

**Northern Ireland Local  
Government Officers'  
Superannuation Committee**

**Draft Funding Strategy  
Statement**

**Last Reviewed: September 2010**

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## **1. OVERVIEW**

- 1.1 This Funding Strategy Statement has been prepared in accordance with Regulation 30 of the Local Government Pension Scheme (Administration) Regulations (Northern Ireland) 2009. The Statement describes the funding strategy of the Northern Ireland Local Government Officers' Superannuation Committee.
- 1.2 As required by Regulation 30(2)(a), the Statement has been prepared having regard to guidance published by CIPFA in March 2004.

## **2. PURPOSES OF THE STATEMENT**

- 2.1 Funding is defined as the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of NILGOSC, acting on the professional advice provided by the Actuary.
- 2.2 The purpose of this statement is:
  - to establish a clear and transparent fund-specific strategy which will establish how employers' pension liabilities are best met going forward;
  - to support the regulatory requirement to maintain as nearly constant employers' contribution rates as possible; and
  - to take a prudent longer-term view of funding those liabilities.
- 2.3 The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives that need to be balanced and reconciled.

## **3. CONSULTATION**

- 3.1 In accordance with Regulation 30(1), all employers participating within the Fund were consulted on the contents of this Statement and their views were taken into account in formulating the final Statement. However, the Statement describes a single strategy for the Fund as a whole.
- 3.2 In addition, NILGOSC has had regard to the Fund's Statement of Investment Principles published under Regulation 10 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations (Northern Ireland) 2000 (as amended).
- 3.3 The Fund Actuary, Hymans, was also consulted on the contents of this Statement.

## **4. PURPOSE AND AIMS OF THE FUND**

### **4.1 Purpose of the Fund**

4.1.1 The purpose of the Fund is to maintain financial assets required for the payment of benefits as laid down in the Local Government Pension Scheme (Benefits, membership and Contribution) Regulations (Northern Ireland) 2009. The Fund:-

- receives monies in respect of contributions from employers and employees, transfer values and investment income; and
- pays out monies in respect of scheme benefits, refunds, transfer values and the costs of pension administration and investment management.

### **4.2 Aims of the Fund**

4.2.1 The aims of the Fund in relation to the Funding Strategy are:-

- Stability** -to enable employers' contribution rates to be kept as nearly constant as possible and at reasonable cost to the Scheme Employers, Admitted Bodies and to the taxpayers.
- Sufficiency** - to ensure that sufficient resources are available to meet all liabilities as they fall due.
- Effectiveness** -to manage fund's liabilities effectively.
- Income Maximisation** - to maximise the income from investments within reasonable risk parameters.

### **4.3 The Aims in Practice**

4.3.1 **Stability** - NILGOSC recognises that the requirement to keep employers' contribution rates as nearly constant as possible can run counter to the following requirements:

- the regulatory requirement to secure solvency,
- the requirement that the costs should be reasonable, and
- maximising income from investments within reasonable risk parameters

4.3.2 Producing low volatility in employers' contribution rates requires material investment in assets that 'match' the employers' liabilities. In this context, 'match' means assets that behave in a similar manner to the liabilities as economic conditions alter. For the liabilities represented by benefits payable by the Scheme, such assets would tend to comprise long-dated index-linked gilt investments.

4.3.3 Other classes of assets, such as shares and property, are perceived to offer higher long term rates of return, on average, and consistent with the requirement to maximise the returns from investments NILGOSC invests a substantial proportion of the Fund in such assets. However, these assets are more risky in nature, and that risk can manifest itself in volatile returns over short-term periods and a failure to deliver the expected return in the long term.

4.3.4 This short-term volatility in investment returns can produce a consequent volatility in the measured funding position of the Fund at successive valuations, with knock on effects on employers' contribution rates.

4.3.5 **Sufficiency** - NILGOSC recognises the need to ensure that the Fund has, at all times, sufficient liquid assets to be able to pay pensions, refunds, transfer values, costs, charges and other expenses. It is NILGOSC's policy that such expenditure is met, in the first instance, from incoming employers' and employees' contributions to avoid the expense of disinvesting assets. NILGOSC monitors the position on a daily basis to ensure that all cash requirements can be met.

4.3.6 **Effectiveness** - NILGOSC seeks to ensure that all employers' liabilities are managed effectively. In a funding context, this is achieved by seeking regular actuarial advice ensuring that employers and Committee members are properly informed through regular monitoring of the funding position and the outlook for employers' contributions after the next triennial actuarial valuation.

4.3.7 **Income Maximisation** - NILGOSC recognises the desirability of maximising investment income within reasonable risk parameters. Investment returns higher than those available on holding index-linked gilts are sought through investment in other asset classes such as shares and property. NILGOSC ensures that risk parameters are reasonable by:

- restricting investment to the levels permitted by the Investment Regulations,
- restricting investment to asset classes generally recognised as appropriate for UK pension funds,
- analysing the potential risk represented by those asset classes in collaboration with the Fund's Actuary, Investment Advisors and Fund Investment Managers;
- limiting concentration risk by developing a diversified asset strategy; and
- monitoring the risk of the value of liabilities rising if long-term interest rates fall.

## **5. RESPONSIBILITIES OF THE KEY PARTIES**

5.1 Although a number of parties, including investment fund managers, investment advisers and external auditors, have responsibilities to the Fund, the key parties for the strategy are seen as NILGOSC, each individual employer and the Fund Actuary.

### **5.2 Responsibilities of NILGOSC, the Administering Authority**

5.2.1 NILGOSC should collect employers' and employees' contributions and, as far as NILGOSC is able to, ensure these contributions are paid by the due date. Details of how it meets this requirement are shown below:-

- Individual employers must pay contributions in accordance with Regulations 34, 35, 36 and 37 of the Regulations. NILGOSC has advised all employers of its policy on the remittance of pension contributions and the procedures which will apply in the event of late or non-payment.
- Employers' contributions are due to the Committee on the first day of the month following the month that they were deducted from employees' pay. If

contributions are overdue by 10 days the Committee will levy an interest charge in accordance with Regulation 39(4).

- NILGSOC will ensure that action is taken to recover liabilities from Admission Bodies whose Admission Agreement has ceased. The Fund Actuary will calculate the cessation deficit due at the date the Admission Agreement ends and NILGOSC will notify the Admission Body of the cessation debt required to meet any deficit at the cessation of the Agreement.

5.2.2 NILGOSC should invest surplus monies in accordance with the Regulations. It does this by ensuring that NILGOSC's Statement of Investment Principles comply with the Investment Regulations.

5.2.3 NILGOSC should ensure that cash is available to meet liabilities as and when they fall due. NILGOSC monitors the position on a daily basis to ensure that all cash requirements can be met.

5.2.4 NILGOSC should manage the valuation process in consultation with the Fund Actuary. NILGOSC ensures it communicates effectively with the Fund Actuary to:

- agree timescales for the provision of information and provision of triennial valuation results,
- ensure provision of data of suitable accuracy,
- ensure that the Fund Actuary is clear about the Funding Strategy, including the setting of individually assessed employer contribution rates under Regulation 31(7),
- ensure that participating employers receive appropriate communication throughout the process,
- ensure that reports are made available as required by Guidance and Regulation.

5.2.5 The application of individually assessed employer contributions is restricted to the following types of employers:

- those admission bodies that have closed to new entrants;
- those employers that have joined the fund in recent years;
- any transferee admission bodies (contractors) that join for a limited period.
- those employers who are funding a one-off strain cost through employers' contributions
- those employers which the actuary regards as outside of the category of public sector long term secure.

5.2.6 Any employers that elect to raise their contributions more rapidly than the *minimum* level set by the Committee or make one-off contributions will enjoy the benefit of the extra contributions at the subsequent valuation.

5.2.7 NILGOSC is required to prepare and maintain a Statement of Investment Principles and a Funding Strategy Statement after due consultation with

interested parties. NILGOSC will comply with the Regulations and follow Best Practice in the formulation of both of these policies.

- 5.2.8 NILGOSC will monitor all aspects of the Fund's performance and funding and amend the Statement of Investment Principles or Funding Strategy Statement if required. NILGOSC monitors the funding position and the investment performance of the Fund on a quarterly basis.

### **5.3 Responsibilities of Individual Employers**

5.3.1 Individual employers are responsible for:

- deducting contributions from employees' pay,
- paying all contributions, including their employers' contribution as determined by the Actuary, promptly by the due date,
- exercising discretions within the regulatory framework and ensuring NILGOSC has copies of current policies covering those discretions,
- paying for additional membership in accordance with agreed arrangements,
- paying the capital costs resulting from early retirements, augmentation of membership, additional pension, or exercises of discretion allowing the early payment of deferred benefits. Payment is due immediately.
- notifying NILGOSC promptly of all changes to membership, or other changes, which affect future funding.

### **5.4 Responsibilities of the Fund Actuary**

5.4.1 The Actuary will prepare valuations and issue a Rates and Adjustments Certificate. This includes the setting of employers' contribution rates, after agreeing assumptions with NILGOSC and having regard to the Funding Strategy Statement and relevant admission agreements. Valuations will be prepared in accordance with generally accepted actuarial methods and reported on in accordance with Guidance Note 9 issued by the Institute and Faculty of Actuaries, to the extent that the Guidance Note is relevant to the Scheme.

5.4.2 The Actuary will prepare advice and calculations in connection with bulk transfers, cessation valuations, and individual benefit related matters. Such advice will take account of the funding position and Funding Strategy Statement, along with other relevant matters.

## **6. SOLVENCY**

6.1 NILGOSC will prudently seek to secure the solvency of the Fund. For this purpose NILGOSC defines solvency as being achieved when the value of the Fund's assets is greater than or equal to the value of the Fund's liabilities in respect of service prior to the measurement date when measured using 'ongoing' actuarial methods and assumptions.

6.2 Ongoing actuarial methods and assumptions are taken to be measurement by use of the Projected Unit method of valuation, using assumptions generally recognised as suitable for an open, ongoing UK pension fund with a sponsoring employer of sound covenant.

- 6.3 The financial assumptions used to assess the funding level will have regard to the yields available on long-term fixed interest and index-linked gilt edged investments. NILGOSC has also agreed with the Fund Actuary that the assumptions will make partial allowance for the higher long-term returns that are expected on the assets actually held by the Fund, and understands the risks of such an approach if those additional returns fail to materialise.

## **7. FUNDING STRATEGY**

### **7.1 Valuation Methods**

- 7.1.1 Consistent with the aim of enabling employers' contribution rates to be kept as nearly constant as possible, contribution rates are set by use of the Projected Unit valuation method for most employers.
- 7.1.2 The Projected Unit method was used in the actuarial valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period.
- 7.1.3 The Attained Age method is used for employers who no longer admit new members. This means that the contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.

### **7.2 Recovery period**

- 7.2.1 Where a valuation reveals that the Fund is in surplus or deficiency against the solvency measure, employers' contribution rates will be adjusted to target restoration of the solvent position over a period of years (the recovery period). The recovery period applicable for each participating employer is set by NILGOSC in consultation with the Fund Actuary, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.
- 7.2.2 NILGOSC recognises that a large proportion of the Fund's liabilities are expected to give rise to benefit payments over long periods of time. NILGOSC recognises the risk in relying on long recovery periods and has agreed with the Fund Actuary a limit of 20 years.

### **7.3 Treatment and recovery of deficits on closure of an employer**

- 7.3.1 When an organisation participating in the Fund withdraws from the Scheme, the Fund Actuary will carry out a cessation valuation. NILGOSC will then recover any debt from that organisation. The only exception to this is where a successor organisation, which is also a participating employer in the Fund, formally adopts the pension liabilities of the previous organisation as its own.
- 7.3.2 NILGOSC has a policy of requiring admission bodies to obtain a guarantor. A guarantor is required to agree that it will meet the shortfall if the admission body closes and cannot pay the contributions due.

7.3.3 If an employer (other than a transferee admission body) fails and it and its guarantor cannot pay the contributions due, the Regulations require that all employers in the Fund must pay revised contributions to meet the shortfall.

#### **7.4 Stepping**

7.4.1 Consistent with the requirement to keep employer contribution rates as nearly constant as possible, NILGOSC will consider, at each valuation, whether new contribution rates should be payable immediately, or should be reached by a series of steps over future years. NILGOSC will discuss with the Fund Actuary the risks inherent in such an approach, and will examine the financial impact and risks associated with each employer.

7.4.2 NILGOSC's policy is to limit the number of permitted steps to six annual steps. NILGOSC will apply a different stepped approach to those employers paying standard contribution rates and those paying individually assessed rate (as described in paragraph 5.2.5). Those paying the standard rates will pay a stabilised employers' contribution rate over time with increases or decreases restricted to +/- 1%. We cannot apply the same long term approach to those Employers who do not fall into this category and a contribution rate will be based on their own experience using assumptions consistent with the Fund's investment strategy.

#### **7.5 Monitoring of the Funding Level between Valuations**

7.5.1 NILGOSC will monitor the funding level between triennial valuations. If it is considered appropriate, an indicative interim valuation will be carried out. The purpose of this monitoring process is to give employers advance warning of likely changes that may be required following the next triennial valuation. This allows improved budgeting decisions to be made and allows an employer to take an informed decision on paying contributions over and above the minimum required.

### **8. IDENTIFICATION OF RISKS AND COUNTER MEASURES**

8.1 NILGOSC's overall policy on risk is to identify all risks to the Fund and to consider the position both in aggregate and at an individual risk level. NILGOSC will monitor the risks to the Fund, and will take appropriate action to limit the impact of these both before, and after, they emerge wherever possible. The main risks to the Fund are set out below.

<b>Risk</b>	<b>Explanation</b>
<b>Demographic</b>	<p>The main demographic risks include changing retirement patterns and longevity. NILGOSC will ensure that the Fund Actuary investigates these matters at each valuation or, if appropriate, more frequently, and reports on developments. NILGOSC will agree with the Fund Actuary any changes that are necessary to the assumptions underlying the measure of solvency to allow for observed or anticipated changes.</p> <p>If significant demographic changes become apparent between valuations, NILGOSC will notify all participating employers of the anticipated impact on costs that will emerge at the next valuation and will review any guarantees that are in place for any transferee admitted</p>

	bodies that have been admitted to the Scheme.
<b>Regulatory</b>	<p>These risks relate to changes to regulations, national pension requirements or HM Revenue &amp; Customs rules.</p> <p>NILGOSC will keep abreast of all proposed changes and, where possible and after careful consideration, express its opinion during consultation periods. NILGOSC's policy will be to ask the Fund Actuary to assess the impact on costs of any changes and, where these are likely to be significant, NILGOSC will notify employers of this likely impact and the timing of any change.</p>
<b>Governance</b>	<p>This covers the risk of unexpected structural changes in the Fund membership (for example the closure of an employer to new entrants or the large scale withdrawal or retirement of groups of staff) and the related risk of NILGOSC not being made aware of such changes in a timely manner.</p> <p>NILGOSC's policy is to require regular communication between itself and employers and to ensure regular reviews of such items as guaranteed bond arrangements and funding levels. NILGOSC seeks to ensure that each employer complies with its Admission Agreement (if applicable) and the Scheme Regulations.</p>
<b>Statistical/Financial</b>	<p>This covers items such as the performances of markets and the Fund's investment managers, asset reallocation in volatile markets, pay and price inflation varying from anticipated levels, or the effect of possible increases in employer contribution rates on service delivery and on employers.</p> <p>NILGOSC annually reviews the effect of market movements on the Fund's overall funding position, reviews each investment manager's performance quarterly and annually considers the asset allocation of the Fund by carrying out an annual review meeting with its Investment Advisors, Fund Managers and Fund Actuary.</p>
<b>Solvency measure</b>	<p>NILGOSC recognises that allowing for future investment returns in excess of those available on government bonds introduces an element of risk, in that those additional returns may not materialise.</p> <p>NILGOSC's policy will be to monitor the underlying position assuming no such excess returns are achieved to ensure that the funding target remains realistic relative to the risk position.</p>
<b>Recovery period</b>	<p>NILGOSC recognises that permitting surpluses or deficiencies to be eliminated over a recovery period rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements. NILGOSC's policy is to discuss the risks</p>

	inherent in each situation with the Fund Actuary and to limit the permitted length of recovery period to no longer than 20 years.
<b>Default</b>	NILGOSC is alert to the possibility that an Employer may default on any debt owed to the fund and will seek to ensure that guarantees are in place where the Regulations allow or will seek legal redress to ensure the fund does not suffer a loss.

## **9. LINKS TO INVESTMENT POLICY AS SET OUT IN THE STATEMENT OF INVESTMENT PRINCIPLES**

- 9.1 NILGOSC has produced this Funding Strategy Statement having taken an overall view of the level of risk in the investment policy set out in the Statement of Investment Principles and the funding policy set out in this statement.
- 9.2 The current strategic asset allocation is based upon a review carried out at an annual meeting attended by the Actuary, all the Fund Managers and the Fund's Investment Advisor. The resulting Asset Allocation is set out in the Committee's Statement of Investment Principles.
- 9.3 NILGOSC will continue to monitor the suitability of the investment policy in the light of the Fund's developing liabilities and finances.
- 9.4 NILGOSC will continue to review the Funding Strategy Statement and the Statement of Investment Principles to ensure that the overall risk profile remains appropriate. Such reviews may use asset liability modelling or other analysis techniques.

## **10. FUTURE MONITORING**

- 10.1 NILGOSC plans to review formally this Statement as part of the triennial valuation process unless circumstances arise which require earlier action.
- 10.2 NILGOSC will monitor the funding position of the Fund on an approximate basis at regular intervals between valuations, and will discuss with the Actuary whether any significant changes have arisen that require action.
- 10.3 NILGOSC is currently monitoring the Strain on the Fund costs for those employers who exercise ill-health retirements at a level above those assumed in the actuarial valuation and will consider whether or not these additional costs must be met by the employing authority.