Agenda Item	**7**
Report No	**PC/13/24**

HIGHLAND COUNCIL

Committee: **Pensions Committee**

Date: **9 October 2024**

Report Title: **Pension Fund Contributions and Administration**

Report By: **Chief Officer, Corporate Finance**

1 Purpose/Executive Summary

1.1 The purpose of this periodic report is to update members on matters relating to the administration of the Highland Council Pension Fund ("the Fund").

2 Recommendations

2.1 Members are asked to consider this report and note the following:

i. progress in implementing the staffing structure from the Service Plan (section 6).
ii. the use of the revised index factors for calculating strain on fund (section 7 and Appendix 1).
iii. update on the Member Self Service (Engage) and Altair Pensioner Payroll projects (section 8)
iv. action being taken by officers to review the Fund's compliance with the Pension Regular General Code of Practice (section 9)

3 Implications

3.1 There are resource implications as processes should be in place to ensure that there are adequate resources in place to support the Pensions Administration work.

3.2 In terms of legal implications, the governance of the Fund must comply with all Local Government Pension Scheme (LGPS) legislation and regulations and TPR requirements, or the Fund could be non-compliant and in breach of Regulator requirements.

3.3 The risk management framework is an integral part of governance and risks are considered as part of all the areas covered in this report. There is a Pension Fund risk register which is regularly updated (update is provided at Agenda item 9, risk management update) and project risk registers are in place for the Engage and Altair projects (section 8).

3.4 There are no Health and Safety (risks arising from changes to plant, equipment, or people) or Gaelic implications arising as a direct result of this report.

4. Impacts

4.1 In Highland, all policies, strategies or service changes are subject to an integrated screening for impact for Equalities, Poverty and Human Rights, Children's Rights and Wellbeing, Climate Change, Islands and Mainland Rural Communities, and Data Protection. Where identified as required, a full impact assessment will be undertaken.

4.2 Considering impacts is a core part of the decision-making process and needs to inform the decision-making process. When taking any decision, Members must give due regard to the findings of any assessment.

4.3 This is a monitoring and update report and therefore an impact assessment is not required.

5. Introduction

5.1 The Highland Council is the Administering Authority for the Highland Council Pension Fund. In addition to the Highland Council, 24 employers participate as admitted or scheduled Bodies in the Fund.

5.2 Participating employers are required to calculate and deduct the appropriate rate of pension contributions from salaries in addition to an employer's contribution in accordance with guidance issued by the Highland Council Pension Section. These contributions are remitted monthly to the Highland Council Pension Fund. The statutory deadline for payment to be made is the 22nd of each month.

5.3 This report also provides an update on the Service Plan 2024/25 agreed in February 2024 and budget monitoring for the Fund to 31 August 2024.

6. Update on Service Plan

6.1 There has been substantial progress in implementing the revised staffing structure reported to Pensions Committee in February 2024, whereby there would be dedicated finance resource and additional resource for the Pensions Administration for the Highland Council Pension Fund.

6.2 The majority of vacancies have been filled with appointments made to the post of Pension Manager and Pension Fund Accountant in May 2024. In the Pensions Administration team, there were successful recruitment exercises completed in May and July 2024, following which the Systems team is fully staffed with appointments made to the majority of posts in the Benefits team and the Transfers and Aggregations team. It is estimated that it will take approximately 6-12 months for staff to be trained and achieve full competency. In view of the volumes of backlogs the use of overtime will be used to manage workload as required.

6.3 In terms of other Service Plan key deliverables, the statutory deadlines for the Annual report and accounts (30 June 2024) and the Annual benefit statements (31 August 2024) were achieved.

7. Early Retirement Reduction factors

7.1 As part of the triennial valuation, Hymans complete a review of factors at each valuation for consistency with the assumptions set out in the Funding Strategy Statement which is done in accordance with technical actuarial standards. These factors will be used to calculate the additional cost for allowing members to retire before their normal pension age (NPA) and where their benefits are paid unreduced, which will be recharged to the employers (e.g. redundancy exercise calculations).

7.2 The main difference in the 2023 Valuation compared to the 2020 Valuation is that the factors have increased (due to using same assumptions as used for triennial actuarial valuation) so early retirements will be more expensive for employers.

7.3 The new early retirement reduction factors are to be applied from 1 January 2025.

7.4 The Actuarial report is at **Appendix 1** for consideration by members.

8. Member Self Service (Engage) and Pensioner Payroll

8.1 The Member Self Service (Engage) and Pensioner Payroll are part of the integrated Altair Pensioner Benefits Administration system. The Altair Pensions Administration Benefits system provided by Heywood Limited has been used by Highland Council Pension Fund since July 2019.

8.2 The Pensions Committee approved the Service Plan in February 2024 which included costs for both the implementation of Engage and the Pensioner Payroll modules in financial years 2023/24 and 2024/25 respectively. In May 2023, the People and Finance Systems Programme Board approved the project, and the Procurement

Approval Group approved the contract variation with Heywood Limited.

8.3 As background to this change, some of the reasons for implementing Engage and the payroll module are below.

- the Pensions Industry is moving towards a self-service model, whereby individuals can readily access information on their pensions online, securely and all in one place and the implementation of Engage would be a step towards this objective.
- members in the Highland Council Pension Fund have increased from 31,609 in 2018/19 to 35,551 in 2022/23 (12%) which has increased service demand.
- significant increases in volumes of new entrants, early leavers and retirements to process as well as increased volume of pension benefits estimates has meant reduced performance against key performance indicators and requires process efficiencies to be implemented.
- increasing and complex demands on the pensions administration service include the implementation of McCloud/Goodwin resolution (age discrimination challenge to the transitional protections put in place when the LGPS benefit structure was reformed in 2015) which require process efficiencies to be implemented.
- The process of setting up pensioners on 2 separate systems and reconciling Zellis Resourcelink to Altair is inefficient with the increased risk of inaccuracies and incomplete data and requires considerable resource, which could otherwise be focussed on delivering a higher quality service.

8.4 The benefits of using the fully integrated Altair Engage and pensioner payroll modules is that the modules interface with the Altair system, reducing the need for manual integration and the risks associated with cross-system reconciliation. Some key advantages are summarised below:

- Full integration - enhances efficiency, improves security and reduces costs.
- Single database - this reduces the risk of data discrepancy and processing errors and removes the need for reconciliation between different systems.
- Real-Time Information - payroll calculation results are automatically passed onto an RTI messaging maintenance facility for payroll reporting.
- Flexible processing - a range of payment methods can be efficiently employed, as demonstrated by the supplementary Altair Immediate Payments solution.
- Full audit trail - audit referencing is created upon processing, which augments accountability, supports data validation, and complies with external auditing requirements.
- Interaction – the payroll module connects to Engage, meaning enrolled payees can easily view and print payroll documentation, such as Pay Advice and P60s.

8.5 The key outcomes of the Engage and pensioner payroll projects are:

- Highland Council Pension Fund members will have secure access to comprehensive and accurate information on their payroll and benefits in real time which will enable pensioners and active members to:
  - check and print payroll documentation such as Pay Advice and P60s.
  - generate benefit estimate statements and “what if” modelling and update details.

    - update personal/contact details and nomination of beneficiaries plus bank details for pensioners.
    - new pensioners will no longer need a separate My View account to view payslips and P60s (although My View will be maintained to allow existing pensioners to view historic advice slips).
- Highland Council Pension Fund pensioner payroll and benefits payment are processed and paid securely, accurately and efficiently using a single integrated Pensions Administration system.

8.6 In August 2024, there was a significant deliverable achieved on the Engage project as member annual benefit statements were delivered using the My Pensions website with active members able to access a video explaining their statement.
https://highlandcouncil1.sharepoint.com/sites/staffconnections/SitePages/My-Pension---self-service-portal-has-arrived.aspx

8.7 In terms of progress on the Pensioners' payroll implementation, user acceptance testing was signed off 5 September. The project team are now working on the first parallel run (August), with the second parallel run scheduled to start week commencing 30 September.

8.8 There has been a delay in the Pensioner payroll project timescales due to an incomplete data extract being uploaded during conversion to the parallel run. However, the project team have worked exceptionally hard to get the project back on track and resolve this issue with support from Heywood. The plan continues to be for the Pensioners' Payroll go live in November with a "go-no-go" decision meeting scheduled for 15 October.

9. The Pensions Regulator – General Code of Practice

9.1 TPR's new General Code of Practice (GCoP), was laid in parliament on 10 January 2024 and became effective from 28 March 2024. The new code collates and updates 10 existing codes of practice into one set of clear, consistent expectations on scheme governance and administration. GCoP applies to all pension schemes, public and private.
https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice

9.2 The review of the Fund's compliance with GCoP was included in the Service Plan presented to Pensions Committee in February 2024, with a target date of September 2024.

9.3 The Fund's Actuary, Hymans launched a TPR GCoP compliance checker for LGPS funds. The Fund considered different options to assess compliance with GCoP and the Hyman's compliance checker was the most cost-effective solution. Officers are currently using this tool to complete an initial assessment of compliance with GCoP.

9.4 The compliance checker is a self-assessment tool, which has the following functionality, and officers have been using this tool to assess compliance with GCoP:

- all applicable LGPS areas of the new General Code have been included for self-assessment and ready for Fund Officers to review.
- compliance report available at the touch of a button.
- the ability to track and monitor progress over time.
- fully editable document and can be used by any governance team and can be updated for any future changes to the General Code.

9.5 There will be a report taken to the next Pensions Committee providing a full assessment of compliance with GCoP with an action plan to address areas of non-compliance.

10. Government Pension Review

10.1 The new UK Government announced their Pensions Review on 20 July and launched a call for evidence to all interested parties, with a deadline of 25 September. As this consultation was issued by the UK Government and not Scottish specific, we did not submitted comments but are aware that our advisors provided a response given their remit across UK LGPS funds.

https://www.gov.uk/government/calls-for-evidence/pensions-investment-review-call-for-evidence

10.2 Regarding any proposed changes, the Scottish Government would decide on whether similar legislation or regulation is to be proposed for the Scottish LGPS. There is the example of setting up pooled funds for investments in England and Wales which has not been replicated in Scotland.

10.3 Officers will continue to keep members updated on the progress of government reviews and ongoing developments.

11. Scheme Employers Pension Contributions

11.1 Pension contributions received from employers are checked for accuracy against known parameters and the dates received are recorded and monitored.

11.2 Contact is made with an employer in instances where payments are received late or not to the expected value.

11.3 Contributions from scheme employers are all being received on time and all contributions are up to date.

12. Employers Leaving the Fund

12.1 No employers have left the Fund since the last report.

12.2 In February 2024, one of the employers went into liquidation (Sight Action) and officers will be working with the Fund Actuary to calculate a cessation value.

12.3 There is work ongoing to transfer the Scottish Fire and Rescue Service (administration staff) to the Strathclyde Pension Fund with a view to completing the transfer in early 2025 (81 Pensioners, 69 active employees and 66 deferred member). Scottish Ministers will provide a Direction Order under Schedule 4, Part 1 of the Regulations in respect of the transfer.

12.4 The Fund continues to work with WIPRO to manage the cessation of the admission agreement as part of the transfer of service back to the Council. One pension scheme member remains an employee of WIPRO until the end of the contract and then will revert to Highland Council.

13. Employers joining the Fund

13.1 No employers have joined the Fund.

14. Pension Fund Costs

14.1 The Pension Fund Annual report for 2023/24 included a report on financial performance against budget. This is to comply with the CIPFA guidance, “Preparing the annual report guidance for Local Government Pension Scheme Funds” (April 2019).

14.2 The external audit of the Highland Council Pension Fund Annual report and accounts 2023/24 has been delayed. Accounts were presented to The Highland Council on 27 June and a link to the draft unaudited Highland Council Pension Fund Annual report and accounts 2023/24.
https://www.highland.gov.uk/downloads/file/28732/unaudited_accounts_april_2023_to_march_2024

14.3 The plan is for the Highland Council Pension Fund Annual report and accounts 2023/24 to be approved by Pensions Committee in late 2024, subject to completion of the audit. A special meeting of the Pensions Committee will need to be arranged for approval of the annual accounts.

14.4 The budget monitoring reporting sets out actuals to 31 August 2024 and currently forecast year end expenditure is expected to be in line with budget. It should be noted that fund manager fees are based on market values and the performance of investments which can be volatile.

14.5 Altair project costs are being reported to and monitored by the Human Resource, Payroll and Pensions Project Board

	Actual year to date 24/25 £000	Annual Budget 24/25 £000	Year-end estimate 24/25 £000	Year-end variance 24/25 £000
Administrative expenses				
Medical exams (staff)	2	5	5	0
Conference & seminar (includes subsistence)	0	1	1	0
Subscriptions to organisations	5	5	5	0
Bank charges	0	2	2	0
Other charges (pension levy, tax certification costs)	0	3	3	0
Pensions administration staff	368	1,036	1,036	0
Central support charge (internal ICT support, property costs, payroll, business support)	0	156	156	0
Computer and ICT (external providers)	435	600	600	0
Fares, travel, accommodation	0	1	1	0
Printing and stationery	0	1	2	0
Postages	0	4	4	0
Other pensions admin costs	4	8	8	0
Total	**814**	**1,822**	**1,822**	0
Oversight and governance				
Actuarial Fees	50	100	100	0
Audit Fees	0	36	36	0
Pension Investments and Accounting staff	28	262	262	0
Central support charge (internal ICT support, internal audit, payroll, business support)	0	21	21	0
Training	0	5	5	0
Subsistence and travel	0	1	1	0
Investment Consultant Fees	39	100	100	0
Performance Management Fees	3	50	50	0
Tax and Legal Expenses	0	10	10	0
Total	**120**	**585**	**585**	**0**
Management fees				
Investment expenses	0	350	350	0
Custodian Fees	16	100	100	0
Transaction costs	0	350	350	0
Fund Manager fees				
Unitised insurance policies	3	450	450	0
Equities	709	4,500	4,500	0
Bonds	0	520	520	0
Property	120	500	500	0
Private equity	0	4,000	4,000	0
Property debt	0	318	318	0
Total	**848**	**11,088**	**11,088**	**0**
Overall total	**1,782**	**13,495**	**13,495**	**0**

15. Guaranteed Minimum Pension Comparison Exercise

15.1 Pension schemes, including those in the public sector, are required to undertake a data reconciliation exercise with HMRC. This will ensure that both details of Guaranteed Minimum Pensions (GMP) and periods of contracted out service, which are used to determine entitlement to the new single state pension, are up to date and robust.

15.2 The reconciliation exercise for the Highland Council Pension Fund is complete and final reviews are being undertaken of 118 cases. The remedy is that any negatively affected pensioners have received arrears payments with interest; and any incomplete GMP details for active and deferred members will be uploaded, in the near future. This work will be progressed as soon as possible.

16. Additional Voluntary Contribution (AVC's)

16.1 Prudential has been the appointed Additional Voluntary Contribution (AVC) provider to the Highland Council Pension Fund since 1989.

16.2 To maximise the range of benefits offered to employees, Highland Council has entered into an agreement with AVC wise (a company specialised in this discipline) to provide a Shared Cost AVC scheme to qualifying scheme members.

17. The Pensions Regulator – Equality, diversity and inclusion survey

17.1 During the summer of 2023, TPR issued a survey to Pension Board and Committee members across all UK occupational pension funds on equality diversity and inclusion (EDI) which was circulated to Pension Board and Pension Committee members. https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/2023-press-releases/first-trustee-diversity-and-inclusion-survey-launched-by-tpr

17.2 The results of the survey were published by TPR in March 2024 https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/trustee-diversity-and-inclusion-survey-2023.ashx

17.3 The results of the survey are summarised in the following article by TPR. https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/2024-press-releases/pension-boards-lack-diversity-but-not-the-desire-to-improve

Designation: Chief Officer, Corporate Finance

Date: 26 September 2024

Author: Catriona Stachan, Pension Fund Manager

Background Papers: LGPS regulations, TPR, GCoP

APPENDIX 1

The Highland Council Pension Fund

Early Retirement Strain Cost Factors

March 2024

[redacted] [redacted]

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For and on behalf of Hymans Robertson LLP

Contents

Executive Summary

This paper has been requested by, and is addressed to, The Highland Council in its capacity as Administering Authority of The Highland Council Pension Fund ("the Fund"). The purpose of the paper is to advise replacement early retirement strain cost factors for use by the Fund.

The Fund needs strain cost factors to determine the added cash which an employer must pay whenever a member takes early retirement on unreduced benefits. These benefits cost the Fund more than it had been expecting, so the employer must pay the additional cost.

We recommend that the current Fund factors are replaced by those shown in Appendix 1 and the associated spreadsheet. The Fund should consider the exact method and timing of implementing the new factors, as outlined under "Implementation" below.

The new Fund factors have been compared to those we believe are in place currently: this shows that the current factors understate the strain cost in most circumstances, and therefore **adopting the new factors will generally give rise to higher strain costs required from employers**.

This advice should be reviewed at the next formal actuarial valuation, or if the funding basis is materially altered, whichever occurs first.

Background

At the triennial valuation, the actuary calculates the estimated cost of providing benefits to members, over and above the member contributions and expected investment returns. This estimated cost is then charged to employers as their required regular contributions. In valuing the benefits, the actuary generally assumes that active members will start taking benefits around the earliest date they are able to do so in full, the “Normal Pension Age” or NPA.

LGPS Regulations determine the NPA for different tranches of benefit for a given member and the employer contributions are based on that data. If a member was to take early retirement on unreduced benefits before NPA then an added cost (also referred to as the “early retirement strain cost”) arises for the Fund. This is due to:

- The longer expected payment period: the member’s expected age at death is unchanged, but the start date of payments is earlier;
- The missing investment returns which the Fund would have expected on those assets if they hadn’t been needed for early retirement benefit payments but had remained invested until NPA instead (NB this is partly offset by the expected future salary and CPI growth which would have increased the benefits).

There are a number of approaches to calculating this added cost:

A. The true cost of any given early retirement can only be known at the death of the member. At that point the Fund could exactly determine the benefit payments actually made and their excess over those which would have been made from NPA, together with investment returns.

Other approaches can therefore only be estimates of the true cost:

B. The accounting cost as estimated at the next accounting disclosure (under FRS102 or IAS19), which will use different assumptions from those used for funding.

C. The funding cost as estimated at the next funding valuation, which will use different assumptions from those used for accounting.

D. The immediate cash cost payable by the employer, calculated using factors, typically derived using a simplified calculation methodology as outlined below. This methodology is adopted to be easily incorporated within the Fund’s administration software. This paper considers these factors, as an approximate estimate of the true cost as per A above, to have the bulk of the anticipated added cost being paid into the Fund in the short term.

It is almost inevitable, given the inherent approximations, that the factors under approach D will give rise to added contributions which prove, at the next valuation, to be lower or higher than the calculated costs at that time. The difference will therefore affect the employer’s deficit position at the next valuation date, so that the required balancing contributions are collected in the longer term. However, the use of these factors is a pragmatic approach to ensure that a significant part of the cost is collected from the member’s employer at the time of early retirement.

Given the different actuarial assumptions which apply for accounting purposes, it is also inevitable that the cost under approach D will differ markedly from the past service cost likely to be disclosed under FRS102/IAS19.

The factors methodology (Approach D)

The Fund needs some ready way to calculate the added cost arising from each early retirement, so that the employer concerned can be billed appropriately at the time of the retirement. In practice this is calculated by the pension's administrator using Early Retirement Strain Cost Factors. These factors are determined by each fund and are not mandated by the Regulations or the Government Actuary's Department.

The factors we understand are currently used by the Fund are attached as Appendix 1 to this paper and were introduced in 2021.

In essence the strain cost is calculated as:

{Unreduced pension} x {ERR factor} x {Annuity Factor at ERA}

where:

- ERR factor = the Early Retirement Reduction factor which would have applied to the member's pension had the retirement not been with employer consent. (NB These are calculated for funding purposes and will therefore differ from the standard GAD early retirement reduction factors which would be applied if the member's pension was actually being reduced).
- Annuity Factor at ERA = the cost of paying a pension of £1 p.a. (plus future increases in payment) for the remainder of the member's expected lifetime from their Early Retirement Age.

These early retirement strain cost factors are typically derived using the actuarial assumptions adopted at the most recent triennial valuation of the Fund. Once a valuation has been completed, it is therefore common practice to revisit these factors to allow for the updated valuation assumptions.

Assumptions underlying proposed new Factors

Background

From the above, we would therefore propose that the Fund adopts new factors where the underlying assumptions reflect those used at the most recent formal funding valuation as at 31 March 2023. The rationale for these assumptions is that the strain costs are a funding cost for the employer and should therefore use the same assumptions as those underpinning the most recent formal funding valuation.

We understand that the administration software only permits a single table of factors to be used for all Fund members, which in turn implies the use of a single set of assumptions. However, at the 31 March 2023 formal funding valuation we measured funding positions using different assumed investment returns (as at the valuation date) for different types of employer. In the interests of pragmatism, we have proposed an assumed investment return below which relates (at the valuation date) to the reported whole Fund funding position. This is taken to be appropriate for employers of the majority of Fund members, on the long term funding target (as opposed to contractor or cessation funding targets – see next page).

Principal assumptions adopted

We have therefore used the following principal long term average assumptions:

- Assumed investment return = 5.2% p.a.
- Pay growth rate = 3.1% p.a.
- CPI pension increase rate = 2.3% p.a.
- Pre-retirement increase rate = 2.7% p.a. (average of pay growth and pension increase rates – see next page)
- Life expectancy as per whole Fund averages.

The derivation of these assumptions was detailed in the advice provided for the formal valuation as at 31 March 2023, including the formal valuation report.

(The financial assumptions used for the existing factors were 3.2%, 2.5%, 1.7% and 2.5% respectively, i.e. in line with the most recent funding valuation at that time).

Simplifying assumptions adopted

In determining the ERR factors for strain cost purposes, we have had to make the following simplified assumptions:

- Member's NPA = 67 for the age at which members can receive all accrued retirement benefits unreduced. This assumption of a single NPA is because the ERR factor will differ whether (for example) the member is retiring 5 years early at age 55 with an NPA of 60 or retiring at age 62 with an NPA of 67. The administration software does not allow this distinction, it uses the same factor for a given number of years early, regardless of NPA, so we have chosen 67 as a suitable average across LGPS active members: this is in line with the funding assumption adopted at the most recent valuation of the Fund.
- As the administration system only permits one ERR factor regardless of gender, we have taken the average of male and female factors.

Note that another simplification is due to the application of a single revaluation assumption which is equal to the average of the salary increase assumption and the CPI assumption for all pension (rather than allowing for separate revaluation of the pre- and post-2015 element of the member's accrued pension). We have used this simplification because:

- The administration software does not permit different ERR factors to be applied to different tranches of benefit for early retirement strain cost purposes;
- With the passing of time since 2015, the pre-2015 and post-2015 elements of the average accrued pension will likely become more balanced for members retiring in the near future (in recent years we would have expected the majority of a retiring member's pension to be pre-2015);
- The higher strain costs will generally occur where the member has much longer service, in which case the salary-related pre-2015 element will be a larger element of the total anyway and therefore it is important to maintain a link to the salary increase assumption in our calculations;
- We consider this an acceptable approximation in the context of other simplifications applied in this calculation, as identified above;
- The calculated strain cost is only ever an interim payment requested from the employer, so any difference from the cost calculated at the next valuation (as per approach C above) will be picked up in employer contributions at that stage.

The resulting factors are shown in Appendix 1.

Employers with alternative funding targets

The use of the lower assumed investment return in alternative funding targets would, all other things being equal, give rise to lower strain cost calculations. We would therefore expect that strain costs calculated for employers on contractor or cessation funding targets are more likely to be higher than strictly necessary, thus giving rise to funding gains at the next funding valuation. However, we consider this to be acceptable, partly on the grounds of administrative simplicity (we only expect a small minority of early retirements to take place among such employers). Furthermore, as these employers are heading to a cessation event, this would either:

- reduce the amount of cessation debt which the employer has to pay at that time anyway, or
- increase any surplus which may be returned to them under the discretionary decision made by the Fund with regard to an exit credit at that time,

depending on their funding position at cessation.

Impact of proposed assumptions

We have proposed the above assumptions as they are in line with the assumptions underpinning the majority of employer funding strategies as at the last valuation.

If different assumptions were to be adopted for these factors, then there would be a disconnect between the measurement of the required strain payment, and the measurement of the existing funding reserve immediately prior to early retirement.

It is not possible to state whether a more or less prudent set of assumptions for these factors would give rise to higher or lower strain payments, since different assumptions affect different parts of the strain cost calculation in different ways. For instance, a lower real assumed investment return would give a lower ERR factor but a higher Annuity Factor, and the overall impact would vary by age and term to NPA.

However, we can state that:

- Higher calculated strain costs will, all other things being equal, mean a lower likelihood that a further deficit arises at the future valuations, and a higher likelihood that the strain payment will prove to be overly sufficient (and vice versa);
- Changes to market conditions and to future valuation assumptions will mean that the strain cost factors will become more or less likely to meet the true cost and future funding and accounting requirements. For the reasons stated above it is not possible to state simply that a given change will give rise to a greater or smaller likelihood of the strain payment proving to be sufficient.

Comparison between existing and proposed factors

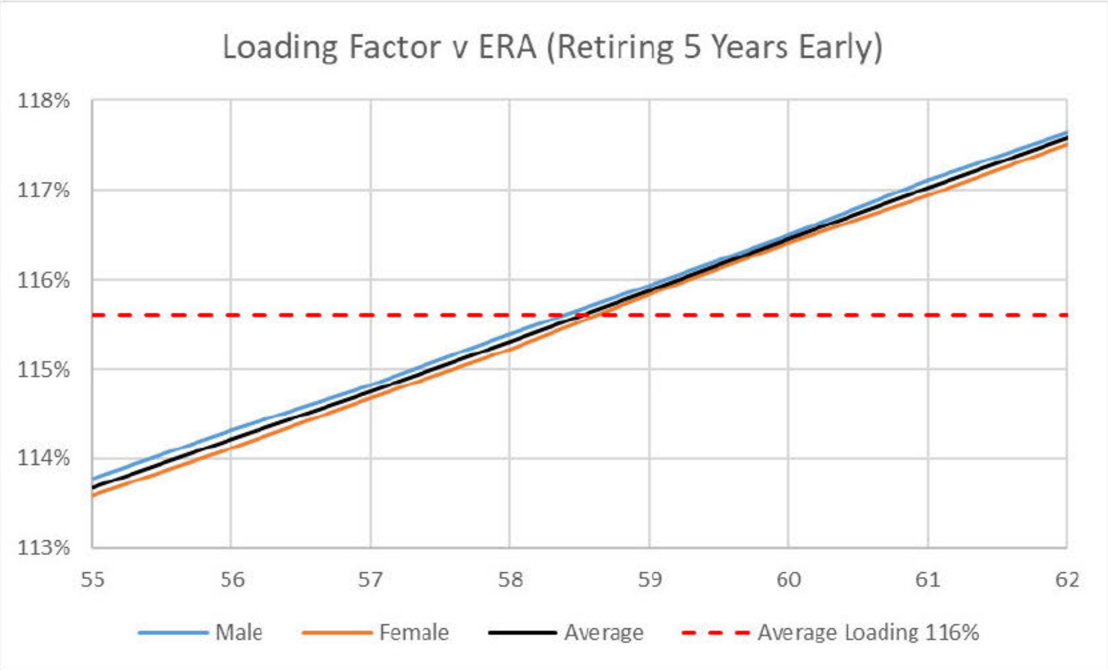
We have calculated the strain cost which would apply for a variety of notional members, of different ages, gender and term to retirement, using the following:

- The assumptions adopted at the formal funding valuation as at 31 March 2020 (i.e. the current factors being used by the Fund, which are shown in Appendix 1).
- The assumptions adopted at the most recent formal funding valuation as at 31 March 2023 (i.e. the proposed new factors, also shown in Appendix 1).

By comparing the resulting strain costs under the two sets of assumptions, this allows us to determine the impact of moving from the current assumptions to the new assumptions being proposed.

The chart below shows our analysis for a particular cohort of hypothetical members – namely those that retire 5 years earlier than their Normal Pension Age. For these members, we have compared the strain costs that arise at each Early Retirement Age (ERA) under the current and new assumptions.

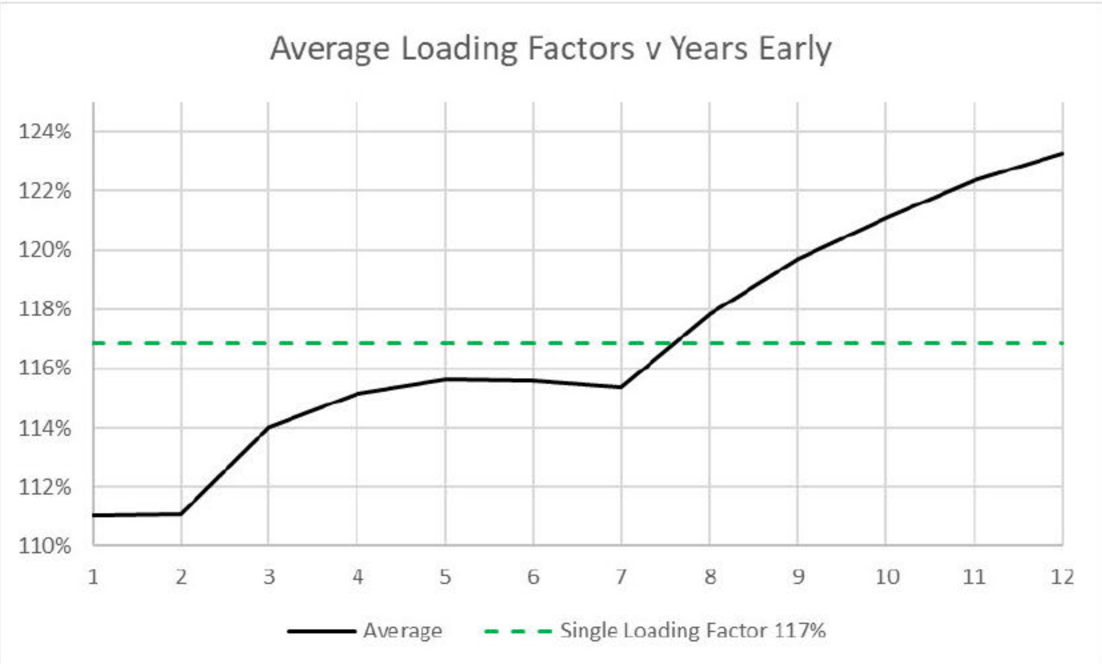
We have analysed this impact for both males and females but also looked at the average impact across these two groups.



The chart above shows that (for example) the strain cost arising for a male retiring 5 years early at age 55 is around 14% greater under the new assumptions than under the current ones. For a corresponding female at age 55, the new strain cost is around 14% higher. The average of the two (shown by the black line) is an increase of around 14% at age 55.

Looking across all ages and genders in the chart above, we have determined that the average impact is around 16%. This is shown by the red dashed line.

We have expanded and repeated this analysis for a wide range of scenarios, where members retire between 1 and 12 years early. The results are presented in the chart below.



The black line in the chart again shows the average impact of moving to the new assumptions for each early retirement scenario. For example, as already established, for members retiring 5 years early the strain costs are around 16% higher under the new assumptions. For those retiring 10 years early, the increase is around 21%.

Looking across the range of scenarios, we have determined that the average impact of adopting the new assumptions is an increase in strain cost of around 17%. This is shown by the green dashed line above.

Implementation

A. **Factors**: The proposed factors are shown in Appendix 1, for the principal ages and numbers of year early which will tend to arise in practice. However, alongside this paper we have provided a spreadsheet which contains these factors in a format easier to upload to your administration system and also applicable for all possible ages and number of years early.

B. **Use of factors**: The factors should be used in the manner outlined in the Instruction Manual previously issued to the Fund. This paper should therefore be read in conjunction with that Manual, for the purpose of applying the new factors in practice. Note that we have not changed the methodology since that Manual was passed to the Fund, so officers should be able to simply replace the Fund's existing factors with these new ones, without amending the calculation methodology. If the Fund or any employers use these factors in any spreadsheets or ready reckoners, please ensure these are updated. If you have any queries regarding their application, please contact your Fund Actuary in the first place.

C. **Loading**: For the avoidance of doubt there should be no added loading applied to the use of the proposed factors, i.e. the loading should be 100% (we are aware that many funds may in the past have used loadings of 125% or 140% applicable to factors in place at that time).

D. **Testing**: We would recommend the Fund carries out some testing of the new factors once uploaded, to ensure these are giving reasonable results across a variety of members' ages and both genders. If you have any queries regarding these tests, please contact your Fund Actuary in the first place.

E. **Timing**: The Fund should carefully consider the date at which these factors start to be applied. We recommend that they are applied with immediate effect, subject to issues such as:

- time to upload the new factors on to the Fund's administration system and carry out any necessary testing;
- strain cost quotes already issued (i.e. whether these should be honoured as they stand or replaced with the new factors);
- use of factors in a manner affecting members' benefits (see (F) below);
- strain cost quotes requested but not yet issued to the employer;
- any governance processes required, such as formal approval by Section 95 Officer or Pensions Committee;
- any employer communication requirements, for instance if employers expect any changes to be notified to them before coming into effect.

There is no single correct approach but the Fund should record (and where necessary communicate) its approach taking account of the above. If you have any queries regarding timing and process issues, please contact your Fund Actuary in the first place.

F. **Impact on members**: The factors do not explicitly affect members' benefit levels in most circumstances, as they are intended to calculate the funding strain cost payable by the employer on the assumption that the member is retiring with unreduced benefits. However, we are aware that the factors may occasionally be used in a manner which potentially impacts members' benefits, for instance where the employer is considering possible early retirements but its decision will be partly cost-based, or where the member is asked to contribute to their early retirement cost. In such circumstances, these new factors will have an impact on whether the member is granted early retirement, or the cost to the member of that retirement. The impact will depend on the specific circumstances, and if there are any queries please contact your Fund Actuary in the first place.

G. **Ill-health strain costs**: For the avoidance of doubt, the new factors may be used to calculate the strain cost applicable for Tier 1 & Tier 2 ill-health early retirement cases. However, the cost of added service under Tier 1 is not explicitly matched by these factors: the use of the Annuity Factor is likely to be appropriate albeit this does not include the cost of a dependant's pension and so will slightly understate (typically by 10-20%) the cost of that added service.

Please note that any external ill-health insurance will be affected by any change to the early retirement strain cost factors, as these affect the amount of strain cost being insured and the claim payments made by the insurer. Therefore, changes in factors may cause the premium rate to rise or fall. In the interests of full disclosure, as Hymans receives commission on these premiums, then a rise or fall in strain costs arising from a change in factors will lead to a commensurate rise or fall in the amount of commission we receive. By instructing us to review the strain cost factors for the Fund in this report, we assume that the Fund is comfortable with this situation. We have not carried out an analysis to identify the impact for individual insured employers as part of this factors review exercise.

H. **Exit payment cap**: At the time of writing, the Government has proposed but not yet implemented legislation which would limit the award of unreduced early retirement benefits in some circumstances, due to the application of a cap (proposed at £95,000) on the combined value of an employee's severance package. We have not taken account of this legislation in the proposed factors, due to the lack of clarity on whether and how such regulations would apply. If and when such regulations are brought into effect, please contact your Fund Actuary to verify whether and how the use of these factors is affected.

I. **Post valuation events**. If you wish to discuss the impact of any post valuation events (since 31 March 2023) on your early retirement strain cost factors - either now or in future – please contact your Fund Actuary.

Professional notes

The paper is not intended for any party other than the Fund, nor for any other purpose than determining early retirement strain cost payments, and Hymans Robertson does not accept any liability relating to any other party or purpose.

This paper is subject to and complies with the following Technical Actuarial Standards set for the actuarial profession:

- TAS 100 (Principles for Technical Actuarial Work), and
- TAS 300 (Pensions).

If there are any queries, please direct these to me or your usual Fund Actuary contact in the first place.

[redacted]

Douglas Green FFA

28 March 2024

For and on behalf of Hymans Robertson LLP

Appendix

Appendix 1 – Factors for early retirement strain costs

The tables below show the factors required, based on the approach described in this report, for calculating the strain arising on early retirement. We have also shown the existing factors for comparison: NB we assume there is no added loading currently in place (see part C under "Implementation").

The actual factors to be uploaded to the Fund's administration software are provided in spreadsheet format accompanying this paper.

Table 1: Early Retirement Reduction (ERR) factors

Years to Funded Retirement Date	Early Retirement Reduction	
	Existing Factors	Proposed Factors
0 (or past FRD already)	0.00%	0.00%
1	3.85%	5.08%
2	7.42%	9.83%
3	10.75%	14.69%
4	13.83%	19.18%
5	16.68%	23.34%
6	19.34%	27.18%
7	21.81%	30.74%
8	23.53%	34.04%
9	25.13%	37.10%
10	26.61%	39.93%
11	28.01%	42.56%
12	29.34%	45.01%
13	30.60%	46.91%
14	31.80%	48.68%
15	32.95%	50.34%
16	34.05%	51.90%
17	35.11%	53.38%

As per our Instruction Manual:

- Different Early Retirement Reductions may apply for a member's different tranches of benefits, based on the Funded Retirement Date (FRD) as defined in the Manual. The FRD is technically slightly different from our 2023 valuation compared to the Manual, but the principles remain the same.
- ERR should be interpolated based on the number of years and complete months before FRD.

Table 2: Annuity factors

Age Next Birthday	Existing Factors		Proposed Factors	
	Male Factors	Female Factors	Male Factors	Female Factors
50	25.28	26.98	19.82	21.52
51	24.94	26.78	19.70	21.41
52	24.60	26.56	19.56	21.29
53	24.25	26.32	19.40	21.15
54	23.90	26.06	19.23	20.99
55	23.52	25.76	19.04	20.81
56	22.99	25.21	18.69	20.47
57	22.44	24.65	18.34	20.11
58	21.89	24.07	17.96	19.73
59	21.32	23.48	17.58	19.34
60	20.75	22.87	17.19	18.93
61	20.17	22.26	16.79	18.52
62	19.58	21.65	16.39	18.10
63	19.00	21.03	15.98	17.66
64	18.41	20.41	15.56	17.22
65	17.83	19.79	15.14	16.78
66	17.26	19.18	14.72	16.34
67	16.69	18.57	14.31	15.89

The Annuity Factor to be used is that applicable to the member's age at the **next** birthday.