

Funding Strategy Statement

Greater Manchester
Pension Fund

March 2011



*Funding Strategy
Statement*

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www.gmpf.org.uk

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Greater Manchester Pension Fund Funding Strategy Statement

1. Introduction

This is the Funding Strategy Statement (FSS) of the Greater Manchester Pension Fund ("the Fund" or "GMPF"), which is administered by Tameside MBC ("the Administering Authority").

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

1.1 Regulatory Framework

Members' accrued benefits are guaranteed by statute. Members' contributions are fixed in the Regulations at a level which covers only part of the cost of accruing benefits. Employers currently pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers or pools of employers pay for their own liabilities.

The FSS forms part of a framework which includes:

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

Operating within this framework, the Fund Actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, for example when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

The key requirements relating to the FSS are that:

- After consultation with such persons as it considers appropriate, the Administering Authority will prepare and publish their funding strategy.
- In preparing the FSS, the Administering Authority must have regard to:
 - FSS guidance produced by CIPFA in March 2004
 - its Statement of Investment Principles published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

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- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

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

1.2 Reviewing the FSS

The FSS is reviewed in detail at least every three years in line with triennial valuations being carried out, with the next full review due to be completed by 31 March 2014.

The FSS is a summary of GMPF's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact Steven J Taylor in the first instance at Steven.Taylor@gmpf.org.uk or on 0161-342 2880.

2. Purpose

2.1 Purpose of FSS

The then Office of the Deputy Prime Minister (ODPM) [now the Department for Communities and Local Government (CLG)] stated that the purpose of the FSS is:

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

These objectives are desirable individually, but may be mutually conflicting.

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

2.2 Purpose of the Fund

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

- receives contributions, transfer payments and investment income;
- pays scheme benefits, transfer values and administration costs.

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

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

2.3 Aims of the Funding Policy

The objectives of GMPF's funding policy include the following:

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

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- to ensure that employers are aware of the risks and potential returns of the investment strategy;
- to help employers recognise and manage pension liabilities as they accrue, with consideration as to the effect on the operation of their business where the Administering Authority considers this to be appropriate;
- to try to maintain stability of employer contributions;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer ceasing participation or defaulting on its pension obligations;
- to address the different characteristics of the disparate employers or groups of employers to the extent that this is practical and cost-effective; and
- to maintain the affordability of the Fund to employers as far as is reasonable over the longer term.

3. Solvency Issues and Target Funding Levels

3.1 Derivation of Employer Contributions

Employer contributions are normally made up of two elements:

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

The Fund Actuary is required by the regulations to report the *Common Rate of Employer's Contribution*¹, for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit under (b) is currently spread over a period of up to 20 years.

The Fund Actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to an individual employer². It is the adjusted contribution rate which employers are actually required to pay. The sorts of peculiar factors which are considered are discussed in Section 3.5.

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

For some employers it may be agreed by all relevant parties to pool contributions, see Section 3.7.8.

A breakdown of each employer's contributions following the 2007 valuation for the financial years 2008/09, 2009/10 and 2010/11 can be found in the 31/3/07 Actuarial Valuation report (finalised in 2008). It includes a reconciliation of each employer's rate with the *Common Contribution Rate*. It also identifies which employers' contributions have been pooled with others.

The treatment of any costs of non ill-health and ill-health early retirements differs between employers who are either part of a pool involving a Local Authority employer, or a major employer grouping or not part of any pool, on the one hand, and employers who are part of a pure Non-Local Authority pool, on the other. The former have "early retirement allowances" for non ill-health and for ill-health early retirements built-in to their employer contribution rate and initially the aggregate of these two allowances are used to fund any such costs. Costs in excess of the aggregate of the "allowances" are met by separate lump-sum employer contributions.

¹ See Regulation 77(4)

² See Regulation 77(6)

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The latter have no "allowance" for non ill-health early retirements but do have an "allowance" for ill-health early retirements built into their contribution rates. For these employers the costs of non ill-health early retirements are met by separate lump-sum employer contributions whilst the costs of ill-health early retirements in excess of the allowance are dealt with via an appropriate adjustment to their contribution rate at the next valuation. (cf Sub-Section 3.9.1)

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

3.2 Solvency and Target Funding Levels

The Fund Actuary is required to report on the "solvency" of the whole Fund at least every three years.

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

The ongoing funding basis has traditionally been used for each triennial valuation for all employers in the Fund. For those scheme employers where the administering authority believes they have a strong strength of covenant the ongoing funding basis will continue to apply.

Where an admission agreement for an Admission Body that is not a Transferee Admission Body and has no guarantor is likely to terminate within the next 5 to 10 years or lose its last active member within that timeframe, the Fund reserves the right to set contribution rates by reference to liabilities valued on a gilts basis (i.e. using a discount rate that has no allowance for potential investment outperformance relative to gilts). The target in setting contributions for any employer in these circumstances is to achieve full funding on a gilts basis by the time the agreement terminates or the last active member leaves in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required when a cessation valuation is carried out.

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

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

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The Fund operates an identical target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. The time horizon of the funding target for Community and Transferee Admission Bodies will vary depending on the expected duration of their participation in the Fund. Please refer to Section 3.8 for the treatment of departing employers.

3.3 Ongoing Funding Basis

The demographic assumptions are intended to be best estimates of future outcomes within GMPF as advised by the Fund Actuary, based on the past experience of LGPS funds and of GMPF. It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in mortality, is uncertain. Employers should be aware that their contributions are likely to increase in future if longevity exceeds the funding assumptions.

The approach taken is considered reasonable in light of the long term nature of the Fund and the statutory guarantee underpinning members' benefits. The demographic assumptions vary by type of member and so reflect the different member profiles of employers.

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

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

Given the very long-term nature of the liabilities, a long term view of prospective returns from equities is taken. For the 2010 valuation, the Main Fund assumption is that GMPF's investments will deliver an average real additional return of 1.8% a year in excess of the return available from investing in index-linked government bonds at the time of the valuation. Based upon the asset allocation of the Main Fund as at 31 March 2010, this is equivalent to taking credit for excess returns on equities of 2.3% pa over and above the gross redemption yield on index linked gilts on the valuation date and for excess returns of 0.4% pa on the non-equity assets (excluding gilts).

The same financial assumptions are adopted for the majority of employers. The anticipated future return on investments may vary between employers who follow different investment strategies. However, any such variations can only lead to reductions in the anticipated returns as compared with the position of the majority of employers.

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3.4 Future Service Contribution Rates

The future service element of the employer contribution rate is traditionally calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies and some resolution bodies that may have the power not to admit automatically all eligible new staff to GMPF, depending on the terms of their Admission Agreements and employment contracts. It should be noted that employers within a pool will pay the contribution rate applicable to the pool as a whole. Where it is considered appropriate to do so, the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a gilts basis (most usually for admission bodies that are not a Transferee Admission Body and that have no guarantor in place).

3.4.1 Employers that admit new entrants

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

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

3.4.2 Employers that do not admit new entrants

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

To give more long term stability to such employers' contributions, the *Attained Age* funding method is typically adopted. This will limit the degree of future contribution rises by paying higher rates at the outset. However, the Administering Authority may choose to adopt the *Projected Unit Method* where the circumstances relating to an employer appear to warrant such treatment and where the employer has been advised of the impact of the use of this basis.

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

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

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3.5 Adjustments for Individual Employers

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

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

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (eg mix of members by age, gender, manual/non manual, part-time/full-time);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the savings in early retirement provisions;
- the effect of more or fewer leavers than assumed;

over the period between each triennial valuation.

Actual investment returns achieved by following each investment strategy between each valuation are applied proportionately across all relevant employers as appropriate. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers, unless the circumstances dictate otherwise.

The Fund Actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation [where Hymans Robertson calculates asset shares – see section 3.6 below], including, but not limited to:

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

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

3.6 Asset Share Calculations for Individual Employers

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

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

3.7 Stability of Employer Contributions

3.7.1 *Strategies re the balance between Stability & Solvency*

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

- capping of employer contribution rate increases / decreases within a pre-determined range ("Stabilisation"); [3.7.2]
- use of extended deficit recovery periods; [3.7.3 & 3.7.4]
- phasing in of contribution increases / decreases; [3.7.5 – 3.7.7]
- pooling of contributions amongst employers with similar characteristics; [3.7.8]

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In addition to these strategies for improving the stability of employer contributions, the Administering Authority may, at its absolute discretion, permit greater "flexibility" around the employer's contributions provided that the employer has provided additional "security" to the satisfaction of the Administering Authority. Such greater "flexibility" may include a reduced rate of contribution, an extended deficit recovery period, or permission to join a pool with another body (eg a relevant and agreeable Local Authority). Additional "security" may include, but is not limited to, provision of a suitable financial bond, a legally-binding guarantee from an appropriate third party, or security over an employer owned asset of sufficient value.

The degree of greater "flexibility" extended to a particular employer is likely to take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan;
- whether the admission agreement is likely to be open or closed to new entrants.

3.7.2 Stabilisation

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

In view of this possibility, the Administering Authority has commissioned the Fund Actuary to carry out extensive modelling to explore the long term effect on the Fund of capping future contribution increases and decreases. The results of this modelling indicate that it is justifiable to limit employer contribution rate changes to +1% / -1% of employers' contributions per annum from 1 April 2011, subject to the following conditions being met:

- the Administering Authority is satisfied that the status of the employer merits adoption of a stabilised approach; and
- there are no material events between now and 1 April 2011 which render the stabilisation unjustifiable.

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

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

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

3.7.3 Deficit Recovery Periods

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

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

Where an employer's workforce/payroll is expected to decline, the Administering Authority may choose to specify that any deficit contributions are payable as periodic lump sum cash amounts rather than as a percentage of payroll.

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

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Type of Employer	<i>Maximum</i> Length of Deficit Recovery Period
Statutory bodies with tax raising powers and other Govt 'supported' employers	a period not exceeding 20 years
Community Admission Bodies with funding guarantees, subject to the approval of the guarantor and the agreement of the Administering Authority	a period not exceeding 20 years
Transferee Admission Bodies	the period from the start of the revised contributions to the end of the employer's contract or as otherwise agreed with the parent Local Authority letting the contract
Community Admission Bodies that are closed to new entrants e.g. Bus Companies, whose admission agreements continue after the last active member retires	a period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers, or such other period agreed by the employer and approved by the Administering Authority
All other types of employer	a period equivalent to the expected future working lifetime of the remaining scheme members

This *maximum* period is used in calculating each employer's *minimum* contributions. Employers may opt to pay higher regular contributions than these minimum rates. For employers that are in deficit at this valuation, there will be no reduction in contribution rates. This will lead to shorter deficit recovery periods for some employers.

3.7.4 *Surplus Spreading Periods*

Any employers deemed to be in surplus may be permitted to reduce their contributions below the cost of accruing benefits, by spreading the surplus element over 15 years or such other period agreed with the employer and approved by the Administering Authority.

However, to help meet the stability requirement, employers may prefer not to take such reductions.

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3.7.5 *Phasing in of Contribution Rises*

Phasing in periods will be influenced by the perceived credit worthiness of the employer and this will normally be a maximum of 3 years, and statutory bodies with tax raising powers a maximum of 4 years. Increases of less than 2% will be phased in over a maximum of 3 years.

3.7.6 *Phasing in of Contribution Reductions*

Any contribution reductions will be phased in over 6 years for all employers except Transferee Admission Bodies who may adopt a shorter period.

3.7.7 *The Effect of Opting for Longer Spreading or Phasing-In*

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

However any adjustment is expressed for different employers, the overriding principle is that the discounted value of the contribution adjustment adopted for each employer will be equivalent to the employer's deficit.

3.7.8 *Pooled Contributions*

3.7.8.1 *Smaller Employers*

The Administering Authority allows smaller employers [of similar types] to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service. The normal maximum number of active members to participate in a pool is set at 50.

Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not permitted to participate in a pool except with the approval of the relevant Local Authority and/or Administering Authority. Transferee Admission Bodies may only participate in pooling with the relevant parent Local Authority.

Employers who do not wish to continue with current/historic pooling arrangements have been and are requested to discuss the issue with the Administering Authority.

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As at the 2007 valuation, separate pools were operated for FE Colleges, Town and Parish Councils and for smaller Admission Bodies.

The Administrating Authority will consult with relevant employers if it proposes the creation of a new pool.

3.7.8.2 Other Contribution Pools

Schools are pooled with their funding Council.

Some Admission Bodies with guarantors are pooled with their Council.

Those employers that have been pooled are identified in the 31/3/10 Actuarial Valuation report (finalised in 2011).

3.8 Admission Bodies ceasing

Admission Agreements for Transferee contractors are assumed to expire at the end of the contract unless otherwise agreed by the relevant local authority and Administering Authority.

Admission Agreements for other employers are generally assumed to be open-ended until all the benefits have been paid out in full. Contributions, expressed as capital payments, can be agreed with employers after all the employees have retired. These Admission Agreements can however be terminated at any point subject to the terms of the agreement.

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

- Last active member ceasing participation in the LGPS;
- The insolvency, winding up or liquidation of the admission body;
- Any breach by the Admission Body of any of its obligations under the agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity or to confirm appropriate alternative guarantor as required by the Fund.

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

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

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

- (a) For Transferee Admission Bodies, the assumptions would be those used for an ongoing valuation to be consistent with the assumptions used to calculate the initial transfer of assets to accompany the active member liabilities transferred. Where a lower risk investment strategy has been adopted, the assumptions used in the calculation of the cessation liabilities will be consistent with that investment strategy.
- (b) For Admission Bodies that are not Transferee Admission Bodies where its participation is voluntarily ended either by themselves or the Fund, or which triggers a cessation event, the Administering Authority must look to protect the interests of other ongoing employers and will require the actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. Where there is a guarantor, the cessation valuation will normally be calculated using an ongoing valuation basis appropriate to the investment strategy. Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis" with no allowance for potential future investment outperformance and with an allowance for further future improvements in life expectancy. This approach results in a higher value being placed on the liabilities than would be the case under a valuation on the ongoing funding basis and could give rise to significant payments being required.
- (c) For Admission Bodies with guarantors, it is possible that any deficit could be transferred to the guarantor in which case it may be possible to simply transfer the former Admission Bodies members and assets to the guarantor, without needing to crystallise any deficit.

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

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

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

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

As an alternative to (b) above where the ceasing Admission Body is continuing in business the Administering Authority, at its absolute discretion, reserves the right to enter into an agreement with the ceasing Admission Body to accept an appropriate alternative security to be held against any funding deficit and to carry out the cessation valuation on an ongoing valuation basis. This approach would be monitored as part of each triennial valuation and the Administering Authority reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified.

3.9 Early Retirement Costs

3.9.1 Non Ill Health early retirements

The overall position in relation to non ill-health early retirements is as set out at the penultimate paragraph of Section 3.1.

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

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

Any additional lump-sum contributions which are required to be made under Section 3.1 arising from non ill-health early retirements become due immediately upon the award of an early retirement. The Administering Authority may agree that an employer be permitted to spread the payment over a period not exceeding 5 years (or the period until the member's normal retirement date if this is shorter). However, the current norm is for the spreading period to be no longer than 3 years.

3.9.2 Ill health early retirement monitoring

The Fund monitors each employer's, or pool of employers, ill health early retirement experience on an ongoing basis. This information is used to determine any necessary lump-sum employer contributions pursuant to the practice outlined at the penultimate paragraph of Section 3.1.

4. Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice.

4.1 Investment Strategy

The investment strategies currently being pursued are described in GMPF's Statement of Investment Principles.

The investment strategies are set for the long-term, but the principal strategy (for the "Main Fund") is reviewed annually, to ensure that it remains appropriate to the relevant liability profile and takes account of major movements in market valuations. The Administering Authority has adopted a Main Fund benchmark, which sets the proportion of assets to be invested in key asset classes such as equities, bonds and property. As at 31 March 2010, the proportion to be held in equities and property was 75% of the total Main Fund assets.

The investment strategy of lowest risk would be that which provides cashflows which replicate the expected benefit cashflows (ie the liabilities). Equity investment would not be consistent with this. This strategy informs policy for part of the Fund where liabilities are mature and employers have agreed such an approach.

The Main Fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from a liability matching strategy. The Administering Authority's strategy recognises the relatively immature liabilities relevant to the Main Fund and the secure nature of most employers' covenants.

The same investment strategy is currently followed for all employers covered by the Main Fund. The Administering Authority offers employers the opportunity to pursue a more cautious investment strategy than the Main Fund norm.

4.2 Consistency with Funding Basis

For employers covered by the Main Fund, the funding basis adopts an asset outperformance assumption of 1.8% pa over and above the redemption yield on index linked gilts. The Main Fund's current bespoke investment strategy is broadly 75% held in real assets and 25% in monetary assets. For employers pursuing a more cautious investment strategy than the Main Fund norm, a lower asset outperformance assumption may be adopted as appropriate. Both the Fund Actuary and the investment adviser to the Fund consider that the funding basis fulfils the requirement to take a "prudent longer-term" approach to funding.

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The Administering Authority is aware that in the short term – such as the three yearly assessments at formal valuations – the proportion of the assets invested in equities brings the possibility of considerable volatility and there is a material chance that in the short-term, and even the medium-term, asset returns will fall short of the outperformance target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.3 Balance between risk and reward

Prior to implementing its current investment strategies, the Administering Authority considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes like equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

In the light of the admission of Transferee contractors on different terms to other employers and the 2007 valuation results which showed the sensitivity of individual employers' contributions to changes in investment returns, the Administering Authority is reviewing whether its "dual strategy" approach should be refined. Enabling other investment strategies will require investment in new systems and higher ongoing costs which would have to be borne by the employers. The potential benefits of multiple investment strategies need to be assessed against the costs.

4.4 Intervaluation Monitoring of Funding Position

The Administering Authority monitors investment performance on a quarterly and annual basis. There is also detailed monitoring of new liabilities arising from early and ill-health retirements, the costs of which are met by employers. In addition, the Fund Actuary routinely assesses the funding position quarterly, taking account of actual experience compared to the financial assumptions underlying the valuation. Formally, the Administering Authority reports back to employers at the GMPF Annual General Meeting.

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5. Key Risks & Controls

5.1 Types of Risk

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

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

5.2 Financial Risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term	<p><i>Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.</i></p> <p><i>Analyse progress at three yearly valuations for all employers.</i></p> <p><i>Use of interim valuations.</i></p>
Inappropriate long-term investment strategy	<p><i>Set Fund-specific benchmark, informed by Asset-Liability modelling of liabilities.</i></p> <p><i>Proposing to examine scope for extending employer-specific investment strategies.</i></p> <p><i>Annual review of investment strategy incorporates consideration of alternative approaches.</i></p>
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	<p><i>Some investment in bonds helps to mitigate this risk and there is scope for employers to increase bond exposure.</i></p>
Active investment manager under-performance relative to benchmark	<p><i>Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.</i></p> <p><i>Regular reporting to employers describes Main Fund performance. If appropriate, the Fund Actuary will be asked to evaluate the implications.</i></p>

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Risk	Summary of Control Mechanisms
Pay and price inflation significantly more than anticipated	<p><i>The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.</i></p> <p><i>Inter-valuation monitoring, as above, gives early warning.</i></p> <p><i>Some investment in bonds, particularly index-linked, also helps to mitigate this risk.</i></p> <p><i>Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.</i></p>
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	<p><i>Seek feedback from employers on scope to absorb short-term contribution rises.</i></p> <p><i>Mitigate impact through deficit spreading and phasing in of contribution rises.</i></p> <p><i>Consult employers on possibility of paying more (extra administration and higher regular contributions) to enable employer-specific investment strategies to give greater certainty of cost.</i></p>

5.3 Demographic Risks

Risk	Summary of Control Mechanisms
Pensioners living longer.	<p><i>Set mortality assumptions with some allowance for future increases in life expectancy.</i></p> <p><i>Fund Actuary monitors combined experience of around 50 LGPS funds to look for early warnings of lower pension amounts ceasing than assumed in funding.</i></p> <p><i>Administering Authority encourage any employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.</i></p>
Deteriorating patterns of ill health and other early retirements	<p><i>Employers are charged the extra capital cost of ill health and other early retirements following each individual decision.</i></p>

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5.4 Regulatory Risk

Risk	Summary of Control Mechanisms
Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees	<i>The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.</i>
Changes to national pension requirements and/or HM Revenue and Customs rules e.g. effect of abolition of earnings cap for post 1989 entrants from April 2006 tax simplification and budget changes for higher earners	<p><i>It considers all consultation papers issued by CLG and comments where appropriate.</i></p> <p><i>The Administering Authority will consult employers where it considers that it is appropriate.</i></p> <p><i>Copies of all submissions are available for employers to see at www.gmpf.org.uk with effect from January 2005.</i></p>

5.5 Governance Risk

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).	<i>The Administering Authority monitors membership movements on an annual basis, via a report from the administrator to the Pension Fund Management Panel.</i>
Administering Authority not advised of an employer closing to new entrants.	<p><i>The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations.</i></p> <p><i>Deficit contributions may be expressed as monetary amounts (see Actuarial Valuation report).</i></p>
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.	<p><i>In addition to the Administering Authority monitoring membership movements on an annual basis, it requires employers with Transferee Admission Agreements to inform it of forthcoming changes.</i></p> <p><i>It also operates a diary system to alert it to the forthcoming termination of Transferee Admission Agreements.</i></p>

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Risk	Summary of Control Mechanisms
<p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p>	<p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.</p> <p>The risk is mitigated by :</p> <ul style="list-style-type: none"> • <i>Seeking a funding guarantee from another scheme employer, or external body, where-ever possible.</i> • <i>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</i> • <i>Vetting prospective employers before admission.</i> • <i>Where permitted under the regulations requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.</i> • <i>Offering lower risk investment strategies – with higher employer contributions - for Transferee Admission Bodies to reduce the risk of volatile contributions and a significant debt crystallising on termination.</i>

END OF MAIN BODY OF FSS

ADOPTED BY THE PENSION FUND MANAGEMENT PANEL : 4 March, 2011

Annex – Responsibilities of Key Parties

The Administering Authority should:-

- collect employer and employee contributions;
- invest surplus monies in accordance with the regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the Fund's actuary;
- prepare and maintain and FSS and a SIP, both after proper consultation with interested parties; and
- monitor all aspects of the Fund's performance and funding and amend FSS/SIP

The Individual Employer should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the administering authorities promptly of all changes to membership or, as may be proposed, which affect future funding.

The Fund Actuary should:-

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

END OF ANNEX

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