead to a change in the required contributions from the employer.

E3 Guidance and regulatory framework

Regulation 61 of the Local Government Pension Scheme (Scotland) Regulations 2018 sets out the way in which LGPS funds should determine employer contributions, including the following;

- Regulation 61 (6) – allows the Administering Authority to review the contribution rate if it becomes likely that an employer will cease participation in the fund, with a view to ensuring that the employer is fully funded at the expected exit date.
- Regulation 61A - sets out specific circumstances where the Administering Authority may revise contributions between valuations (including where a review is requested by one or more employers).

E4 Statement of principles

This statement of principles covers review of contributions between valuations. Each case will be treated on its own merits, but in general:

- The Administering Authority reserves the right to review contributions in line with the provisions set out in the LGPS Regulations. It will also consider requests from employers to do so.
- The decision to make a change to contribution rates rests with the Administering Authority, subject to consultation with employers during the review period.
- Full justification for any change in contribution rates will be provided to employers.
- Advice will be taken from the fund actuary in respect of any review of contribution rates.
- Any revision to contribution rates will be reflected in the Rates & Adjustment certificate.

E5 Policy

E5.1 Circumstances for review

The fund would consider the following circumstances as a potential trigger for review:

- in the opinion of an Administering Authority there are circumstances which make it likely that an employer (including an admission body) will become an exiting employer sooner than anticipated at the last valuation;
- an employer is approaching exit from the fund within the next two years and before completion of the next triennial valuation;
- there are changes to the benefit structure set out in the LGPS Regulations which have not been allowed for at the last valuation;
- it appears likely to the administering authority that the amount of the liabilities arising or likely to arise for an employer or employers has changed significantly since the last valuation;
- it appears likely to the Administering Authority that there has been a significant change in the ability of an employer or employers to meet their obligations (e.g. a material change in employer covenant, or provision of additional security);
- it appears to the Administering Authority that the membership of the employer has changed materially such as bulk transfers, significant reductions to payroll or large-scale restructuring; or
- where an employer has failed to pay contributions or has not arranged appropriate security as required by the Administering Authority.

E5.2 Employer requests

The Administering Authority will also consider a request from any employer to review contributions where the employer has undertaken to meet the costs of that review and sets out the reasoning for the review (which would be expected to fall into one of the above categories, such as a belief that their covenant has changed materially, or they are going through a significant restructuring impacting their membership).

The Administering Authority will require additional information to support a contribution review made at the employer's request. The specific requirements will be confirmed following any request and this is likely to include the following:

- a copy of the latest accounts;
- details of any additional security being offered (which may include insurance certificates);
- budget forecasts; and/or
- information relating to sources of funding.

The costs incurred by the Administering Authority in carrying out a contribution review (at the employer's request) will be met by the employer. These will be confirmed upfront to the employer prior to the review taking place.

E5.3 Other employers

When undertaking any review of contributions, the Administering Authority will also consider the impact of a change to contribution rates on other fund employers. This will include the following factors:

- The existence of a guarantor.
- The amount of any other security held.
- The size of the employer's liabilities relative to the whole fund.

The Administering Authority will consult with other fund employers as necessary.

E5.4 Effect of market volatility

Except in circumstances such as an employer nearing cessation, the Administering Authority will not consider financial market volatility or changes to asset values as a basis for a change in contributions outside a formal valuation.

E5.5 Documentation

Where revisions to contribution rates are necessary, the fund will provide the employer with a note of the information used to determine these, including:

- Explanation of the key factors leading to the need for a review of the contribution rates, including, if appropriate, the updated funding position.
- A note of the new contribution rates and effective date of these.
- Date of next review.
- Details of any processes in place to monitor any change in the employer's circumstances (if appropriate), including information required by the Administering Authority to carry out this monitoring.

The Rates & Adjustments certificate will be updated to reflect the revised contribution rates.

E6 Related Policies

The fund's approach to setting employer contribution rates is set out in the Funding Strategy Statement, specifically "Section 2 – How does the fund calculate employer contributions?".

Appendix F – Policy on bulk transfers

Effective date of policy	1 April 2024
Date approved	tbc
Next review	tbc

Introduction

The purpose of this policy is to set out the Administering Authority's approach to dealing with the bulk transfer of scheme member pension rights into and out of the Fund in prescribed circumstances.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

F1 Aims and Objectives

The Administering Authority's aims and objectives related to this policy are as follows:

- Bulk transfers out of the Fund do not allow a deficit to remain behind unless a scheme employer is committed to repairing this; and
- Bulk transfers received by the Fund must be sufficient to pay for the added benefits being awarded to the members, again with the scheme employer making good any shortfall where necessary.

Bulk transfer requests will be considered on a case-by-case basis.

F2 Background

Bulk transfers into and out of the Fund can occur for a variety of reasons, such as:

- where an outsourcing arrangement is entered into and active Fund members join another LGPS fund, or leave the LGPS to join a broadly comparable scheme;
- where an outsourcing arrangement ceases and active scheme members re-join the Fund from another LGPS fund or a broadly comparable scheme;
- where there is a reorganisation of central government operations (transfers in from, or out to, other government sponsored schemes);
- where there is a reorganisation or consolidation of local operations (brought about by, for example, local government shared services or college mergers); or
- a national restructuring resulting in the admission of an employer whose employees have LGPS service in another LGPS fund, or vice versa.

Unlike bulk transfers out of the LGPS, there is no specific provision to allow for bulk transfers into the LGPS. As a result, any transfer value received into the LGPS, whether on the voluntary movement of an individual or the compulsory transfer of a number of employees, must be treated the same way as individual transfers.

F3 Guidance and regulatory framework

F3.1 Local Government Pension Scheme Regulations

When considering any circumstances involving bulk transfer provisions, the Administering Authority will always ensure adherence to any overriding requirements set out in the Local Government Pension Scheme (Scotland) Regulations 2018 (as amended), including:

- Regulation 93 – applies on transfer out to non-LGPS schemes. It allows for the payment of a bulk transfer value where at least two active members of the LGPS cease scheme membership and join another approved pension arrangement.

- Regulation 94 - gives the LGPS actuary discretion as to the choice of method of calculation used to calculate the bulk transfer value.

- Regulation 95 – allows an individual who holds relevant pension rights under a previous employer to request to be admitted for past service into the LGPS. Members wishing to transfer in accrued rights from a Club scheme (that is schemes with benefits broadly similar to those of the LGPS), who request to do so within 12 months of joining their new LGPS employment, must be granted their request. For members with "non-Club" accrued rights the LGPS fund does not have to grant the request. Any request must be received in writing from the individual within 12 months of active employment commencing or longer at the discretion of the employer and the Administering Authority.

- Regulation 97 - states that any transfer between one LGPS fund and another LGPS fund where 10 or more members elect to transfer will trigger bulk transfer negotiations between Fund actuaries.

F3.2 Local Authorities

The Statutory Guidance to Local Authorities on Contracting, which came into force on 10 August 2006, applies to contracting by local authorities and to any exercise which involves the consideration of a change of service provider or where the transfer of local authority staff is at issue. The statutory guidance:

- requires the contractor to secure pension protection for each transferring employee through the provision of pension rights that are the same as or are broadly comparable to or better than those they had as an employee of the authority

- where a broadly comparable scheme is provided, the new employer's pension scheme should allow transferring employees the option of moving their accrued credits into that scheme on a fully protected basis, and

- provides that the provision of pension protection is enforceable by the employee.

The Guidance also requires similar pension protection in relation to those former employees of an authority, who were transferred under TUPE to a contractor, in respect of any re-tendering of a contract for the provision of services (i.e. second and subsequent rounds of outsourcing).

Where the service provider recruits or allocates staff to work on a local authority contract alongside employees transferred from the local authority, all new recruits should be offered access to pension provision which, where applicable, can be equated broadly comparable to that enjoyed by originally transferred local authority employees.

F3.3 Other employers

For all scheme employers that do not fall under the statutory guidance there is no explicit requirement to provide pension protection on the outsourcing or insourcing of services. However, any successful contractor is free to seek admission body status in the Fund, subject to complying with the Administering Authority's requirements (e.g. having a bond or guarantor in place).

In the absence of a bulk transfer agreement the Administering Authority would not expect to pay out more than individual Cash Equivalent Transfer Value (CETV) amounts, in accordance with appropriate Government Actuary's Department (GAD) guidance.

F4 Statement of principles

This statement of principles covers bulk transfer payments into and out of the Fund. Each case will be treated on its own merits alongside appropriate actuarial advice, but in general:

- Where a group of active scheme members joins (or leaves) the Fund, the Administering Authority's objective is to ensure that sufficient assets are received (or paid out) to meet the cost of providing those benefits.
- Ordinarily the Administering Authority's default approach for bulk transfers out (or in) will be to propose (or accept) that the transfer value is calculated based on CETVs for the members concerned. The Fund will retain the discretion to amend the bulk transfer basis to reflect the specific circumstances of each transfer – including (but not restricted to):
    - the use of cessation assumptions where unsecured liabilities are being left behind;
    - use of ongoing assumptions based on the employer's share of Fund assets (capped at 100% of the value of the liabilities) where this may be more appropriate; or
    - where transfer terms are subject to commercial factors.
- Where an entire employer is transferring in or out of the Fund the bulk transfer should equal the asset share of the employer in the transferring Fund regardless of whether this is greater or lesser than the value of past service liabilities for members.

- There may be situations where the Fund accepts a transfer in amount which is less than required to fully fund the transferred in benefits on the Fund's ongoing basis (e.g. where the employer has suitable strength of covenant and commits to meeting that shortfall over an appropriate period). In such cases the Administering Authority reserves the right to require the receiving employer to fund this shortfall (either by lump sum or by increasing in ongoing employer contributions) ahead of the next formal valuation.
- Any shortfall between the bulk transfer payable by the Fund and that which the receiving scheme is prepared to accept must be dealt with outside of the Fund, for example by a top up from the employer to the receiving scheme or through higher ongoing contributions to that scheme.
- Service credits granted to transferring scheme members should fully reflect the value of the benefits being transferred, irrespective of the size of the transfer value paid or received.

F5 Policy

The following summarises the various scenarios for bulk transfers in or out of the Fund, together with the Administering Authority's associated policies.

F5.1 Inter-fund transfer (transfer between the fund and another LGPS fund)

Scenario	Bulk transfer mechanism	Policy	Methodology
In	< 10 members – GAD guidance	CETVs in accordance with GAD guidance.	On receipt of a transfer value (calculated in line with the CETV transfer out formulae), the Fund will award the member a pension credit on a day-for-day basis.
	10 or more members – Regulation 97 of the Local Government Pension Scheme (Scotland) Regulations 2018	Where agreement can be reached, the Fund and the transferring fund (and their two actuaries) may agree to a negotiated bulk transfer arrangement. However, where agreement cannot be reached: **Actives only transferring:** CETVs in accordance with GAD guidance using transferring fund's actual fund returns for roll up to date of payment (rather than the interest applied for standard CETV's). **All members transferring (i.e. all actives, deferred and pensioners):** Receive all assets attributable to the membership within the transferring scheme.	The Fund's default policy is to accept a transfer value that is at least equal to the total of the individual CETVs calculated using the Club transfer-out formulae. The Fund will consult with the scheme employer whose funding position will be impacted by the transfer before agreeing to a negotiated bulk transfer arrangement. Pension credits will be awarded to the transferring members on a day-for-day basis.
Out	< 10 members – GAD guidance	CETVs in accordance with GAD guidance.	The transfer value paid to the receiving fund will be calculated in line with the CETV transfer-out formulae.
	10 or more members – Regulation 97 of the Local Government Pension Scheme (Scotland)	Where agreement can be reached, the Fund and the receiving Fund (and their two actuaries) may agree to a negotiated bulk transfer arrangement. However, where agreement cannot be reached:	The Fund's default policy is to offer a transfer value that is equal to the total of the individual CETVs calculated using the Club transfer-out formulae. The Fund will consult with the scheme employer whose funding position will be impacted by the transfer

	Regulations 2018	**Some (but not all) actives transferring (i.e. remaining members left behind):** CETV in accordance with GAD guidance using transferring fund's actual fund returns for roll-up to date of payment (rather than the interest applied for standard CETV's). **All actives transferring (i.e. deferred and pensioner members left behind):** Assets will be retained by the Fund to cover the liabilities of the deferred and pensioner members calculated using the Fund's cessation assumptions. The residual assets will then be transferred to the receiving scheme. **All members transferring (i.e. all actives, deferred and pensioners):** Transfer all assets attributable to the membership to the receiving scheme.	before agreeing to a negotiated bulk transfer arrangement. Discretion exists to amend this to reflect specific circumstances of the situation.

8.4 Club Scheme

Scenario	Bulk transfer mechanism	Policy	Methodology
In	Club Memorandum	The Club mechanism ensures the pension credit in the Fund provides actuarially equivalent benefits.	The pension credit awarded to members transferring in will be calculated in line with the Club transfer-in formulae.
Out	Regulation 93 of the Local Government Pension Scheme (Scotland) Regulations 2018 or Club Memorandum	Where agreement can be reached, the Fund and the receiving scheme (and their two actuaries) may agree to a negotiated bulk transfer arrangement. Or Where agreement cannot be reached, revert to the Club transfer out formulae in accordance with GAD guidance.	The Fund's default policy is to offer the receiving scheme transfers out calculated in line with the Club transfer-out formulae. Discretion exists to amend this to reflect specific circumstances of the situation.

8.5 Broadly Comparable Scheme or non-Club scheme

Scenario	Bulk transfer mechanism	Policy	Methodology
In	GAD guidance	Non-Club transfer in formulae in accordance with GAD guidance	The pension credit awarded to members transferring in will be calculated in line with the non-Club transfer in formulae.
Out	1 member only – GAD guidance	CETV in accordance with GAD guidance	The transfer value paid to the receiving scheme will be calculated in line with the CETV transfer-out formulae.
	2 or more members – Regulation 93 of the Local Government Pension Scheme (Scotland) Regulations 2018	Where agreement can be reached, the fund and the receiving scheme (and their two actuaries) may agree to a negotiated bulk transfer arrangement. Or Where agreement cannot be reached, revert to cash equivalent transfer values under GAD guidance	The fund's default policy is to offer the receiving scheme transfers out calculated in line with the CETV transfer-out formulae. Discretion exists to amend this to reflect specific circumstances of the situation.

F6 Practicalities and process

F6.1 Format of transfer payment

Ordinarily payment will be in cash.

A deduction from the bulk transfer will be made for any administration, legal and transaction costs incurred by the Fund as a result of having to disinvest any assets to meet the form of payment that suits the receiving scheme.

F6.2 Impact on transferring employer

Any transfer out or in of pension rights may have an effect on the valuation position of the employer and consequently their individual contribution rate.

The Fund will agree with the transferring employer how this change is dealt with. Though it is likely this will be through adjustments to its employer contribution rate, the Fund may require a lump sum payment or instalments of lump sums to cover any relative deterioration in past service funding position, for example where the deterioration in position is a large proportion of its total notional assets and liabilities. Where the transfer is small relative to the employer's share of the Fund, any adjustment may be deferred to the next valuation.

F6.3 Consent

Where required within the Regulations, for any bulk transfer the Administering Authority will ensure the necessary consent is obtained from each individual eligible to be part of the transfer.

F6.4 Approval process

The Fund will normally agree to bulk transfers into or out of the Fund where this policy is adhered to.

F6.5 Non-negotiable

It should be noted that, as far as possible, the Fund's preferred terms on bulk transfers are non-negotiable. Any differences between the value the Fund is prepared to pay (or receive) and that which the other scheme involved is prepared to accept (or pay) should be dealt with by the employers concerned outside the Fund.

F6.6 Costs

Actuarial and other professional costs will be recharged in full to the employer.

F7 Related Policies

The Fund's general approach to bulk transfers is set out in the Funding Strategy Statement, specifically "Section 6 –What happens if an employer has a bulk transfer of staff?"

Appendix G – Policy on cessations

Effective date of policy	1 April 2024
Date approved	
Next review	

Introduction

The purpose of this policy is to set out the Administering Authority's approach to dealing with circumstances where a scheme employer leaves the Fund and becomes an exiting employer (a cessation event).

It should be noted that this policy is not exhaustive. Each cessation will be treated on a case-by-case basis, however certain principles will apply as governed by the regulatory framework and the Fund's discretionary policies (see below).

G1 Aims and Objectives

The Administering Authority's aims and objectives related to this policy are as follows:

- To confirm the approach for the treatment and valuation of liabilities for employers leaving the Fund.
- To provide information about how the Fund may apply its discretionary powers when managing employer cessations.
- To outline the responsibilities of (and flexibilities for) exiting employers, the Administering Authority, the actuary and, where relevant, the original ceding scheme employer (usually a letting authority).

G2 Background

As described in the section 7 of the Funding Strategy Statement, a scheme employer may become an exiting employer when a cessation event is triggered e.g. when the last active member stops participating in the Fund. On cessation from the Fund, the Administering Authority will instruct the Fund actuary to carry out a valuation of assets and liabilities for the exiting employer to determine whether a deficit or surplus exists. The Fund has full discretion over the repayment terms of any deficit, however is liable for any surplus through the payment of an exit credit.

G3 Guidance and regulatory framework

The Local Government Pension Scheme (Scotland) Regulations 2018 contain relevant provisions regarding employers leaving the Fund (Regulation 61) and include the following:

- Regulation 61 (2) – this regulation states that, where an employing authority ceases to be a scheme employer, the Administering Authority is required to obtain an actuarial valuation of the liabilities of current and former employees as at the termination date.

Further, it requires the Rates & Adjustments Certificate to be amended to show the revised contributions due from, or the exit credit payable to, the exiting employer.

- Regulation 61 (3) – the Administering Authority, at its discretion, may issue a suspension notice to suspend payment of an exit amount for up to three years, where it reasonably believes the exiting employer is to have one or more active members contributing to the Fund within the period specified in the suspension notice.
- Regulation 61 (4B-4G) – the Administering Authority may enter into a written deferred debt agreement, allowing the employer to have deferred employer status and to delay crystallisation of a cessation debt despite having no active members.
- Regulation 61 (5) – in instances where it is not possible to obtain additional contributions from the employer leaving the Fund or from the bond/indemnity or guarantor, the contribution rate(s) for the appropriate scheme employer or remaining Fund employers may be amended.
- Regulation 61 (6) – where it is believed a scheme employer may cease at some point in the future, the Administering Authority may obtain a certificate from the Fund actuary revising the contributions for that employer, with a view to ensuring that the assets are expected to be broadly equivalent to the exit payment that will be due.
- Regulation 61 (7) – following the payment of an exit payment to/from the Fund, no further payments are due to the Fund from the exiting employer.
- Regulation 61B (1) – the Administering Authority may set out a policy on spreading exit payments.

In addition to the 2018 Regulations summarised above, Regulation 25A of the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 ("the Transitional Regulations") give the Fund the ability to levy a cessation debt on employers who have ceased participation in the Fund (under the previous regulations) but for whom a cessation valuation was not carried out at the time. This policy document describes how the Fund expects to deal with any such cases.

These regulations relate to all employers in the Fund.

G4 Statement of Principles

This Statement of Principles covers the Fund's approach to exiting employers. Each case will be treated on its own merits but in general:

- It is the Fund's policy that the determination of any surplus or deficit on exit should aim to minimise, as far as is practicable, the risk that the remaining, unconnected employers in the Fund have to make contributions in future towards meeting the past service liabilities of current and former employees of employers leaving the Fund.
- The Fund's preferred approach is to request the full payment of any exit debt (an exit payment), which is calculated by the actuary on the appropriate basis (as per the FSS

and section 3.1 below). This would extinguish any liability to the Fund by the exiting employer.

- The Fund's key objective is to protect the interests of the Fund, which is aligned to protecting the interests of the remaining employers who are ultimately responsible for meeting any additional costs arising in respect of the pension obligations of ceased employers. A secondary objective is to consider the circumstances of the exiting employer in determining arrangements for the recovery of any cessation debt.

G5 Policies

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus.

Where there is a deficit, payment of this amount in full would normally be sought from the exiting employer. The Fund's normal policy is that this cessation debt is paid in full in a single lump sum within 28 days of the employer being notified.

However, the Fund will consider written requests from employers to spread the payment over an agreed period, in the exceptional circumstance where payment of the debt in a single immediate lump sum could be shown by the employer to be materially detrimental to the employer's financial situation (see 3.2 Repayment flexibility on exit payments below).

In circumstances where there is a surplus, the Administering Authority will determine the amount of exit credit to be paid to the exiting employer in line with the Regulations.

If there is any doubt about the applicable LGPS benefit structure at the date of exit, the Fund's actuary may include an estimate of the possible impact of any resulting benefit changes when calculating an employer's pension liabilities to determine the level of any exit payment or credit.

G5.1 Approach to cessation calculations

Cessation valuations are carried out on a case-by-case basis at the sole discretion of the Fund depending on the exiting employer's circumstances. However, in general the following broad principles and assumptions may apply, as summarised below:

Local Authorities, Police, Fire	Risk-based cessation approach[1]	Shared between other Fund employers
Colleges	Risk-based cessation approach[1]	Shared between other Fund employers
Admission bodies ("TABs" – typically contractors)	Ongoing basis[2]	Letting authority (where applicable), otherwise shared between other Fund employers
Admission bodies ("CABs" – typically any ABs other than contractors)	Risk-based cessation approach	Shared between other Fund employers (if no guarantor exists)

[1]Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (e.g. machinery of Government changes), these cessation principles would apply.

[2]Where a TAB has taken, in the view of the Administering Authority, action that has been deliberately designed to bring about a cessation event (e.g. stopping future accrual of LGPS benefits), then the cessation valuation will be carried out on the risk-based cessation approach.

Risk-based cessation approach

The Fund uses a risk-based approach to set employer funding strategies, including within cessation calculations. In particular, the likelihood of the Fund's assets achieving particular future investment returns is analysed.

Where appropriate, the Fund will use this approach to set an upper and lower amount (or "corridor") in order to consider the amount of assets a ceasing employer must leave behind to pay for its members' benefits.

Under this approach, an employer is deemed to have a deficit if its assets are below the lower amount and a surplus if its assets are above the higher amount (ie there will be no deficit or surplus if a ceasing employer's assets fall within the "corridor").

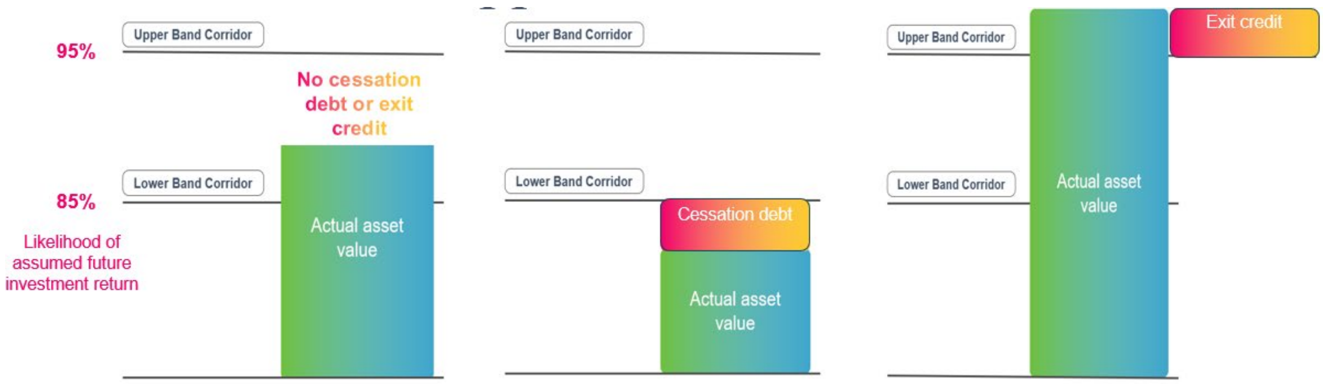
The upper bound of the corridor is defined as the assets required to meet liabilities, where the liabilities have been calculated using an investment return assumption that is expected to be achieved in 95% of outcomes over the next 20 years (based on the Fund's investment strategy at the calculation date).

The lower bound of the corridor is defined as the assets required to meet liabilities, where the liabilities have been calculated using an investment return assumption that is expected to be achieved in 85% of outcomes over the next 20 years (based on the Fund's investment strategy at the calculation date).

When calculating the liabilities, all other financial and demographic assumptions are as set out in the Funding Strategy Statement with the exception of future longevity improvements, where a long-term improvement of 1.75% pa is assumed.

The Administering Authority reserve the right to adopt alternative assumptions if felt necessary to protect the interests of the Fund.

The picture below illustrates how the corridor operates in practice.



The Fund reserves the right to review the definition of the corridor as part of any review of this policy.

G5.2 Repayment flexibility on exit payments

Deferred spreading arrangement (DSA)

The Fund will consider written requests from exiting employers to spread an exit payment over an agreed period, in the exceptional circumstance where payment of the debt in a single immediate lump sum could be shown by the employer to be materially detrimental to the employer's financial situation.

In this exceptional case, the Fund's policy is:

- The agreed spread period is no more than three years, but the Fund could use its discretion to extend this period in extreme circumstances.
- The Fund may consider factors such as the size of the exit payment and the financial covenant of the exiting employer in determining an appropriate spreading period.
- The exiting employer may be asked to provide the Administering Authority with relevant financial information such as a copy of its latest accounts, sources of funding, budget forecasts, credit rating (if any) etc. to help in this determination.
- Payments due under the DSA may be subject to an interest charge.
- The Fund will only consider written requests within three months of the employer exiting the Fund. The exiting employer would be required to provide the Fund with detailed financial information to support its request.
- The Fund would take into account the amount of any security offered and seek actuarial, covenant and legal advice in all cases.
- The Fund reserves the right to require that the exiting employer provides some form of security (such as a charge over assets, bond indemnity or guarantee) relating to the unpaid amount of debt at any given time.
- The Fund proposes a legal document, setting out the terms of the exit payment agreement, to be prepared by the Fund and signed by all relevant parties prior to the payment agreement commencing.
- The terms of the legal document should include reference to the spreading period, the annual payments due, interest rates applicable, other costs payable and the responsibilities of the exiting employer during the exit spreading period.
- Any breach of the agreed payment plan would require payment of the outstanding cessation amount immediately.
- Where appropriate, cases may be referred to the Pensions Committee for consideration and considered on its individual merit. Decisions may be made by Fund Officers, in consultation with the Chair, if an urgent decision is required between Committee meetings.

- All costs of the arrangement are to be met by the employer, such as the cost of advice to the Fund, ongoing monitoring or the arrangement and correspondence on any ongoing contribution and security requirements.

Deferred debt agreement (DDA)
When an exiting employer is unable to pay the required cessation payment as a single lump-sum, the Fund's preferred policy is to spread the payment via a deferred spreading arrangement (DSA). However, in the event that spreading of payments will create a high risk of bankruptcy for the exiting employer, the Fund may exercise its discretion to set up a deferred debt agreement as described in Regulation 61 (4B)).

Where a DDA is in place, the employer must continue to meet all regulatory and Fund-specific requirements on Scheme employers and pay the secondary rate of contributions as determined by the Fund actuary until the termination of the DDA.

The Administering Authority may consider a DDA in the following circumstances:

- The employer requests the Fund consider a DDA.
- The employer is expected to have a deficit if a cessation valuation was carried out.
- The employer is expected to be a going concern.
- The covenant of the employer is considered sufficient by the Administering Authority.

The Administering Authority will normally require:

- A legal document to be prepared, setting out the terms of the DDA and signed by all relevant parties prior to the arrangement commencing.(including details of the time period of the DDA, the annual payments due, the frequency of review and the responsibilities of the employer during the period).
- Relevant financial information for the employer such as a copy of its latest accounts, sources of funding, budget forecasts, credit rating (if any) to support its covenant assessment.
- Security be put in place covering the employer's deficit on their cessation basis and the Fund will seek actuarial, covenant and legal advice in all cases.
- Regular monitoring of the contribution requirements and security requirements
- All costs of the arrangement are met by the employer, such as the cost of advice to the Fund, ongoing monitoring of the arrangement and correspondence on any ongoing contribution and security requirements.

A DDA will normally terminate on the first date on which one of the following events occurs:

- The employer enrols new active Fund members.
- The period specified, or as varied, under the DDA elapses.

- The take-over, amalgamation, insolvency, winding up or liquidation of the employer.
- The Administering Authority serves a notice on the employer that the Administering Authority is reasonably satisfied that the employer’s ability to meet the contributions payable under the DDA has weakened materially or is likely to weaken materially in the next 12 months.
- The Fund actuary assesses that the employer has paid sufficient secondary contributions to cover all (or almost all) of the exit payment due if the employer becomes an exiting employer on the calculation date (i.e. employer is now largely fully funded on their exit basis).
- The Fund actuary assesses that the employer’s value of liabilities has fallen below an agreed *de minimis* level and the employer becomes an exiting employer on the calculation date.
- The employer requests early termination of the agreement and settles the exit payment in full as calculated by the Fund actuary on the calculation date (i.e. the employer pays their outstanding cessation debt on their cessation basis).

On the termination of a DDA, the employer will become an exiting employer and a cessation valuation will be completed in line with this policy.

G6 Practicalities and process

G6.1 Responsibilities of ceasing employers

An employer which is aware that its participation in the Fund is likely to come to an end must:

- advise the Fund, in writing, of the likely ending of its participation (either within the terms of the admission agreement in respect of an admission body (typically a 3 month notice period is required) or otherwise as required by the Regulations for all other scheme employers). It should be noted that this includes closed employers where the last employee member is leaving (whether due to retirement, death or otherwise leaving employment).
- provide any relevant information on the reason for leaving the Fund and, where appropriate, contact information in the case of a take-over, merger or insolvency.
- provide all other information and data requirements as requested by the Administering Authority which are relevant, including in particular any changes to the membership which could affect the liabilities (e.g. salary increases and early retirements) and an indication of what will happen to current employee members on cessation (e.g. will they transfer to another Fund employer, will they cease to accrue benefits within the Fund, etc.).
- meet the cost of all fees and charges incurred by the Fund in the course of cessation including, but not limited to, the cost to obtain the cessation valuation report from the Fund Actuary and the cost of implementing a flexible repayment option (as set out in section 3.2).

G6.2 Responsibilities of Administering Authority

The Administering Authority will:

- gather information as required, including, but not limited to, the following:
    - details of the cessation - the reason the employer is leaving the Fund (i.e. end of contract, insolvency, merger, machinery of government changes, etc.) and any supporting documentation that may have an effect on the cessation.
    - complete membership data for the outgoing employer and identify changes since the previous formal valuation.
    - the likely outcome for any remaining employee members (e.g. will they be transferred to a new employer, or will they cease to accrue liabilities in the Fund).
- identify the party that will be responsible for the employer’s deficit on cessation (i.e. the employer itself, an insurance company, a receiver, another Fund employer, guarantor, etc.).
- commission the Fund actuary to carry out a cessation valuation under the appropriate regulation.

- where applicable, discuss with the employer the possibility of paying adjusted contribution rates that target a 100% funding level by the date of cessation through increased contributions in the case of a deficit on the cessation basis or reduced contributions in respect of a surplus.
- where applicable, liaise with the original ceding employer or guarantor and ensure it is aware of its responsibilities, in particular for any residual liabilities or risk associated with the outgoing employer's membership.
- having taken actuarial advice, notify the employer and other relevant parties in writing of the payment required in respect of any deficit on cessation and pursue payment.

G6.3 Responsibilities of the actuary

Following commission of a cessation valuation by the Administering Authority, the Fund actuary will:

- calculate the surplus or deficit attributable to the outgoing employer on an appropriate basis, taking into account the principles set out in this policy.
- provide actuarial advice to the Administering Authority on how any cessation deficit should be recovered, giving consideration to the circumstances of the employer and any information collected to date in respect to the cessation.
- where appropriate, advise on the implications of the employer leaving on the remaining Fund employers, including any residual effects to be considered as part of triennial valuations.

G7 Related Policies

The Fund's approach to exiting employers is set out in the FSS, specifically "Section 7 – What happens when an employer leaves the Fund?".

The approach taken to set the actuarial assumptions for cessation valuations is set out in Appendix D of the FSS.