PAPER B

# DRAFT
# ANNUAL REPORT
# AND
# ACCOUNTS

# ISLE OF WIGHT COUNCIL
# PENSION FUND
# 2016-17

Please note this report is a draft version and is subject to audit, so items within it could change.

Registration number with the Registrar of Occupational and Personal Pensions Schemes 49/22

## Contents

## Foreword

To be inserted following the AGM

## Scheme management and advisers

Members of the Isle of Wight Council Pension Fund Committee are appointed following the annual meeting of the Full Council. The members during the period were:

| | | Re-Appointed | Resigned |
|---|---|---|---|
| Councillor I Warlow | Chair | | 5 May 2017 |
| Councillor A Axford | Chair | 17 May 2017 | |
| Councillor B Abraham | | 16 June 2017 | |
| Councillor R Barry | | | 5 May 2017 |
| Councillor R Barry | | 16 June 2017 | |
| Councillor R Blezzard | | | 27 February 2017 |
| Councillor P Brading | | 16 June 2017 | |
| Councillor V Churchman | | 16 June 2017 | |
| Councillor D Eccles | | | 5 May 2017 |
| Councillor S Hutchinson | | | 5 May 2017 |
| Councillor G Kendall | | | 5 May 2017 |
| Councillor D Pitcher | | | 8 July 2016 |
| Councillor S Smart | | 16 June 2017 | |
| Councillor I Stephens | | 16 June 2017 | |

The Committee is advised by:

Mr C Ward, Director of Finance and section 151 officer
Ms J Holden, Investment Consultant – Mercer Limited
Mrs J Thistlewood, Technical Finance Manager

In addition a non-voting representative of both the admitted/scheduled bodies and staff union attend the Pension Fund Committee meetings

Investment Managers

Baillie Gifford & Co
Calton Square
1 Greenside Row
Edinburgh EH1 3AN

Majedie Asset Management Ltd
5th Floor
10 Old Bailey
London EC4M 7NG

Newton Investment Management Ltd
The Bank of New York Mellon Centre
160 Queen Victoria Street
London EC4V 4LA

Schroder Investment Management Limited
31 Gresham Street
London EC2V 7QA

Actuarial Services

Hymans Robertson LLP
20 Waterloo Street
Glasgow G2 6DB

Investment Consultants

Mercer Limited
Belvedere
12 Booth Street
Manchester M2 4AW

AVC Provider

Prudential
AVC Customer Services
Stirling FK9 4UE

Custodian

BNP Paribas Securities Services
10 Harewood Avenue
London NW1 6AA

Auditors

Ernst & Young LLP
Apex Plaza
Forbury Road
Reading RG1 1YE

Bankers

National Westminster
3 Hampshire Corporate Park
PO Box 462
Templars Way
Chandlers Ford SO53 3RY

Scheme Administrator

Isle of Wight Council
County Hall
Newport
Isle of Wight PO30 1UD

## Financial Performance

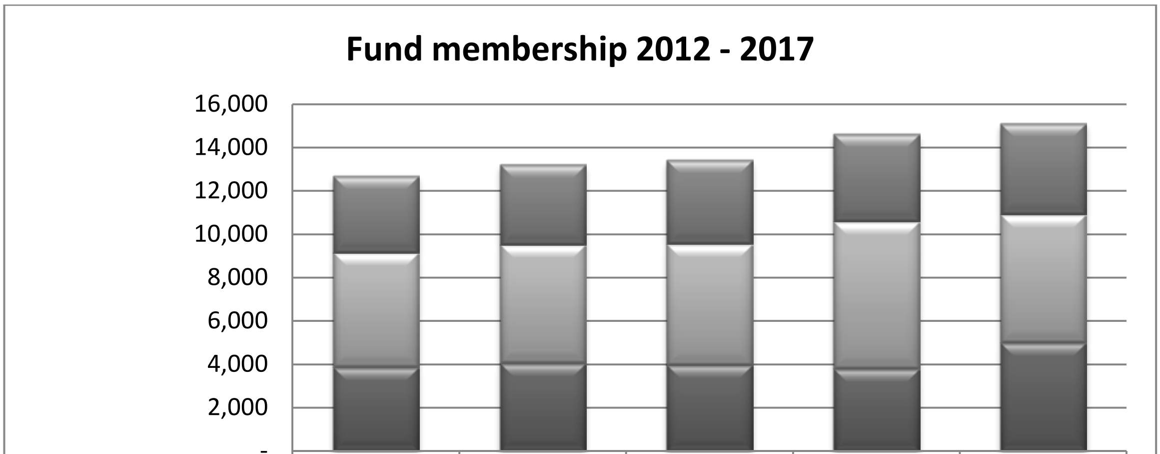
**Analytical review**

| **Fund account** | **2016-17 £000** | 2015-16 £000 | **Notes** |
|---|---|---|---|
| Net withdrawals from dealings with members | **(1,895)** | (2,828) | Increase in basic contributions; reduction in pension strain contributions; inflationary increases in benefits paid; lower payments to leavers |
| Management expenses | **(2,220)** | (3,947) | Lower performance fees paid to UK and global equity managers, reflecting under-performance compared to benchmarks. |
| Net return on investments | **89,325** | 1,292 | Positive performance in UK equities markets. All fund managers generated positive absolute returns. |
| Net increase in net assets | **85,210** | (5,483) | |

| **Net Assets Statement** | **2016-17 £000** | 2015-16 £000 | **Notes** |
|---|---|---|---|
| Equities | **111,854** | 93,993 | Positive performance in UK Equities market |
| Pooled Investment Vehicles | **448,164** | 383,781 | Good performance in Global equities market. |
| Cash deposits | **5,949** | 2,028 | Increase in cash balance held for future investment reflecting low investment returns |
| Other net liabilities | **(6,763)** | (5,808) | Increase in short term borrowing to fund operational activities. |
| Total net assets | **559,204** | 473,994 | |

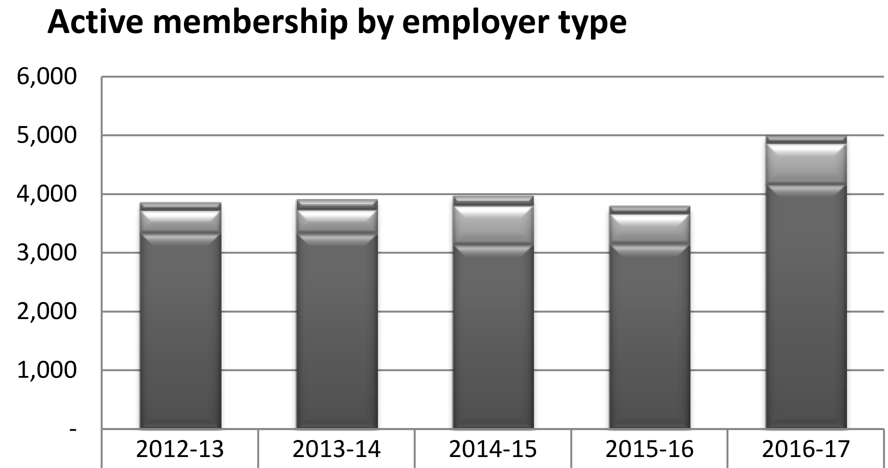
**Membership data**

Total membership of the fund continues to increase year on year, and active membership has increased as a result of auto-enrolment into the Fund. The profile of membership numbers from 2012 to 2017 is shown below:




| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 |
|---|---|---|---|---|---|
| Pensioners | 3,558 | 3,687 | 3,873 | 4,036 | 4,192 |
| Deferred members | 5,265 | 5,461 | 5,574 | 6,777 | 5,926 |
| Active members | 3,883 | 4,067 | 3,973 | 3,807 | 5,003 |
| Total | 12,706 | 13,215 | 13,420 | 14,620 | 15,121 |

This year two employers ceased to be part of the Pension Fund, but two new employers joined as staff were transferred across. There were also two Town and Parish Councils that joined the Fund.
The Isle of Wight Council remains the largest employer in the fund, and its share of the active members has adopted an upward trend in real numbers. Despite this there is an overall decline in the proportion from 86.1% in 2012/13 to 83.5% as at 31 March 2017. The composition of active membership numbers is shown below:




| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 |
|---|---|---|---|---|---|
| Admitted bodies | 135 | 179 | 162 | 137 | 128 |
| Scheduled bodies | 385 | 404 | 658 | 511 | 700 |
| Administering authority | 3,344 | 3,338 | 3,153 | 3,159 | 4,175 |
| Total | 3,864 | 3,921 | 3,973 | 3,807 | 5,003 |

**Contributions analysis**

The table below sets out the employers of the fund, including the number of active members, the basic employees and employers contributions received in the year, and the number of times (and percentage value) of late paid contributions during the year. The LGPS Regulations specify that contributions must be received by the 19th of the following month.
No interest was charged on any of the instances of late payment.

| | Active members at 31 March 2017 | Employee basic conts. £000 | Employer basic conts. £000 | instances late | % value late |
|---|---|---|---|---|---|
| **Administering Authority** | | | | | |
| Isle of Wight Council | 4,175 | 2,865 | 10,861 | - | - |
| | 4,175 | 2,865 | 10,861 | - | - |
| **Scheduled Bodies** | | | | | |
| Isle of Wight College | 271 | 209 | 839 | - | - |
| Sandown Bay Academy | 105 | 74 | 284 | - | - |
| Ryde Academy | 86 | 47 | 186 | - | - |
| Lanesend Academy | 70 | 23 | 98 | | |
| Cowes Enterprise College | 65 | 49 | 190 | - | - |
| Northwood Primary | 35 | 18 | 51 | - | - |
| St Blasius Academy | 35 | 11 | 47 | - | - |
| Island Free School | 20 | 15 | 62 | - | - |
| Ryde Town Council | 4 | 6 | 22 | 5 | 48.1% |
| IoW Studio School | 3 | 4 | 14 | 1 | 7.8% |
| St Catherines School | 2 | 8 | 18 | 5 | 40.4% |
| Wootton Bridge Parish Council | 1 | 1 | 4 | 2 | 14.8% |

| | Active members at 31 March 2017 | Employee basic conts. £000 | Employer basic conts. £000 | instances late | % value late |
|---|---|---|---|---|---|
| Northwood Parish Council | 1 | 1 | 2 | - | - |
| Newport Parish Council | 1 | 1 | 5 | - | - |
| Chale Parish Council | 1 | 0 | 1 | | |
| Cowes Town Council | 1 | 1 | 2 | | |
| Gurnard Parish Council | 1 | 1 | 3 | - | - |
| | 511 | 469 | 1,828 | 13 | 2.1% |
| | | | | | |
| **Admitted Bodies** | | | | | |
| Sovereign Housing Group | 39 | 76 | 235 | - | - |
| Island Roads | 31 | 60 | 215 | - | - |
| Southern Vectis | 16 | 14 | 66 | - | - |
| Barnardo's | 14 | 15 | 52 | - | - |
| Cowes Harbour Commissioners | 5 | 18 | 45 | - | - |
| Southern Housing Group | 5 | 10 | 39 | - | - |
| Yarmouth Harbour Commissioners | 4 | 10 | 31 | - | - |
| Top Mops | 3 | 2 | 7 | 2 | 19.3% |
| Ventnor Botanic Gardens | 2 | 3 | 9 | 6 | 61.1% |
| Ryde Arena | 2 | 1 | 3 | 1 | 8.0% |
| Caterlink | 2 | 2 | 6 | - | - |
| Trustees of Carisbrooke Castle Museum | 1 | - | 2 | - | - |
| Visit IOW Ltd | 1 | 2 | 7 | 1 | 4.2% |
| | 125 | 213 | 717 | 9 | 2.6% |
| **TOTAL** | **5,002** | **3,547** | **13,406** | **24** | **0.2%** |

# ISLE OF WIGHT COUNCIL PENSION FUND

## Report and Accounts for the period ending 31 March 2017

### Introduction

The Fund's investments have been managed during the year under review by Majedie, Newton, Baillie Gifford and Schroder. The strategic benchmark allocation as at 31 March 2017 was:

| Manager | Mandate | Allocation | Control ranges | Benchmarks |
|---|---|---|---|---|
| Majedie | UK Equities | 22.5% | 19.5 – 25.5% | FTSE All-Share index |
| Newton | Global Equities | 32.5% | 29.5 – 35.5% | MSCI AC (All Countries) World index (net dividends re-invested) |
| Baillie Gifford | Diversified Growth | 15.0% | 11.0 – 19.0% | UK Base Rate + 3.5% |
| Schroder | UK Bonds | 22.0% | 18.0% – 26.0% | Merrill Lynch Sterling Broad Market |
| Schroder | UK Property | 8.0% | 4.0% – 12.0% | IPD Pooled Property Fund indices All Balanced Funds Median |
| **Total** | | **100.0%** | **-** | |

*Source: Statement of Investment Principles*

### Summary of strategic changes

There have been no strategic benchmark changes over the year. The asset allocation at the start and end of the year is shown in the table below.

### Asset Allocation

| Manager/Asset Class | Actual Asset Allocation | | | | Benchmark Allocation (%) |
|---|---|---|---|---|---|
| | Start of Year (£'000) | End of Year (£'000) | Start of Year (%) | End of Year (%) | |
| Majedie – UK Equity | 106,119 | 129,587 | 22.1 | 22.8 | 22.5 |
| Newton – Global Equity | 176,010 | 219,561 | 36.6 | 38.7 | 32.5 |
| Baillie Gifford – Diversified Growth | 70,603 | 78,020 | 14.7 | 13.8 | 15.0 |
| Schroder – UK Bonds | 98,856 | 108,739 | 20.5 | 19.2 | 22.0 |
| Schroder – UK Property | 29,580 | 31,332 | 6.1 | 5.5 | 8.0 |
| **Total** | **481,168** | **567,239** | **100.0** | **100.0** | **100.0** |

*Source: Investment Managers*
*Figures may not sum to total due to rounding.*

**Reasons for variance from Benchmark**

The Fund's actual asset allocation was maintained within the control ranges set relative to the strategy benchmark over the period.

The Fund began the year with an overweight to equities and underweight to bonds, diversified growth and property. The Fund has remained overweight to global equities and underweight property, diversified growth and bonds over the year.

## Market Background

**Investment Markets**[1]

Over the 12 month period to 31 March 2017, both risk and defensive asset classes generally posted strongly positive returns as the ultra-accommodative monetary policy measures adopted by the world's major central banks continued to support financial markets. The strong returns posted by most asset classes came despite bouts of volatility following the surprise result of the UK's referendum in June 2016, where the electorate voted to leave the European Union and the unexpected victory for Donald Trump in the US Presidential Election in November 2016. The latter event in particular served to support equities in developed markets, as investors perceived Trump's fiscal policies as being supportive for corporate earnings.

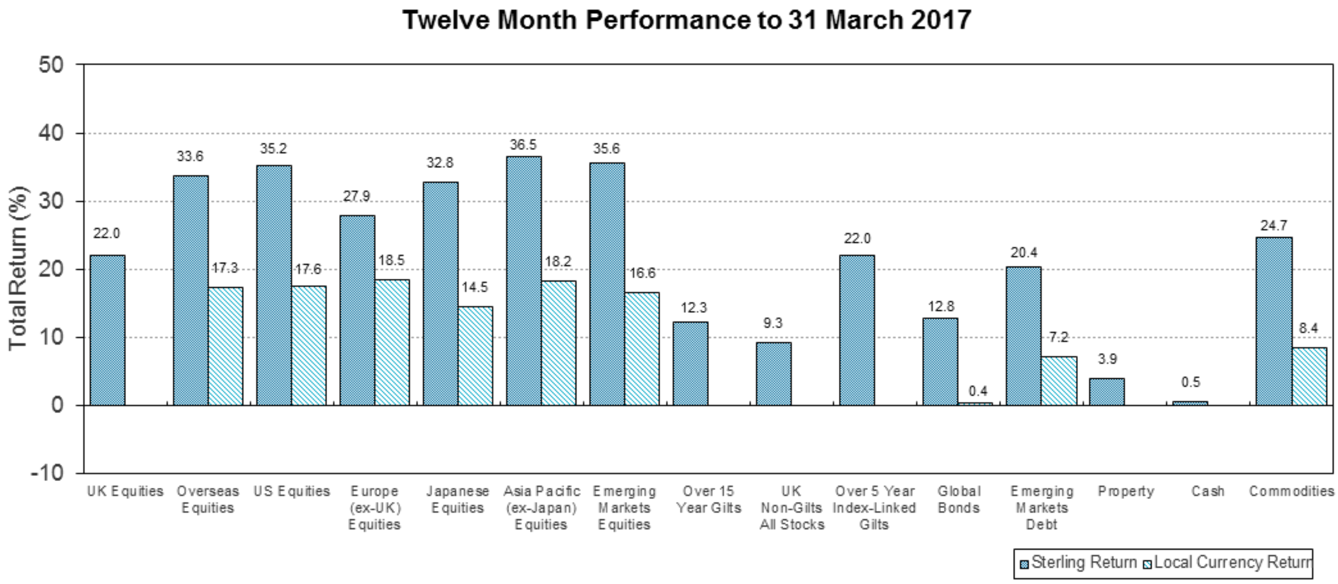
Sterling depreciated sharply against its major counterparts following the 'Brexit' vote and ended the year 13% weaker against the US Dollar compared to the prior year. This led to material gains for unhedged Sterling investors in foreign assets. Meanwhile, subdued growth expectations in the UK culminated in further loosening of monetary policy by the Bank of England in August 2016, and led to a downward shift in government bond yields. This augmented strong returns for defensive assets, notably index-linked bonds, where returns were further amplified by increased inflation expectations in the UK in light of the depreciation of Sterling.

Financial markets continue to be sensitive to the actions of the world's major central banks. In the US, the Federal Reserve Bank (the "Fed") matched investors' expectations by increasing its target rate by 0.25% at its December 2016 meeting and then a further 0.25% at its March 2017 meeting. Elsewhere the European Central Bank ("ECB") announced in December 2016 that its extended Quantitative Easing programme would continue until December 2017 at the earliest, albeit at a slightly reduced pace of asset purchases. The ECB subsequently confirmed in the first quarter of 2017 that further stimulus to this is unlikely to be needed in the near term. The Bank of Japan announced an explicit shift to yield curve targeting in September 2016.

While significant political and economic uncertainty remains following the referendum vote, economists now forecast UK Real GDP growth for 2017 to be 1.7% (a reduction from 2.1% from a forecast before the vote but an increase from 0.7% from the forecast just after) whereas inflation, as measured by the change in the Consumer Price Index, is expected to increase to 2.6% (from 1.6% before the vote) reflecting the depreciation of Sterling[2].

---

[1] Statistics sourced from Thomson Reuters Datastream unless otherwise specified.
[2] Sourced from Consensus Economics, 10 April 2017




**Equities**

At a global level, developed markets as measured by the FTSE World index, returned 32.9%. Meanwhile, a return of 35.6% was recorded by the FTSE All World Emerging Markets index.

At a regional level, European markets returned 27.9% as indicated by the FTSE World Europe ex UK index. At a country level, UK stocks as measured by the FTSE All Share index returned 22.0%. The FTSE USA index returned 35.2% while the FTSE Japan index returned 32.8%.

Equity market total return figures are in Sterling terms over the 12 month period to 31 March 2017.

**Bonds**

Returns on UK Government Bonds as measured by the FTSE Gilts All Stocks Index, returned 6.6%, while long dated issues as measured by the corresponding Over 15 Year Index had a return of 12.3% over the year. The yield for the FTSE Gilts All Stocks index fell over the year from 1.9% to 1.4%.

The FTSE All Stocks Index Linked Gilts index returned 19.9% with the corresponding over 15 year index exhibiting a return of 26.1%.

Corporate debt as measured by the Bank of America Merrill Lynch Sterling Non-Gilts index returned 9.3%.
Bond market total return figures are in Sterling terms over the 12 month period to 31 March 2017.

**Property**

UK property investors continued to benefit from the improving property market. Over the 12 month period to 31 March 2017, the IPD UK All Property Index returned 3.8% in Sterling terms. The three main sectors of the UK Property market each recorded positive returns over the period (retail: 2.3%; office: 1.4%; and; industrial 9.4%).

**Currencies**

Over the 12 month period to 31 March 2017, Sterling fell by 13.0% against the US Dollar from $1.437 to $1.250. Sterling depreciated 13.75% against the Yen from ¥161.55 to ¥139.34. Sterling depreciated against the Euro by 7.3% from €1.26 to €1.17 over the same period.

## Investment Performance

| Manager/Asset Class | Last Year | | Last 3 Years | |
|---|---|---|---|---|
| | Fund (%) | Benchmark (%) | Fund (% p.a.) | Benchmark (% p.a.) |
| Majedie – UK Equity | 26.0 | 22.0 | 8.4 | 7.7 |
| Newton – Global Equity | 24.2 | 32.2 | 15.5 | 15.6 |
| Baillie Gifford – Diversified Growth | 10.9 | 3.8 | 6.0 | 4.0 |
| Schroder – UK Bonds | 10.0 | 8.0 | 8.6 | 7.8 |
| Schroder – UK Property | 6.7 | 5.2 | 12.1 | 10.8 |
| **Total** | **18.7** | **18.2** | **10.4** | **10.2** |

*Figures shown are based on performance provided by State Street and investment managers. Performance figures are gross of fees.*

The Fund has outperformed the benchmark over both the one and three year period by 0.4% and 0.2% respectively. This came largely from the outperformance of Majedie, Baillie Gifford and Schroders.

## Linking the Investment Strategy with the Funding Strategy

Although the investment strategy is set from a long-term perspective, it is formally reviewed every 3 years or so after every actuarial valuation. The Committee reviews the investment strategy to ensure that it remains appropriate for the Fund's liability profile.

The Committee believes that the investment strategy in place provides the Fund with the necessary potential for future returns to meet future benefits while also minimising the risk being taken. The majority of the Fund's investments can be considered liquid to ensure that pensions can be paid as they fall due.

## Custodial Arrangements

| Manager | Custodian |
|---|---|
| Majedie | BNP Paribas |
| Newton | Bank Of New York Mellon |
| Baillie Gifford | Bank Of New York Mellon |
| Schroder | BNP Paribas |

*Source: Investment Managers*
*Pooled funds have no direct custody arrangements in place, the custodians shown are appointed by the investments managers.*

The Committee is responsible for ensuring the Fund's assets continue to be securely held. The Committee reviews the custodian arrangements from time to time and the Fund auditor is authorised to make whatever investigations it deems are necessary as part of the annual audit procedure.

## Investment Manager Fees

Please note that the investment manager fees listed below are the managers' annual management charges. There may be other expenses charged on the Fund's assets, e.g. custodian and administration charges, which would be in addition to these fee scales.

| Manager | Asset Class | Fees |
|---|---|---|
| Majedie | UK Equities | 0.35% p.a. plus 20% of any outperformance above the benchmark return plus 1% on an annualised 3 year rolling basis |
| Newton | Global Equities | 0.20% p.a. on the first £100m<br>0.17% p.a. for the next £200m<br>0.12% p.a for the next £700m<br>0.10% p.a. on the remainder<br>plus 20% of any outperformance above benchmark |
| Baillie Gifford | Diversified Growth | 0.65% p.a. on the first £30m<br>0.50% p.a. on the next £90m<br>0.45% p.a. on the remainder |
| Schroder | UK Bonds | 0.20% p.a. |
| Schroder | UK Property | c0.5% p.a.* |

**estimated by Schroder*

## Social, Environmental and Ethical Considerations

The Committee recognises that social, environmental and ethical considerations are among the factors which investment managers will take into account, where relevant, when selecting investments for purchase, retention or sale. Each of the managers has produced a statement setting out its policy in this regard. The managers have been delegated by the Committee to act accordingly.

## The Myners Review and Code of Best Practice

The Myners principles codify best practice in investment decision making. While they are voluntary, pension fund trustees are expected to consider their applicability to their own fund and report on a 'comply or explain' basis how they have used them.

The principles continue to emphasise the essentials of investment governance, notably the importance of effective decision making, clear investment objectives and a focus on the nature of each scheme's liabilities. The principles also require that trustees include a statement of the scheme's policy on responsible ownership in the Statement of Investment Principles and report periodically to members on the discharge of these responsibilities.

The Committee monitors their investment policies against Myners to ensure that their implementation is in keeping with the revised principles for the Fund. The following table is taken from the Fund's latest Statement of Investment Principles and provides an update on the Fund's compliance with each of the 6 Myners Principles.

| Principle | Response on Adherence |
|---|---|
| **Principle 1 Effective Decision Making:**<br>Administering authorities should ensure:<br>• That decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and | **Compliant**<br>Decisions are taken by the Committee which is responsible for the management of the fund.<br>The Committee has support from council officers with sufficient experience to assist them. The Committee also seeks advice from professional actuarial and investment advisers to ensure it can be familiar with the |

| | |
|---|---|
| • That those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest. | issues concerned when making decisions. **The Committee hold a one hour training session before every Committee meeting.**<br>**The Committee** is able to make robust challenges to advice and is aware of where potential conflicts of interest may reside within the Committee and in relation to service providers. |
| **Principle 2 Clear objectives:**<br>An overall investment objective should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers. | **Compliant**<br>The Committee has established objectives for the fund which takes account of the nature of fund liabilities and the contribution strategy. This involved discussions with the actuary to enable the Committee to set the overall risk budget for the fund. This is reflected in the investment mandates awarded to the asset managers.<br>There is dialogue with admitted bodies within the fund in relation to the contributions they pay, their capacity to pay these contributions and the level of guarantees they can provide. |
| **Principle 3 Risk and liabilities:**<br>• In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.<br>• These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk. | **Compliant**<br>The investment strategy is considered in the light of the nature of the fund liabilities, the timescale over which benefits will be paid, and financial and demographic factors affecting the liabilities, such as inflation and improving longevity.<br>The Committee and council officers have discussed the contribution strategy with the actuary taking account of the strength of covenant of the council and its long term horizon. Discussions have also taken place with admitted bodies in relation to the affordability of contributions and the strengths of their covenants. |
| **Principle 4 Performance assessment:**<br>• Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.<br>• Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members. | **Partially Compliant**<br>The performance of the fund and its individual managers are monitored on a regular basis.<br>The quality of advisers is assessed on a qualitative basis but is not formally measured. Advisers are subject to periodic re-tender.<br>The Committee is developing formal processes to measure its own effectiveness. |
| **Principle 5 Responsible Ownership:**<br>Administering authorities should<br>• Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents.<br>• Include a statement of their policy on responsible ownership in the Statement of Investment Principles.<br>• Report periodically to scheme members on the discharge of such responsibilities. | **Partially Compliant**<br>The Committee encourages its investment managers to adopt the ISC Statement of Principles on the responsibilities of shareholders and agents on the fund's behalf<br>This Statement of Investment Principles includes a statement on the fund's policy on responsible ownership.<br>The Committee needs to consider the implications of the UK Stewardship Code (issued in September 2012) to ensure it is fully compliant with the new requirements. |
| **Principle 6 Transparency and Reporting:**<br>Administering authorities should | **Compliant**<br>The Committee maintains minutes of meetings which |

| | |
|---|---|
| • Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.<br>• Should provide regular communication to scheme members in the form they consider most appropriate. | are available on the council website.<br>The Committee holds a formal annual meeting for members and also meets periodically with sponsoring employer bodies. An Admitted Bodies representative and a Member representative attend Committee meetings.<br>The Statement of Investment Principles is published on the council website and is available to members on request. Other information on the scheme is available to members on the council website. |

MERCER

## Important Notices

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.



This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer's prior written permission.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualised investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

This does not contain regulated investment advice in respect of actions you should take. No investment decision should be made based on this information without obtaining prior specific, professional advice relating to your own circumstances.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest.

Please also note:

- The value of investments can go down as well as up and you may not get back the amount you have invested. In addition investments denominated in a foreign currency will fluctuate with the value of the currency.

- The valuation of investments in property based portfolios, including forestry, is generally a matter of a valuer's opinion, rather than fact.

- When there is no (or limited) recognised or secondary market, for example, but not limited to property, hedge funds, private equity, infrastructure, forestry, swap and other derivative based funds or portfolios it may be difficult for you to obtain reliable information about the value of the investments or deal in the investments.

- Where the investment is via a fund of funds the investment manager typically has to rely on the underlying managers for valuations of the interests in their funds.

- Care should be taken when comparing private equity / infrastructure performance (which is generally a money-weighted performance) with quoted investment performance (which is generally a time-weighted performance). Direct comparisons are not always possible.

**Jo Holden**
**June 2017**

**Actuarial Statement**

# Isle of Wight Council Pension Fund ("the Fund") Actuarial Statement for 2016/17

This statement has been prepared in accordance with Regulation 57(1)(d) of the Local Government Pension Scheme Regulations 2013. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

## Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated March 2017. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is still around a 75% chance that the Fund will return to full funding over 20 years.

## Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 62 of the Local Government Pension Scheme Regulations 2013 was as at 31 March 2016. This valuation revealed that the Fund's assets, which at 31 March 2016 were valued at £518 million, were sufficient to meet 92% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2016 valuation was £44 million.

Each employer had contribution requirements set at the valuation, with the aim of achieving full funding within a time horizon and probability measure as per the FSS. Individual employers' contributions for the period 1 April 2017 to 31 March 2020 were set in accordance with the Fund's funding policy as set out in its FSS.

## Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2016 valuation report.

## Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

## Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2016 valuation were as follows:

| Financial assumptions | 31 March 2016 |
|---|---|
| Discount rate | 4.0% |
| Salary increase assumption | 2.6% |
| Benefit increase assumption (CPI) | 2.1% |

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI 2013 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

| | Males | Females |
|---|---|---|
| Current Pensioners | 22.3 years | 24.7 years |
| Future Pensioners* | 23.9 years | 26.5 years |

*Aged 45 at the 2016 Valuation.

Copies of the 2016 valuation report and Funding Strategy Statement are available on request from the Administering Authority to the Fund.

## Experience over the period since 31 March 2016

Since the last formal valuation, real bond yields have fallen placing a higher value on the liabilities. The effect of this has been broadly offset by strong asset returns. Both events have roughly cancelled each other out in terms of the impact on the funding position as at 31 March 2017.

The next actuarial valuation will be carried out as at 31 March 2019. The Funding Strategy Statement will also be reviewed at that time.

Peter Summers FFA
For and on behalf of Hymans Robertson LLP
6 July 2017

Hymans Robertson LLP
20 Waterloo Street, Glasgow, G2 6DB

## Statement of Responsibilities for the Statement of Accounts

Extracted from Isle of Wight Council Statement of Accounts 2016-17

This will be inserted once the audit of the Isle of Wight Council accounts has been completed

## Fund Account

| 2015-16 £000 | FUND ACCOUNT | Notes | 2016-17 £000 |
|---|---|---|---|
| | Dealings with members, employers and others directly involved in the fund | | |
| 17,714 | Contributions | 7 | 18,318 |
| 221 | Transfers in from other pension funds | 8 | 40 |
| 23 | Other income | 9 | 17 |
| 17,958 | | | 18,375 |
| | | | |
| (19,262) | Benefits | 10 | (20,102) |
| (1,524) | Payments to and on account of leavers | 11 | (168) |
| (20,786) | | | (20,270) |
| (2,828) | | | (1,895) |
| | | | |
| (3,947) | Management expenses | 12 | (2,220) |
| | | | |
| | Returns on investments | | |
| 8,605 | Investment income | 13 | 8,156 |
| (413) | Taxes on income | 14 | (38) |
| (6,880) | Profit and losses on disposal of investments and changes in the market value of investments | 17 | 81,242 |
| (20) | Interest payable | 16 | (35) |
| 1,292 | Net returns on investments | | 89,325 |
| | | | |
| (5,483) | Net increase (decrease) in the net assets available for benefits during the year | | 85,210 |
| 479,477 | Opening Net Assets of the Scheme | | 473,994 |
| 473,994 | Closing Net Assets of the Scheme | | 559,204 |

## Net Asset Statement

| 2016<br>£000 | NET ASSETS STATEMENT AS AT 31 MARCH | Notes | 2017<br>£000 |
|---|---|---|---|
| | | | |
| 478,267 | Investment assets | 17 | 560,499 |
| 2,028 | Cash deposits | 17 | 5,949 |
| 480,295 | | | 566,448 |
| | | | |
| - | Investment liabilities | 17 | (108) |
| (6,505) | Borrowings | 19A | (7,045) |
| 21 | Long term assets | 23 | 157 |
| 811 | Current assets | 24 | 895 |
| (628) | Current liabilities | 25 | (1,143) |
| | | | |
| 473,994 | Net assets of the fund available to fund benefits at the period end | | 559,204 |

The fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end. The actuarial present value of promised retirement benefits is disclosed at note 22.

## ISLE OF WIGHT COUNCIL PENSION FUND

## NOTES TO THE ACCOUNTS

### 1. DESCRIPTION OF THE FUND

The Isle of Wight Council Pension Fund ("the fund") is part of the Local Government Pension Scheme (LGPS) and is administered by Isle of Wight Council ("the council"). The council is the reporting entity for this pension fund.

The following description of the fund is a summary. For more detail, reference should be made to the Isle of Wight Council Pension Fund Annual Report 2016-17 and the underlying statutory powers underpinning the scheme, namely the Public Service Pensions Act 2013 and the Local Government Pension Scheme Regulations.

#### a) General

The fund is governed by the Public Service Pensions Act 2013. The fund is administered in accordance with the following secondary legislation:

- the Local Government Pension Scheme Regulations 2013 (as amended)
- the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 (as amended)
- the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

It is a contributory defined benefit pension scheme administered by Isle of Wight Council to provide pensions and other benefits for the majority of local government employees throughout the Isle of Wight, and a range of other scheduled and admitted bodies on the Isle of Wight. Teachers, police officers and fire-fighters are not included as they come within other national pension schemes.

The fund is overseen by the Isle of Wight Pension Fund Committee ("the committee"), which is a committee of Isle of Wight Council.

#### b) Membership

Membership of the LGPS is voluntary and employees are free to choose whether to join the scheme, remain in the scheme or make their own personal arrangements outside the scheme.

Organisations participating in the Isle of Wight Council Pension Fund include:

- Scheduled bodies, which are local authorities and similar bodies whose staff are automatically entitled to be members of the fund.
- Admitted bodies, which are other organisations that participate in the fund under an admission agreement between the fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

The scheduled bodies of the fund with active members at 31 March 2017 are:

| | |
|---|---|
| Chale Parish Council | Newport Parish Council |
| Cowes Town Council | Northwood Parish Council |
| Cowes Enterprise College, an Ormiston Academy | Northwood Primary Academy |
| Gurnard Parish Council | Ryde Academy |
| Isle of Wight College | Ryde Town Council |
| Isle of Wight Free School | Sandown Bay Academy |
| Isle of Wight Studio School | St Blasius Primary Academy |
| Lanesend Primary Academy | Wootton Bridge Parish Council |

The admitted bodies of the fund with active members at 31 March 2017 are:

Barnados
Caterlink (NEW)
Cowes Harbour Commissioners
Island Roads Limited
Southern Housing Limited
Southern Vectis
Sovereign Housing Limited
St Catherine's School Ltd
Top Mops Ltd (NEW)
Trustees of Carisbrooke Castle Museum
Ventnor Botanic Gardens
Visit IOW Limited
Yarmouth (IW) Harbour Commissioners

The membership of the scheme is shown below:

Year ended 31 March 2017

| | Administering Authority | Scheduled Bodies | Admitted Bodies | Total |
|---|---|---|---|---|
| Number of employers with active members | 1 | 16 | 13 | 30 |
| | | | | |
| Number of contributors (Active members) | 4,175 | 700 | 128 | 5,003 |
| Number of frozen refunds [1] | 596 | 11 | 4 | 611 |
| Number of deferred pensioners [2] | 4,795 | 401 | 119 | 5,315 |
| Number of pensioners/ widows/dependant pensioners | 3,831 | 199 | 162 | 4,192 |
| | 13,397 | 1,311 | 413 | 15,121 |

Year ended 31 March 2016

| | Administering Authority | Scheduled Bodies | Admitted Bodies | Total |
|---|---|---|---|---|
| Number of employers with active members | 1 | 14 | 13 | 28 |
| | | | | |
| Number of contributors (Active members) | 3,159 | 511 | 137 | 3,807 |
| Number of frozen refunds [1] | 601 | 10 | 4 | 615 |
| Number of deferred pensioners [2] | 5,520 | 520 | 122 | 6,162 |
| Number of pensioners/ widows/dependant pensioners | 3,706 | 182 | 148 | 4,036 |
| | 12,986 | 1,223 | 411 | 14,620 |

[1] Frozen refunds are former employees who do not have any pension entitlement apart from a return of the contributions paid into the Scheme during their employment but have not yet claimed the refund

[2] A deferred pensioner is a former employee who has accrued pension rights within the Scheme but has not yet reached retirement age to enable them to access their benefits or transferred their accrued rights to another Scheme/provider

### c) Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the fund in accordance with the LGPS Regulations 2013.

The pay bands and rates applicable for the year ended 31 March 2017 are detailed below.

| Range (Actual pensionable pay) | Contribution rate |
|---|---|
| Up to £13,600 | 5.5% |
| More than £13,601 and up to £21,200 | 5.8% |
| More than £21,201 and up to £34,400 | 6.5% |
| More than £34,401 and up to £43,500 | 6.8% |
| More than £43,501 and up to £60,700 | 8.5% |
| More than £60,701 and up to £86,000 | 9.9% |
| More than £86,001 and up to £101,200 | 10.5% |
| More than £101,201 and up to £151,800 | 11.4% |
| More than £151,800 | 12.5% |

Employee contributions are matched by employers' contributions which are set based on triennial actuarial valuations. The last such valuation was at 31 March 2016. The current and future employer contribution rates as determined by that valuation are detailed in note 21.

### d) Benefits

Prior to 1 April 2014, pension benefits under the LGPS were based on final pensionable pay and length of pensionable service, summarised below.

| | Service pre 1 April 2008 | Service post 31 March 2008 |
|---|---|---|
| **Pension** | Each year worked is worth 1/80 x final pensionable salary | Each year worked is worth 1/60 x final pensionable salary |
| **Lump Sum** | Automatic lump sum of 3 x salary.<br>In addition, part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up. | No automatic lump sum.<br>Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up. |

From 1 April 2014, the scheme became a career average scheme, whereby members accrue benefits based on their pensionable pay in that year at an accrual rate of 1/49th. Accrued pension is uprated annually in line with the Consumer Prices Index.

There are a range of other benefits provided under the scheme including early retirement, disability pensions and death benefits. For more details, please refer to the Pensions Office website: http://www.iwight.com/council/OtherServices/Pensions-IWC

## 2. BASIS OF PREPARATION

The Statement of Accounts summarises the fund's transactions for the 2016-17 financial year and its position at year-end as at 31 March 2017. The accounts have been prepared in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2016/17* which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed at note 22 of these accounts.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Fund account – revenue recognition

a) **Contribution income**

Normal contributions, both from the members and from the employer, are accounted for on an accruals basis at the percentage rate recommended by the actuary in the payroll period to which they relate.

Employer deficit funding contributions are accounted for on the due dates on which they are payable under the schedule for contributions set by the scheme actuary or on receipt if earlier than the due date.

Employers' augmentation contributions and pension strain contributions are accounted for in the period in which the liability arises. Any amount due in year but unpaid will be classed as a current financial asset. Amounts not due until future years are classed as long-term financial assets.

b) **Transfers to and from other schemes**

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations 2013 (see notes 8 and 11).

Individual transfers in/out are accounted for when paid/received, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions (see below) to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers In (see note 8).

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

c) **Investment income**

i) *Interest income*

Interest income is recognised in the fund accounts as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs (where material) or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii) *Dividend income*

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iii) *Distributions from pooled funds*

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

*iv) Movement in the net market value of investments*

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

### Fund account – expense items

d) **Benefits payable**

Pensions and lump-sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

**e) Taxation**

The fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers from withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a fund expense as it arises.

**f) Management expenses**

The code does not require any breakdown of pension fund administrative expenses. However, in the interests of greater transparency, the council discloses its pension fund management expenses in accordance with the CIPFA guidance *Accounting for Local Government Pension Scheme Management Costs (2016)*

*Administrative expenses*

All administrative expenses are accounted for on an accruals basis. All staff costs of the pensions administration team are charged direct to the fund. Associated management, accommodation and other overheads are apportioned to the fund in accordance with council policy.

*Oversight and governance costs*

All oversight and governance expenses are accounted for on an accruals basis. All staff costs associated with governance and oversight are charged direct to the fund. Associated management, accommodation and other overheads are apportioned to this activity and charged as expenses to the fund.

*Investment management expenses*

All investment management expenses are accounted for on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly these are based on the market values of the investments under their management and therefore increase or reduce as the value of these investments change.

In addition the fund has negotiated with the following managers that an element of their fee be performance related:

- Majedie Asset Management Limited – UK Equities
- Newton Investment Management Limited – Global Equities

Where an investment manager's fee note has not been received by the balance sheet date, an estimate based on the market value of their mandate as at the end of the year is used for inclusion in the fund account. In 2016-17 no fees are based on such estimates (2015-16: nil)

The cost of obtaining investment advice from external consultants is included in investment management charges.

A proportion of the council's costs representing management time spent by officers on investment management is also charged to the fund.

**g) VAT**

VAT payable is included as an expense only to the extent that it is not recoverable from Her Majesty's Revenue and Customs (HMRC). VAT receivable is excluded from income.

## Net assets statement

**h) Financial assets**

Financial assets are included in the net assets statement on a fair value basis at the reporting date. A financial asset is recognised in the net assets statement on the date the fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes in the fair value of the asset are recognised by the fund.

The values of investments as shown in the net assets statement have been determined at fair value in accordance with the requirements of the Code and IFRS13 (see Note 18). For the purposes of disclosing levels of fair value hierarchy, the fund has adopted the classification guidelines recommended in *Practical Guidance on Investment Disclosures* (PRAG/Investment Association, 2016) *i) Foreign currency transactions*

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of transaction. End-of-year spot market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchases and sales outstanding at the end of the reporting period.

*j) Cash and cash equivalents*

Cash comprises cash in hand and demand deposits and includes amounts held by the fund's external managers.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

*k) Financial liabilities*

The fund recognises financial liabilities at fair values at the reporting date. A financial liability is recognised in the net assets statement on the date the fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised by the fund.

*l) Actuarial present value of promised retirement benefits*

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under the Code, the fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statement (note 22).

*m) Additional Voluntary Contributions*

Isle of Wight Council Pension Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the pension fund. The fund has appointed Prudential Life and Pensions as its AVC provider. AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for individual contributors.
Each AVC contributor receives an annual statement showing the amount held in their accounts and the movements in the year.

AVCs are not included in the accounts in accordance with section 4(1)(b) of the Local Government Pension Scheme (Management and Investment Funds) Regulations 2016 but are disclosed as a note only (note 26).

n) *Accruals of expenditure and income*

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Revenue from the sale of goods is recognised when the council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the council.
- Revenue from the provision of services is recognised when the council can measure reliably the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the council.
- Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the balance sheet.
- Expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather that when payments are made.
- Interest receivable on investments and payable on borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract.
- Where revenue and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the balance sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

o) *Provisions, Contingent Liabilities and Contingent Assets*

A contingent liability arises where an event has taken place prior to the year-end giving rise to a possible financial obligation whose existence will only be confirmed or otherwise by the occurrence future events. Contingent liabilities can also arise in circumstances where a provision would be made, except that it is not possible at the balance sheet date to measure the value of the financial obligation reliably.

A contingent asset arises where an event has taken place that gives the authority a possible asset, whose existence will only be confirmed by the occurrence or otherwise of uncertain future events.

Contingent liabilities are not recognised in the net assets statement but disclosed in note 28 to the accounts.

## 4. CRITICAL JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

**Pension fund liability**

The pension fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines.
This estimate is subject to significant variances based on changes to the underlying assumptions which are agreed with the actuary and have been summarised in Note 22.

These actuarial revaluations are used to set future contribution rates and underpin the fund's most significant investment management policies, for example in terms of the balance struck between longer term investment growth and short-term yield/growth.

## 5. ASSUMPTIONS MADE ABOUT THE FUTURE AND OTHER MAJOR SOURCES OF ESTIMATION UNCERTAINTY

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for the revenues and expenses during the year. Estimates and assumptions are made taking into account historical experience, current trends and other relevant factors. However, the nature of estimation means that actual outcomes could differ from the assumption and estimates.

The items in the net assets statement at 31 March 2017 for which there is a significant risk of material adjustment within the forthcoming financial year are as follows:

| Item | Uncertainties | Effect if actual results differ from assumptions |
|---|---|---|
| Actuarial present value of promised retirement benefits | Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the fund with expert advice about the assumptions to be provided. | The effects on the net pension liability of changes in individual assumptions can be measured. For instance:<br>A 0.5% increase in the discount rate assumption would result in a decrease in the pension fund deficit of £69m.<br>A 0.5% increase in assumed earnings inflation would increase the deficit by approximately £13m.<br>A 0.5% increase in assumed price inflation/pension increases would increase the deficit by approximately £56m.<br>A one-year increase in assumed life expectancy would increase the deficit by approximately £27m |
| Pooled Property Funds | Valuation techniques are used to determine the carrying amount of pooled property funds. Where possible these valuation techniques are based on observable data, but where this is not possible management uses the best available data. Changes in the valuation assumptions used, together with significant | The effect of variations in the factors supporting the valuation would be an increase or decrease in the value of pooled property funds. |

changes in rental growth, vacancy levels or the discount rate could affect the fair value of the property.

## 6. EVENTS AFTER THE BALANCE SHEET DATE

These are events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:

- those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period) and
- those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)

Events taking place after the date of authorisation for issue are not reflected in the financial statements.

There are no post balance sheet events recorded prior to the authorised for issue date and any events that occurred after this date have not been recognised in the statement of accounts.

## 7. CONTRIBUTIONS RECEIVABLE

**By category:**

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 14,191 | Employers | 14,764 |
| 3,523 | Members | 3,554 |
| 17,714 | | 18,318 |

**By authority:**

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 13,535 | Administering authority | 14,166 |
| 2,302 | Scheduled bodies | 2,416 |
| 1,877 | Admitted bodies | 1,736 |
| 17,714 | | 18,318 |

By type:

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 3,497 | Employees’ normal contributions | 3,531 |
| 26 | Employees’ additional contributions | 23 |
| 13,065 | Employers’ normal contributions | 13,436 |
| 826 | Employers’ deficit recovery contributions | 824 |
| 300 | Employers’ augmentation contributions | 504 |
| 17,714 | | 18,318 |

## 8. TRANSFERS IN FROM OTHER PENSION FUNDS

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| - | Group transfers | - |
| 221 | Individual transfers | 40 |
| 221 | | 40 |

## 9. OTHER INCOME

| 2015-16<br>£000 | | 2016-17<br>£000 |
|---|---|---|
| 19 | Miscellaneous income | 12 |
| 4 | Contribution Equivalent Premiums | 5 |
| 23 | | 17 |

Contribution Equivalent Premiums (CEPs) are sums relating to National Insurance Contributions payable when an employee leaves the pension fund without entitlement to benefits. Sums are held as a contingent asset and/or liability and these amounts remain so until the relevant employee requests a refund of contributions payable, a transfer is made to another pension fund or the employee returns to the employ of the Isle of Wight Council (see note 26).

## 10. BENEFITS PAYABLE

**By category:**

| 2015-16<br>£000 | | 2016-17<br>£000 |
|---|---|---|
| 16,556 | Pensions | 17,061 |
| 2,577 | Commutation and lump sum retirement benefits | 2,837 |
| 129 | Lump sum death benefits | 204 |
| 19,262 | | 20,102 |

**By authority:**

| 2015-16<br>£000 | | 2016-17<br>£000 |
|---|---|---|
| 17,474 | Administering authority | 18,160 |
| 1,187 | Scheduled bodies | 1,269 |
| 601 | Admitted bodies | 673 |
| 19,262 | | 20,102 |

## 11. PAYMENTS TO AND ON ACCOUNT OF LEAVERS

| 2015-16<br>£000 | | 2016-17<br>£000 |
|---|---|---|
| 28 | Refund to members leaving service | 55 |
| - | Group transfers | 31 |
| 1,496 | Individual transfers | 82 |
| 1,524 | | 168 |

## 12. MANAGEMENT EXPENSES

| 2015-16<br>£000 | | 2016-17<br>£000 |
|---|---|---|
| 326 | Administrative costs | 389 |
| 3,363 | Investment management expenses | 1,474 |
| 258 | Oversight and governance costs | 357 |
| 3,947 | | 2,220 |

## 12A. INVESTMENT MANAGEMENT EXPENSES

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 1,065 | Management Fees | 1,161 |
| 2,262 | Performance Related Fees | 274 |
| 36 | Custody Fees | 39 |
| | Transaction Costs | |
| 3,363 | | 1,474 |

The analysis of the costs of managing the Isle of Wight Council Pension Fund during the period has been prepared in accordance with CIPFA guidance.

In addition to these costs, indirect costs are incurred through the bid-offer spread on investments sales and purchases. These are reflected in the cost of investment acquisitions and in the proceeds from the sales of investments (see note 17a).

## 13. INVESTMENT INCOME

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 4,210 | Income from equities | 4,709 |
| | Income from pooled investment vehicles: | |
| 968 | - Property | 982 |
| 3,416 | - Bonds | 2,891 |
| - | - Unit Trusts | |
| 11 | Interest on cash deposits | 3 |
| - | Other | (429) |
| 8,605 | | 8,156 |

## 14. TAXATION

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 413 | Withholding tax - equities | 38 |
| 413 | | 38 |

## 15. EXTERNAL AUDIT COSTS

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 21 | Payable in respect of external audit | 21 |
| 21 | | 21 |

## 16. INTEREST PAYABLE

| 2015-16 £000 | | 2016-17 £000 |
|---|---|---|
| 20 | Interest on short term borrowing | 35 |
| 20 | | 35 |

## 17. INVESTMENTS

| Market value 31 March 2016 £000 | | Market value 31 March 2017 £000 |
|---|---|---|
| | Investment assets | |
| 93,993 | Equities | 111,854 |
| 383,781 | Pooled Investment Vehicles | 448,164 |
| 2,028 | Cash deposits | 5,949 |
| 474 | Investment income due | 389 |
| - | Amounts receivable for sales | 78 |
| 19 | Recoverable withholding tax | 14 |
| 480,295 | Total investment assets | 566,448 |
| | Investment liabilities | |
| - | Amounts payable for purchases | (108) |
| - | Total investment liabilities | (108) |
| 480,295 | Net investment assets | 566,340 |

## 17A. RECONCILIATION OF MOVEMENTS IN INVESTMENTS

| | Market value 1 April 2016 | Purchases during the year | Sales during the year | Change in market value during the year | Market value 31 March 2017 |
|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 |
| Equities | 93,993 | 40,243 | (44,036) | 21,654 | 111,854 |
| Pooled Investment Vehicles | | | | | |
| Global Equities | 176,010 | - | - | 43,551 | 219,561 |
| Property | 28,587 | 982 | (155) | 890 | 30,304 |
| Bonds | 98,856 | 2,891 | - | 6,992 | 108,739 |
| Diversified Growth Fund | 70,603 | 1,497 | - | 5,920 | 78,020 |
| Unit Trusts | 9,725 | - | (157) | 1,972 | 11,540 |
| | 477,774 | 45,613 | (44,348) | 80,979 | 560,018 |
| Cash deposits | 2,028 | | | 254 | 5,949 |
| Amounts receivable for sales of investments | - | | | | 78 |
| Investment income due | 474 | | | 8 | 389 |
| Recoverable withholding tax | 19 | | | | 14 |
| Amounts payable for purchases of investments | – | | | 1 | (108) |
| Net investment assets | 480,295 | | | 81,242 | 566,340 |

| | Market value 1 April 2015 | Purchases during the year | Sales during the year | Change in market value during the year | Market value 31 March 2016 |
|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 |
| Equities | 105,258 | 37,571 | (37,911) | (10,925) | 93,993 |
| Pooled Investment Vehicles | | | | | |
| Global Equities | 171,942 | - | - | 4,068 | 176,010 |
| Property | 25,772 | 716 | (13) | 2,112 | 28,587 |
| Bonds | 96,647 | 3,416 | - | (1,207) | 98,856 |
| Diversified Growth Fund | 72,004 | 70,610 | (70,548) | (1,463) | 70,603 |
| Unit Trusts | 9,393 | - | (215) | 547 | 9,725 |
| | 481,016 | 112,313 | (108,687) | (6,868) | 477,774 |
| Cash deposits | 1,279 | | | (9) | 2,028 |
| Amounts receivable for sales of investments | 34 | | | | - |
| Investment income due | 317 | | | (3) | 474 |
| Recoverable withholding tax | 36 | | | | 19 |
| Amounts payable for purchases of investments | (13) | | | | – |
| Net investment assets | 482,669 | | | (6,880) | 480,295 |

### 17B. ANALYSIS OF INVESTMENTS

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| | Equities | |
| | UK | |
| 78,269 | Quoted | 95,406 |
| | Overseas | |
| 15,724 | Quoted | 16,448 |
| 93,993 | | 111,854 |
| | Pooled funds – additional analysis | |
| | UK | |
| 98,856 | Fixed income unit trusts | 108,739 |
| 256,338 | Unit Trusts | 309,121 |
| 355,194 | | 417,860 |
| 28,587 | Pooled property investments | 30,304 |
| 28,587 | | 30,304 |
| 2,028 | Cash Deposits | 5,949 |
| 474 | Investment income due | 389 |
| - | Amounts receivable from sales | 78 |
| 19 | Withholding Tax | 14 |
| 2,521 | | 6,430 |
| 480,295 | Total investment assets | 566,448 |
| | Investment Liabilities | |
| - | Amounts payable for purchases | (108) |
| - | Total Investment Liabilities | (108) |
| 480,295 | Net investment assets | 566,340 |

### 17C. INVESTMENTS ANALYSED BY FUND MANAGER

| Market value 31 March 2016 | | | Market value 31 March 2017 | |
|---|---|---|---|---|
| £000 | % | | £000 | % |
| 98,856 | 20.6% | Schroder Investment Management – Bonds | 108,739 | 19.2% |
| 28,687 | 6.0% | Schroder Investment Management – Property | 30,404 | 5.4% |
| 176,010 | 36.6% | Newton Investment Management – Overseas Equities | 219,561 | 38.8% |
| 106,120 | 22.1% | Majedie Asset Management – UK Equities | 129,601 | 22.9% |
| 70,603 | 14.7% | Baillie Gifford – Diversified Growth Fund | 78,021 | 13.8% |
| 480,276 | | | 566,326 | |
| 19 | 0.0% | Recoverable withholding tax | 14 | 0.0% |
| 480,295 | | | 566,340 | |

All the above companies are registered in the United Kingdom.

**The following investments represent more than 5% of the total net assets of the fund**

| Market value 31 March 2016 | | | Market value 31 March 2017 | |
|---|---|---|---|---|
| £000 | % of total fund | | £000 | % of total fund |
| 176,010 | 37.13% | Newton International Growth X Account | 219,561 | 39.29% |
| 98,856 | 20.86% | Schroder Institutional Sterling Broad Market X Account | 108,739 | 19.46% |
| 70,603 | 14.9% | Baillie Gifford Diversified Growth Pension Fund | 78,020 | 13.96% |
| 28,687 | 6.03% | Schroder UK Property Fund | 30,304 | 5.42% |

**The following investments represent more than 5% of their asset class**

| Market value 31 March 2016 | | | Market value 31 March 2017 | |
|---|---|---|---|---|
| £000 | % of asset class | | £000 | % of asset class |
| | | Equities | | |
| 6,113 | 6.50% | Royal Dutch Shell | 9,121 | 8.15% |
| 6,245 | 6.64% | BP plc | 7,687 | 6.87% |
| 6,422 | 6.83% | HSBC | 6,570 | 5.87% |
| 5,317 | 5.66% | Vodafone Group | 4,265 | 3.81% |

| Market value 31 March 2016 | | | Market value 31 March 2017 | |
|---|---|---|---|---|
| £000 | % of asset class | | £000 | % of asset class |
| | | Pooled Investment Vehicles | | |
| | | Global Equities | | |
| 176,010 | 100% | Newton International Growth X Account | 219,561 | 100% |
| | | Bonds | | |
| 98,856 | 100% | Schroder Institutional Sterling Broad Market X Account | 108,739 | 100% |
| | | Property | | |
| 28,687 | 100% | Schroder UK Property Fund | 30,404 | 100% |
| | | Diversified Growth Funds | | |
| 70,603 | 100% | Baillie Gifford Diversified Growth Pension Fund | 78,021 | 100% |
| | | Unit Trusts | | |
| 9,725 | 100% | Majedie Asset Management Special Situations Investment Fund | 11,540 | 100% |

## 18. FAIR VALUE – BASIS OF VALUATION

The basis of the valuation of each class of investment asset is set out below. There has been no change in the valuation techniques used during the year. All assets have been valued using fair value techniques which represent the highest and best value available at the reporting date.

| Description of Asset | Valuation Hierarchy | Basis of Valuation | Observable and unobservable inputs |
|---|---|---|---|
| **Market quoted investments** | Level 1 | Published bid market price ruling on the final day of the accounting period | Not required |
| **Exchange traded pooled investments** | Level 1 | Closing bid value on published exchanges | Not required |
| **Pooled investments – overseas unit trusts and property funds** | Level 2 | Closing bid price where bid and offer prices are published<br>Closing single price where single price published | NAV- based pricing set on a forward pricing basis |

## 18A. FAIR VALUE HEIRARCHY

Asset and liability valuations have been classified into three levels, according to the quality and reliability of information used to determine fair values. Transfers between levels are recognised in the year in which they occur.

**Level 1**
Assets and liabilities at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities, quoted fixed securities, quoted index linked securities and unit trusts.

**Level 2**
Assets and liabilities at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value.

**Level 3**
Assets and liabilities at Level 3 are those where at least one input that could have a significant impact on the instrument's valuation is not based on observable market data.

At 31 March 2017, the fund does not have any investments which should be classified as Level 3.

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Levels 1 to 3, based on the level at which the fair value is observable:

| 31 March 2016 | | | | 31 March 2017 | | |
|---|---|---|---|---|---|---|
| Quoted Market Price | Using Observable Inputs | Total | | Quoted Market Price | Using Observable Inputs | Total |
| £000 | £000 | £000 | | £000 | £000 | £000 |
| 451,708 | 28,587 | 480,295 | Financial assets at fair value through profit and loss | 536,144 | 30,304 | 566,448 |
| - | - | - | Financial liabilities at fair value through profit and loss | - | (108) | (108) |
| 451,708 | 28,587 | 480,295 | Net investment assets | 536,144 | 30,196 | 566,340 |

### 19A. CLASSIFICATION OF FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

The following table analyses the carrying amounts of financial instruments by category and the net assets statement heading. No financial instruments were reclassified during the accounting period.

| 31 March 2016 | | | | 31 March 2017 | | |
|---|---|---|---|---|---|---|
| Fair value through profit and loss | Loans and receivables | Financial liabilities at amortised cost | | Fair value through profit and loss | Loans and receivables | Financial liabilities at amortised cost |
| £000 | £000 | £000 | | £000 | £000 | £000 |
| | | | Financial assets | | | |
| 93,993 | | | Equities | 111,854 | | |
| 383,781 | | | Pooled investment vehicles | 448,164 | | |
| | 2,042 | | Cash | | 5,949 | |
| 493 | | | Other investment balances | 481 | | |
| | 133 | | Debtors | | 98 | |
| 478,267 | 2,175 | - | | 560,499 | 6,047 | - |
| | | | Financial liabilities | | | |
| | | | Other investment balances | (108) | | |
| | | (433) | Creditors | | | (907) |
| | | | Bank Balance | | (20) | |
| | | (6,505) | Borrowings | | | (7,045) |
| - | - | (6,938) | | (108) | (20) | (7,952) |
| 478,267 | 2,175 | (6,938) | | 560,391 | 6,027 | (7,952) |

### 19B. NET GAINS AND LOSSES ON FINANCIAL INSTRUMENTS

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| | Financial assets | |
| (6,871) | Designated at fair value through profit and loss | 80,987 |
| (9) | Loans and receivables | 254 |
| | Financial liabilities | |
| - | Fair value through profit and loss | 1 |
| - | Financial liabilities at amortised cost | - |
| (6,880) | Total | 81,242 |

The pension fund has not entered into any financial guarantees that are required to be accounted for as financial instruments

### 20. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

**Risk and risk management**

The fund's primary long-term risk is that its assets will fall short of its liabilities (i.e. promised benefits payables to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the fund and to maximise the opportunity for gains across the whole fund portfolio. The fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk, and interest rate risk) and credit risk to an acceptable level. In addition, the fund manages its liquidity risk to ensure there is sufficient liquidity to meet the fund's forecast cash flows. The council manages these investment risks as part of its overall pension fund risk management programme.

Responsibility for the fund's risk management strategy rests with the pension fund committee. Risk management policies are established to identify and analyse the risks faced by the council's pensions operations. Policies are reviewed regularly to reflect changes in activity and market conditions.

Because the fund adopts a long term investment strategy, the high level risks described below will not alter significantly during the year unless there are significant strategic or tactical changes in the portfolio.

**a) Market risk**
Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The fund is exposed to market risk from its investment activities, particularly through it equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix.

The objective of the fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, while optimising the return from the investment portfolio.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the council and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

The fund's investments are managed on behalf of the fund by the appointed investment managers. Each investment manager is required to invest the assets managed by them in accordance with the terms of their investment guidelines or pooled fund prospectus. The committee has determined that the investment management structure is appropriate and is in accordance with its investment strategy. The committee regularly monitors each investment manager and considers and takes advice on the nature of the investments made and associated risks.

**Other price risk**
Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all such instruments in the market.

Other price risk arises from uncertainty about the future value of the financial instruments that the fund holds. All investments present a risk of loss of capital, the maximum risk being determined by the fair value of the financial instruments. The investment managers mitigate this risk through diversification and the selection of securities and other financial instruments is monitored by the council to ensure it is within limits specified in the fund investment strategy.

**Other price risk - sensitivity analysis**
Following analysis of historical data during the financial year, the council has determined that the following movements in market price risk are reasonably possible for the 2016/17 reporting period. The volatility data is broadly consistent with a one-standard deviation movement in the value of the assets. The analysis assumes that all other variables remain constant.

Had the market price of the fund investments increase/decreased in line with the percentages below, the change in the net assets available to pay benefits in the market price would have been as follows (the prior year comparator is shown below).

| | Value as at 31 March 2017 | Volatility of return | Value on increase | Value on decrease |
|---|---|---|---|---|
| | £000 | % | £000 | £000 |
| Cash & cash equivalents | 5,949 | 0.0% | 5,949 | 5,949 |
| Investment portfolio assets | | | | |
| Equities – UK | 95,407 | 7.4% | 102,466 | 88,346 |
| Equities – overseas | 16,447 | 9.6% | 18,027 | 14,869 |
| Pooled investment vehicles: | | | | |
| Global equities | 219,561 | 6.8% | 234,491 | 204,631 |
| Property | 30,304 | 1.8% | 30,849 | 29,758 |
| Bonds | 108,739 | 3.4% | 112,436 | 105,042 |
| Diversified Growth Fund | 78,020 | 2.9% | 80,283 | 75,758 |
| Unit Trusts | 11,540 | 6.3% | 12,267 | 10,813 |
| Amounts receivable for sales | 78 | 0.0% | 78 | 78 |
| Investment income due | 389 | 0.0% | 389 | 389 |
| Recoverable withholding tax | 14 | 0.0% | 14 | 14 |
| Amounts payable for purchases | (108) | 0.0% | (108) | (108) |
| Total | 566,340 | | 597,141 | 535,539 |

| | Value as at 31 March 2016 | Volatility of return | Value on increase | Value on decrease |
|---|---|---|---|---|
| | £000 | % | £000 | £000 |
| Cash & cash equivalents | 2,028 | 0.0% | 2,028 | 2,028 |
| Investment portfolio assets | | | | |
| Equities – UK | 78,269 | 5.3% | 82,417 | 74,121 |
| Equities – overseas | 15,724 | 9.1% | 17,156 | 14,294 |
| Pooled investment vehicles: | | | | |
| Global equities | 176,010 | 3.1% | 181,467 | 170,554 |
| Property | 28,587 | 3.3% | 29,530 | 27,644 |
| Bonds | 98,856 | 1.5% | 100,339 | 97,373 |
| Diversified Growth Fund | 70,603 | 1.5% | 71,662 | 69,544 |
| Unit Trusts | 9,725 | 2.4% | 9,959 | 9,492 |
| Amounts receivable for sales | - | 0.0% | - | - |
| Investment income due | 474 | 0.0% | 474 | 474 |
| Recoverable withholding tax | 19 | 0.0% | 19 | 19 |
| Amounts payable for purchases | - | 0.0% | - | - |
| Total | 480,295 | | 495,051 | 465,543 |

**b) Interest rate risk**

The fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The fund’s direct exposure to interest rate movements as at 31 March 2017 and 31 March 3016 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value.

**Interest rate risk - sensitivity analysis**

The council recognises that interest rates can vary and can affect both income to the fund and the carrying value of fund assets, both of which affect the value of the net assets available to pay benefits.

The fund does not directly hold any fixed interest securities; hence a change in interest rates will not impact on the fair value of assets.

Changes in interest rates do not impact on the fair value of cash balances, but they will impact on the interest income earned.

### c) Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The fund is exposed to currency risk on investments that are denominated in any currency other than sterling. For a sterling based investor, when sterling weakens, the sterling value of foreign currency denominated investments rises. As sterling strengthens, the sterling value of foreign currency denominated investment falls.

The following table summarises the fund's currency exposure as at 31 March 2017, and as at the previous period end:

| | Asset value as at 31 March 2017 | Asset value as at 31 March 2016 |
|---|---|---|
| | £'000 | £'000 |
| Overseas Quoted Securities | 13,890 | 15,412 |
| Investment income due | 246 | 202 |
| | 14,136 | 15,614 |

**Currency risk – sensitivity analysis**

Following analysis of historical data, the council considers the likely volatility associated with foreign exchange movements to be 8.06% (2015-16: 6.49%) (as measured by one standard deviation), based on historical movements on the month-end exchange rates over a rolling 36-month period.

This analysis assumes that all other variables, in particular interest rates, remain constant.

Movements in the relative strength of the pound against the various currencies in which the fund holds investments would increase/decrease the net assets available to pay benefits as follows:

| | Value as at 31 March 2017 | Value on increase +8.06% | Value on decrease -8.06 % |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Overseas Quoted Securities | 13,890 | 15,003 | 12,776 |
| Investment income due | 246 | 272 | 220 |
| | 14,136 | 15,275 | 12,996 |

| | Value as at 31 March 2016 | Value on increase +6.49% | Value on decrease -6.49% |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Overseas Quoted Securities | 15,412 | 16,416 | 14,408 |
| Investment income due | 202 | 212 | 192 |
| | 15,614 | 16,628 | 14,600 |

### d) Credit Risk

Credit risk represents the risk that the counterparty to a transaction or financial instrument will fail to discharge an obligation and cause the fund to incur a financial loss. This is often referred to as counterparty risk. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the find's financial assets and liabilities.

The fund is exposed to credit risk through its underlying investments (including cash balances) and the transactions it undertakes to manage its investments. The careful selection and monitoring of counterparties including brokers, custodian and investment managers minimises credit risk that may occur though the failure to settle transactions in a timely manner.

Contractual credit risk is represented by the net payment, or receipt that remains outstanding, and the cost of replacing the position in the event of a counterparty default. The residual risk is minimal due to the various insurance policies held by the exchanges to cover defaulting counterparties. Bankruptcy or insolvency of the custodian may affect the fund's access to its assets. However, all assets held by the custodian are ring-fenced as "client assets" and therefore cannot be claimed by creditors of the custodian. The fund manages its risk by monitoring the credit quality and financial position of the custodian.

The fund does not hold any fixed interest securities directly, hence has limited credit risk through its underlying investments in bonds.

Another source of credit risk is the cash balances held to meet operational requirements or by the managers at their discretion. Internally held cash is managed on the fund's behalf by the council's treasury management team in line with the council's Treasury Management Strategy which sets out the permitted counterparties and limits. The fund invests surplus cash held with the custodian in diversified money market funds.

The fund does not engage in securities lending activities, hence is not exposed to the counterparty risk of the collateral provided by borrowers against the securities lent.

The fund does not have any foreign exchange contracts, hence is not subject to credit risk in relation to the counterparties of the contracts.

The council believes it has managed its exposure to credit risk, and has had no experience of default or uncollectable deposits over the past five financial years.

**e) Liquidity Risk**

Liquidity risk represents the risk that the fund will not be able to meet its financial obligations as they fall due. The council therefore takes steps to ensure that the pension fund has adequate cash resources to meet its commitments. This will particularly be the case for cash from the cash flow matching mandates from the main investment strategy to meet the pensioner payroll costs.

A substantial portion of the fund's investments consist of readily realisable securities, in particular equities and fixed income investments, even though a significant proportion is held in pooled funds. However, the main liability of the fund is the benefits payable, which fall due over a long period and the investment strategy reflects the long term nature of these liabilities. Therefore the fund is able to manage the liquidity risk that arises from its investments in less liquid asset classes such as property which are subject to longer redemption periods and cannot be considered as liquid as the other investments.

The fund maintains a cash balance to meet working requirements, which is supported by an available credit line from the Isle of Wight Council. Note 27 includes details of borrowing from the council for this purpose.

Management prepares periodic cash flow forecasts to understand and manage the timing of the fund's cash flows. The appropriate strategic level of cash balances to be held forms part of the fund investment strategy.

All financial liabilities at 31 March 2016 are due within one year.

**Refinancing risk**

The key risk is that the council will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The council does not have any financial instruments that have a refinancing risk as part of its treasury management and investment strategies.

## 21. FUNDING ARRANGEMENTS

In accordance with the Local Government Pension Scheme Regulations 2013, the fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The last such valuation took place as at 31 March 2016 and the next valuation will take place as at 31 March 2019.

**Description of Funding Policy**

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated March 2017. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund by recognising the link between assets and liabilities and adopting an investment strategy that balances risk and return.
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to determine how each employer can best meet its own liabilities over future years; and

- to use reasonable measures to reduce the risk to other employers and ultimately to the council tax payer from an employer defaulting on its pension obligations.

The aim is to have 100% solvency over a period of 20 years and to provide stability in employer contribution rates by spreading any increases in rates over a period of time. Normally this is three years but in some cases a maximum period of 15 years can be granted. Solvency is achieved when the funds held, plus future expected investment returns and future contributions are sufficient to meet expected future pension benefits payable. When an employer's funding level is less than 10% of the 100% funding target, then a deficit recovery plan will be put in place requiring additional employer contributions.

**Funding Position as at the last formal funding valuation**

At the 2016 actuarial valuation, the fund was assessed as 92% funded (78% at the March 2013 valuation). This corresponded to a deficit of £44m (2013 valuation £111m) at that time. Contribution increases will be in effect from 1 April 2017 for both scheme employers and admitted bodies.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is still a better than 75% chance that the Fund will return to full funding over 20 years. Individual employers' contributions for the period 1 April 2017 to 31 March 2020 were set in accordance with the Fund's funding policy as set out in its FSS.

Minimum Total Contribution Rates expressed as a percentage of pensionable pay are as set out below:-

| Employer Name | | Minimum Contributions for the Year Ending 31 March | | | |
|---|---|---|---|---|---|
| | | 2017 | 2018 | 2019 | 2020 |
| | | % of pay | % of pay | % of pay | % of pay |
| Isle of Wight Council | | 23.5 | 23.5 | 23.5 | 23.5 |
| | | | | | |
| Barnardos | | 22.0 | 23.5 | 23.5 | 23.5 |
| Caterlink | | 23.5 | 23.5 | 23.5 | 23.5 |
| Cowes Enterprise College, an Ormiston Academy | * | 23.5 | 23.5 | 23.5 | 23.5 |
| Cowes Harbour Commissioners | | 21.0 | 21.5 | 21.5 | 21.5 |
| The Island Free School | * | 20.7 | 23.5 | 23.5 | 23.5 |
| Island Roads | | 23.5 | 21.1 | 21.1 | 21.1 |
| Isle of Wight College (from 1 August) | | 25.5 | 23.8 | 23.8 | 23.8 |
| Isle of Wight Studio School | | 20.7 | 19.1 | 19.1 | 19.1 |
| Lanesend Academy | * | 23.5 | 23.5 | 23.5 | 23.5 |
| Northwood Academy | * | 23.5 | 23.5 | 23.5 | 23.5 |
| Ryde Academy | * | 23.5 | 23.5 | 23.5 | 23.5 |
| Sandown Bay Academy | * | 23.5 | 23.5 | 23.5 | 23.5 |
| Southern Vectis (Wightbus) | | 27.7 | 23.8 | 23.8 | 23.8 |
| Southern Housing Group | | 25.7 | 28.3 | 28.3 | 28.3 |
| Sovereign Housing Group | | 20.5 | 26.9 | 26.9 | 26.9 |
| St Blasius Academy | * | 23.5 | 23.5 | 23.5 | 23.5 |
| St Catherine's School Ltd | | 20.3 | 22.6 | 22.6 | 22.6 |
| Top Mops | | 21.5 | 21.5 | 21.5 | 21.5 |
| Trustees of Carisbrooke Castle Museum | | 22.3 | 26.8 | 26.8 | 26.8 |
| Ventnor Botanical Gardens | | 18.9 | 18.9 | 18.9 | 18.9 |
| Visit Isle of Wight | | 23.5 | 20.6 | 20.6 | 20.6 |
| Yarmouth Harbour Commissioners | | 21.6 | 24.8 | 24.8 | 24.8 |

In addition, certain employers make a lump sum contribution:

| Employer Name | Minimum Contributions for the Year Ending 31 March | | | |
|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2020 |
| | Lump sum £000 | Lump sum £000 | Lump sum £000 | Lump sum £000 |
| St Catherine's School Ltd | 44 | 51 | 51 | 51 |
| IOW Society for the Blind | 41 | 41 | 41 | 41 |
| Yarmouth Harbour Commissioners | 59 | 57 | 57 | 57 |
| Cowes Harbour Commissioners | 20 | 19 | 19 | 19 |
| Southern Housing Group | 122 | 170 | 170 | 170 |
| Sovereign Housing Group | 109 | 139 | 139 | 139 |

* During 2016-17, academies within the fund were asked whether they wished to pool with the administering authority for contribution rate purposes only. Seven of the academies in operation at the time of the 2016 valuation opted to pool, and the pooled rates are shown above.

**Principal Actuarial Assumptions and Method used to value the liabilities**
Full details of the methods and assumptions used are described in the valuation report dated 28 March 2017.

<u>Method</u>
The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

<u>Assumptions</u>
A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2016 valuation were as follows:

| Financial Assumptions | 31 March 2016 |
|---|---|
| | % p.a. Nominal |
| Discount rate | 4.00% |
| Salary Increases | 2.60% |
| Price inflation/Pension Increases | 2.10% |

(Explanatory note: The pay increases shown above are for the purposes of the actuarial valuation only and not a reflection of what actual pay rises will be in the short-term. The assumptions are consistent with other assumptions used in the actuarial valuation and reflect longer term trends.)

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's bespoke set of VitaCurves in line with the CMI 2013 model, assuming the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.

Based on these assumptions, the average future life expectancies are as follows:

| | Males | Females |
|---|---|---|
| Current Pensioners | 22.3 years | 24.7 years |
| Future Pensioners * | 23.9 years | 26.5 years |

* based on members aged 45 at the valuation date.

Copies of the 2016 valuation report and the Funding Strategy Statement are available on request from the Finance Department of the Isle of Wight Council, administering authority to the fund.

## 22. ACTUARIAL PRESENT VALUE OF PROMISED RETIREMENT BENEFITS

In addition to the triennial funding valuation, the fund's actuary also undertakes a valuation of the pension fund liabilities, on an IAS 19 basis, using the same base data as the funding valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year. This valuation is not carried out on the same basis as that used for setting fund contribution rates and the fund accounts do not take account of the liabilities to pay pensions and other benefits in the future.

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Note 21). The actuary has also used valued ill health and death benefits in line with IAS 19.

**Balance sheet**

| Year ended | 31 March 2017<br>£ m | 31 March 2016<br>£ m |
|---|---|---|
| Present value of Promised Retirement Benefits | (720) | (643) |
| Fair value of scheme assets (bid value) | 559 | 474 |
| Net Liability | (161) | (169) |

Liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2016. The actuary estimates this liability at 31 March 2017 comprises £253 million in respect of employee members (2016: £290 million), £169 million in respect of deferred pensioners (2016: £111 million) and £298 million in respect of pensioners (2015: £243 million). The approximation involved in the roll forward model means that the split of scheme liabilities between the three classes of member may not be reliable. However, the actuary is satisfied the aggregate liability is a reasonable estimate of the actuarial present value of benefit promises. The actuary has not made any allowance for unfunded benefits.

The above figures include both vested and non-vested benefits, although the latter is assumed to have a negligible value.

It should be noted the above figures are appropriate for the Administering Authority only for preparation of the accounts of the Pension Fund. They should not be used for any other purpose (i.e. comparing against liability measures on a funding basis or a cessation basis).

Assumptions

The assumptions used are those adopted for the Administering Authority's IAS19 report as required by the Code of Practice. These are given below. The actuary estimates that the impact of the change of assumptions to 31 March 2017 is to increase the actuarial present value by £97m.

Financial assumptions

| Year ended | 31 March 2017<br>% p.a. | 31 March 2016<br>% p.a. |
|---|---|---|
| Inflation/Pension Increase Rate | 2.4% | 2.20% |
| Salary Increase Rate | 2.8% | 4.20% |
| Discount Rate | 2.6% | 3.50% |

(Explanatory note: The pay increases shown above are for the purposes of the actuarial valuation only and not a reflection of what actual pay rises will be in the short-term. The assumptions are consistent with other assumptions used in the actuarial valuation and reflect longer term trends.)

Longevity assumption

The life expectancy assumption is based on the Fund's bespoke VitaCurves in line with the CMI 2013 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

| | Males | Females |
|---|---|---|
| Current Pensioners | 22.3 years | 24.7 years |
| Future Pensioners * | 23.9 years | 26.5 years |

* Future pensioners are assumed to be currently aged 45 at the most recent formal valuation as at 31 March 2016

Please note that the assumptions are identical to those used for the previous IAS26 disclosure for the Fund.

Commutation assumption
An allowance is included for future retirements to elect to take 25% of the maximum additional tax-free cash up to HMRC limits for pre-April 2008 service and 63% of the maximum tax-free cash for post-April 2008 service.

**23. LONG TERM ASSETS**

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| | Debtors | |
| 21 | • Contributions due - employers | 157 |
| 21 | | 157 |

**Analysis of debtors**

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| 21 | Local authorities | 140 |
| - | Other entities and individuals | 17 |
| 21 | | 157 |

**24. CURRENT ASSETS**

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| | Debtors | |
| 118 | • Contributions due - employees | 116 |
| 484 | • Contributions due - employers | 609 |
| 62 | • Taxation | 72 |
| 8 | • Sundry debtors | 2 |
| 125 | • Payments in advance | 96 |
| 14 | Cash balances | - |
| 811 | | 895 |

**Analysis of debtors**

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| 62 | Central government bodies | 72 |
| 13 | Local authorities | 77 |
| 722 | Other entities and individuals | 746 |
| 797 | | 895 |

**25. CURRENT LIABILITIES**

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| | Creditors | |
| 195 | • Taxation | 216 |
| 286 | • Accruals | 375 |
| 147 | • Sundry creditors | 532 |
| | • Cash Balances | 20 |
| 628 | | 1,143 |

**Analysis of creditors**

| 31 March 2016 £000 | | 31 March 2017 £000 |
|---|---|---|
| 196 | Central government bodies | 216 |
| 116 | Local authorities | 157 |
| 316 | Other entities and individuals | 750 |
| 628 | | 1,123 |

## 26. ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVCS)

| Market value 31 March 2016 £000 | | Market value 31 March 2017 £000 |
|---|---|---|
| 807 | Prudential Life and Pensions | 782 |

AVC contributions of £45.5 thousand were paid directly to Prudential Life and Pensions during the year (2015-16: £46.8 thousand).

## 27. RELATED PARTY TRANSACTIONS

**Isle of Wight Council**
The Isle of Wight Council Pension Fund is administered by Isle of Wight Council. Consequently there is a strong relationship between the council and the pension fund.

During the reporting period, the council incurred costs of £367 thousand (2015-16: £305 thousand) in relation to the administration of the fund and was subsequently reimbursed by the fund for these expenses. The council is also the single largest employer of members of the pension fund and contributed £11.0 million in 2016-17 (2015-16: £10.7 million) to the fund. All monies owing to the fund, with the exception of deferred balances in respect of pension strain costs totalling £274.5 thousand (2016: £29.7 thousand), were paid during the year.

During the year, the pension fund borrowed funds from the council to support its working cash flow requirements; interest was charged on these borrowings at the broker local authority interest rate relevant to the amount and duration of the borrowing at the time it was made. The maximum amount borrowed during 2016-17 was £7.0 million (2015-16: £6.5 million). The balance due to the council at 31 March 2017 is £7.0 million (2016: £6.5 million),
Interest of £ 34.4 thousand (2015-16: £20.0 thousand) was paid on the borrowings in the year.

| Repayment profile of borrowings from Isle of Wight Council | Year ended 31 March 2016 £m | Year ended 31 March 2017 £m |
|---|---|---|
| less than 1 month | 0.3 | 0.1 |
| 2 - 3 months | 0.5 | - |
| 3 - 6 months | 2.5 | 4.5 |
| 6 - 9 months | 0.8 | 1.0 |
| 9 – 12 months | 2.4 | 1.4 |
| **Total value of borrowings** | **6.5** | **7.0** |

**Governance**
There are three members of the pension fund committee who are in receipt of pension benefits from the Isle of Wight Council Pension Fund (Cllrs Barry, Kendall and Warlow). In addition committee members Cllrs Barry, Kendall and Warlow are active members of the pension fund.

Each member of the pension fund committee is required to declare their interests at each meeting.

Council members named in note 30 form the Pension Fund Committee as trustees.

## 27A. KEY MANAGEMENT PERSONNEL

The key management personnel of the fund are the Director of Finance and S151 Officer and the Technical Finance Manager.

Total remuneration payable to key management personnel is set out below:

| 31 March 2016 £'000 | | 31 March 2017 £'000 |
|---|---|---|
| 32 | Short-term benefits | 33 |
| 6 | Post-employment benefits | 6 |
| - | Other long-term benefits | - |
| - | Termination benefits | - |
| - | Share-based payments | - |
| **38** | | **39** |

## 28. CONTINGENT ASSETS AND LIABILITIES

At 31 March 2017 there were contingencies relating to Contribution Equivalent Premiums (CEPs) amounting to a net sum of £131 thousand (2016: £137 thousand) due to the Pension Fund. Assets amounted to £186 thousand and liabilities totalled £55 thousand (2016: £186 thousand and £49 thousand respectively). The sums do not form part of the net assets of the fund. Refunds and payments will only be made on application by the employee.

In 2006 a decision was taken by the Investment Panel to join in a Class Action against the HMRC to recover tax credits on overseas dividends. A sum of £880 thousand has been estimated as the possible benefit to the pension fund. This case is on-going. The sums do not form part of the net assets of the fund.

## 29. CAPITAL COMMITMENTS

There were no capital commitments as at 31 March 2017 (2016: nil)

## 30. TRUSTEES REPORT 2016-17

The trustees of the pension fund are the members for the time being of the Pension Fund Committee, who at 31 March 2017 were Councillors Barry, Eccles, Hutchinson, Kendall, and Warlow (chair).

Throughout the year the committee has been advised by the Director of Finance and Section 151 Officer, the Technical Finance Manager, Mercer Limited (the fund's investment consultants), and Hymans Robertson LLP (the fund's actuaries). In addition, non-voting representatives from the admitted bodies and the staff union attend the committee.

<u>Investment Performance</u>
The net assets of the fund at 31 March 2017 were £559.2 million, an increase of 18.0% on the 31 March 2016 valuation of £474.0 million. The fund's total investments over-performed compared to the agreed benchmarks by 0.9% during the year.

The overall performance of the fund in the year to 31 March 2016 is reflective of the performance of UK and global investment markets.

Over the longer term, the fund has continued to outperform annualised benchmark returns for three years (0.2% outperformance).

<u>Funding Level</u>
The Fund's last triennial actuarial valuation was undertaken at 31 March 2016, showing a funding level of 91.5%, compared to 77.7% at the previous valuation at 31 March 2013. The results of this latest valuation, in terms of revised contribution rates, were implemented with effect from April 2017.

The actuary's interim funding projection report at 31 March 2017 showed that the notional funding level had remained at 91.5%, the same as the last triennial valuation at 31 March 2016. However the deficit of £44 million at 31 March 2016 has increased to a deficit of £52 million at 31 March 2017.

Governance

The committee continues to keep its governance arrangements under review. Following the formation of the Local Pension Board, as required under the Public Service Pensions Act 2013, the arrangements are developing with a view to continuous improvement.

In accordance with the training plan developed in the previous year, training sessions were held before each committee meeting, including presentations from the fund's actuaries on improving the governance framework, and from officers on the pooling of pension investments.

The committee received reports on, and agreed, the valuation results, the funding strategy statement, the investment strategy statement, and the governance compliance statement; and received regular updates on investment changes, new and ceasing employers, membership numbers and contribution payments.

In addition, the committee continues to receive presentations from its fund managers on the fund's investment performance as well as performance benchmarking and advice from its independent consultants, Mercer Limited

## Knowledge and Skills Framework Compliance Statements

Dated: 24 July 2015

**Policy statements**

1. This organisation adopts the key recommendations of the Code of Practice on Public Sector Pensions Finance Knowledge and Skills.

2. This organisation recognises that effective financial administration and decision-making can only be achieved where those involved have the requisite knowledge and skills.

3. Accordingly this organisation will ensure that it has formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective acquisition and retention of the relevant public sector pension scheme finance knowledge and skills for those in the organisation responsible for financial administration and decision-making.

4. These policies and practices will be guided by reference to a comprehensive framework of knowledge and skills requirements such as that set down in the CIPFA Pensions Finance Knowledge and Skills Frameworks.

5. This organisation will report on an annual basis how these policies have been put into practice throughout the financial year.

6. This organisation has delegated the responsibility for the implementation of the requirements of the CIPFA Code of Practice to the Managing Director and Head of Paid Service, who will act in accordance with the organisation's policy statement, and, where he is a CIPFA member, with CIPFA Standards of Professional Practice (where relevant).

### Member and officer training report

The training plan formulated following a training needs analysis undertaken in January 2012, and updated following the appointment of new committee members in May 2013, was kept under review during the year.

Members undertake training before the start of each of the scheduled committee meetings in future. Members of the Isle of Wight Pension Board are also invited to attend these sessions. These training sessions are delivered by a combination of officers, external advisers and fund managers. Separate agendas are issued for these sessions and a record of member and officer attendance is maintained. No training session was held before the annual meeting in July 2016, or the final meeting of the year in March 2017

During 2016-17, the committee received presentations from each of the fund managers in respect of the performance of their particular portfolios. In May 2016, officers delivered a training session on the fund's approach to pooling of investments, including the development of the ACCESS pool. In September 2016, a further development session on the structure of the ACCESS pool's investment vehicle was delivered. In November 2016, the fund's actuaries delivered a briefing on the governance framework of the fund, and action to improve it.

Throughout the year, Councillors Warlow and Blezzard and the Technical Finance Manager attended regular meetings of the ACCESS group, in respect of pooling of investments.

The committee members' attendance at the scheduled training sessions and committee meetings during 2016-17 is set out in the tables below.

Overall attendance at committee meetings has remained at a high level during the year, consistent with the previous year. Overall attendance at training has increased from 70% to 85%.

**Training**

| Councillor: | 20 May 2016 | 18 Nov 2016 | % |
|---|---|---|---|
| R Barry | √ | √ | 100% |
| R Blezzard | √ | Apols | 50% |
| D Eccles | √ | √ | 100% |
| S Hutchinson | √ | √ | 100% |
| G Kendall | √ | √ | 100% |
| D Pitcher – Resigned 7 Jul 16 | Apols | n/a | 0% |
| I Warlow (Chair) | √ | √ | 100% |
| | 86% | 100% | 85% |
| Non-voting members: | | | |
| Employer representative | Apols | √ | 50% |
| Union representative | √ | Apols | 50% |

**Meetings**

| Councillor: | 20 May 2016 | 08 July 2016 (special) | 22 Jul 2016 (AGM) | 07 Sept 2016 (special) | 18 Nov 2016 | 03 March 2017 | % |
|---|---|---|---|---|---|---|---|
| R Barry | √ | √ | √ | √ | √ | √ | 100% |
| R Blezzard – resigned 27 Feb 17 | √ | √ | √ | √ | Apols | n/a | 66% |
| D Eccles | √ | √ | √ | √ | √ | √ | 100% |
| S Hutchinson | √ | √ | √ | √ | √ | √ | 100% |
| G Kendall | √ | √ | √ | Apols | √ | √ | 83% |
| D Pitcher – Resigned 7 Jul 16 | Apols | n/a | n/a | n/a | n/a | n/a | 0% |
| I Warlow (Chair) | √ | √ | √ | √ | √ | √ | 100% |
| | 86% | 100% | 100% | 83% | 83% | 100% | 92% |
| Non-voting members: | | | | | | | |
| Employer representative | √ | Apols | √ | √ | √ | √ | 83% |
| Union representative | Apols | √ | √ | √ | √ | √ | 83% |

## Communications Policy Statement

Last updated 15 May 2013

Effective communication between the Isle of Wight Council (the council), the scheme members, and the employers within the fund is essential to the proper management of the Isle of Wight Council Pension Fund (the fund) on a transparent and accountable basis.

This document sets out a policy framework within which the council, as administering authority for the fund, will communicate with:-

- Members of the scheme (current, deferred and pensioner)
- Representatives of members
- Employing bodies and
- Prospective members

It identifies the format, frequency and method of distributing information and publicity. It also outlines the processes for promoting the scheme to prospective members and employing bodies.

**Members of the scheme:**

The key point of contact for members is the pension administration team. They can be contacted by telephone, email or in writing.

Although the pensions team operate an open door policy for visitors, pre booked appointments are preferable.

A pensions page is maintained on the council's website, http://www.iwight.com/council/OtherServices/Pensions-IWC, which provides:

- Guides to the Local Government Pension Scheme (LGPS) including pension sharing on divorce, increasing pension benefits and the appeals process
- Policy Statements, including the Statement of Investment Principles, the Funding Strategy Statement, and Governance Compliance Statement.
- Annual Reports
- Pensions Bulletins
- Contact list for Pensions Team
- Links to other useful sites including the Local Government Pensions Committee (LGPC), the Department for Communities and Local Government (DCLG) and the LGPS Regulations.

The information held on the pensions page will be reviewed and updated on a regular basis.

Frequency of Communication:

Monthly:

Payslips (if required) to Pensioner Members

Annually:

Benefits Statements to contributing members

Notification of pensions pay award every April.

Publication of the Annual Report of the fund

Annual General Meeting for all employing bodies

Ad hoc:

Statutory notices

Amendments to membership (changes in hours, etc.)

Notice of proposed changes to the scheme

Workshops/employee briefings

General policy is to issue statutory notifications and statements within the prescribed limits and to respond to written enquiries within 10 working days.

**Representatives of members**

A representative sits on the Pension Fund Committee in a non-voting capacity

Employee representatives are invited to the Annual General Meeting

**Employing bodies**

A representative sits on the Pension Fund Committee in a non-voting capacity

Invitation to the Annual General Meeting

Consultation on changes to the Funding Strategy Statement
Notification of changes or proposed changes to scheme conditions
Consultation on actuarial valuation prospects and options
Advice on statutory framework.

**Prospective members**
All new starters receive information about the scheme and how to join.

This policy statement will be reviewed annually.

## Governance Policy Statement

Last updated 13 May 2013

Isle of Wight Council ("the council"), as the administering authority to the fund, has delegated its functions with regard to the fund to its Pension Fund Committee ("the committee").

The committee oversees the proper administration and management of the fund. It is responsible for:

- appointing external fund managers and advisers
- making suitable custody arrangements for the fund's investments
- considering and approving actuarial valuations every three years and determining the level of employers' contributions
- considering changes in Local Government Pension Scheme ("LGPS") regulations and determining actions required
- considering and approving strategic advice on investment policy
- considering and approving the external managers' asset allocation and investment strategies
- monitoring the investment performance of the managers against the scheme specific benchmarks
- the periodic review of this statement, the Statement of Investment Principles, the Funding Strategy Statement and the Communications Policy

The committee normally meets with its fund managers and investment advisor four times each year, in February, May, July and November. Each meeting considers the strategy and performance of the managers, together with any business matters that require attention. These include, at least once per annum, consideration of fund management and investment advice arrangements, and the investment strategy of the fund.

The July meeting also forms the annual meeting to which all employers and employee representatives are invited to discuss fund performance and developments in the statutory framework.

As well as these formal meetings, ad hoc sessions are arranged as required, principally in order to explore available investment strategy options in some depth.

The committee is constituted to reflect the views of the council as administering authority and the largest member employer with 82% of the contributing membership.

The committee consists of

- seven councillors with voting rights plus the Leader of the Council in an ex-officio capacity
- one representatives of the admission bodies/scheduled bodies in an observer capacity
- one representative of the trade unions in an observer capacity

## Terms of Reference of Pension Fund Committee

Extracted from the council's Constitution May 2017 version 8

1. **Terms of Reference**
    1.1. Annually, to elect a chairman (when Full Council has decided not to so appoint)
    1.2. To hold an annual meeting of employer representatives
    1.3. To periodically review the funding strategy statement and statement of investment principles of the fund
    1.4. To determine strategic investment policy
    1.5. To appoint, and regularly monitor performance of fund managers, investment advisors and actuaries
    1.6. To periodically review the structure of investment management for the fund and implement new arrangements as appropriate
    1.7. To periodically review and set limits for the overall asset allocation of the fund
    1.8. To periodically review issues which have an impact on the fund's long term solvency including those issues over which the administering body has discretion
    1.9. To tender and/or re-tender contracts for the provision of all actuarial and investment management services required by the fund in accordance with the council's standing order.
    1.10. To undertake member training on investment issues
    1.11. To consider applications for admitted body status
    1.12. To exercise all discretionary functions of a pension scheme manager including those relating to the fire pension scheme.
    1.13. Annual Report
        1.13.1. The panel will produce an annual report on the performance of the investment fund and this will be circulated to all members and will be formally reported to the audit committee.

2. **Membership**

    7 elected members, appointed on a political proportionality basis.
    1 non-voting employee representative nominated by Unison.
    1 non-voting representative nominated by admitted bodies (external companies who have staff who are members of the pension scheme as a result of staff transfers to them).

    2.1. In Attendance
    Chief executive (or his nominated representative)
    Leader of the council can attend as necessary
    2 representatives as required from pension fund investment managers
    1 representative from investment advisors
    1 administrative support
    1 representative from actuaries will be invited to attend as required eg to consider annual report and after triennial fund valuations

3. **Proceedings**
    3.1. The procedure rules for the regulation of proceedings shall apply to meetings of the Isle of Wight Pension Fund Committee.

4. **Quorum**
    4.1. The quorum for the Committee is 3 elected members.

5. **Meeting Frequency and Length**
    5.1. The committee will meet bi-annually but additional meetings will be arranged with the approval of the chairman of the committee, if required.

6. **Access to information**
    6.1. All meetings of the committee shall be held in public unless there are grounds for excluding the press and public, as set out in the access to information procedure rules or in accordance with legislation.

7. **Agenda**
    7.1. The agenda for the committee will be determined by the Proper Officer in consultation with the chair of the committee.

8. **Voting**
    8.1. Any vote shall be by show of hands. A simple majority prevails and in the event of a tied vote the chairman has a casting vote.

## Terms of Reference of the Pension Board

Extracted from the council's Constitution May 2017 version 8

### 1. Terms of Reference and Delegated Authorities

#### 1.1. Introduction

i) The purpose of this document is to set out the terms of reference for the local Pension Board of the Isle of Wight Council Pension Fund.

#### 1.2. Role of the Local Pension Board

i) The role of the Local Pension Board as defined by sections 5 (1) and (2) of the Public Service Pensions Act 2013, is to –
   - Assist Isle of Wight Council Administering Authority as Scheme Manager; –
     - to secure compliance with the Local Government Pension Scheme (LGPS) regulations and any other legislation relating to the governance and administration of the LGPS
     - to secure compliance with requirements imposed in relation to the LGPS by the Pensions Regulator
     - in such other matters as the LGPS regulations may specify
   - Secure the effective and efficient governance and administration of the LGPS for the Isle of Wight Council Pension Fund
   - Provide the Scheme Manager with such information as it requires to ensure that any member of the pension board or person to be appointed to the board does not have a conflict of interest.

ii) The Pension Board will ensure it effectively and efficiently complies with the code of practice on the governance and administration of public service pension schemes issued by the Pension Regulator.

iii) The Pension Board will also help ensure that the LGPS is managed and administered effectively and efficiently and complies with the code of practice on the governance and administration of public service pension schemes issued by the Pension Regulator.

iv) The Pension Board shall meet sufficiently regularly to discharge its duties and responsibilities effectively.

#### 1.3. Appointment of members of the Pension Board

i) The process for selecting members of the Pension Board is set out below.

ii) The Board shall consist of 4 members and be constituted as follows:
   - 2 employer representatives;
   - 2 scheme member representatives;

iii) One of the employer representatives shall be an elected member of the Isle of Wight Council. The other will be selected by the other employers of the fund, following nominations.

iv) The scheme member representatives shall be appointed by UNISON, who will be responsible for arranging their own election of suitable candidates and advise the Isle of Wight Council of this so that it can be assured that it is open and transparent.

v) Pension Board representatives must not also participate in or act as members of the Isle of Wight Council Pension Fund Committee.

vi) The Chair of the local Pension Board will be determined by the Board on an annual basis.

vii) It will be the role of the Chair to ensure that all members of the Board show due respect for process, that all views are fully heard and considered and to determine when consensus has been met.

viii) Each employer representative and scheme member representative so appointed shall serve for a fixed 2 year period which can be extended for further period(s) subject to re-nomination.

ix) Each Board member is expected to attend all Board meetings during the year. In the event of consistent non-attendance by any Board member, then the tenure of that membership should be reviewed by the other Board members in liaison with the Scheme Manager.

x) Other than by ceasing to be eligible as set out above, a Board member may only be removed from office during a term of appointment by the unanimous agreement of all of the other members.

xi) The Board may, with the approval of the Scheme Manager, co-opt persons who are not members of the Board to serve on sub committees, particularly where this would add skills and experience.

xii) Notwithstanding the appointment of co-opted members, the majority of the Board shall be comprised of employer and scheme member representatives, represented in equal number.

xiii) There will be no provision to allow for substitute members to be appointed.

#### 1.4. Quorum

i) The Board shall have a formal quorum of 3.

**1.5. Conflicts of Interest**

i) The policy for identifying conflicts of interest will be based upon the Council's Code of Conduct and relevant guidance issued by the Pensions Regulator.

ii) No one may be appointed to the Board who has a conflict of interest. It is the responsibility of the board member to provide any information required by the Scheme Manager in order to determine whether a conflict exists.

**1.6. Board Review Process**

i) The Board will undertake each year a formal review process to assess how well it and its sub-committees, if any, and the members are performing with a view to seeking continuous improvement in the Board's performance.

**1.7. Advisers to the Board**

i) The Board may be supported in its role and responsibilities through the appointment of advisers and shall, subject to any applicable regulation and legislation from time to time in force, consult with such advisers to the Board and on such terms as it shall see fit to help better perform its duties. Any cost associated with the use of advisers to the Board must first be agreed with the Administering Authority.

ii) The Board shall ensure that the performances of the advisers so appointed are reviewed on a regular basis.

**1.8. Knowledge and Skills**

i) A member of the Pension Board must be conversant with –
- The legislation and associated guidance of the Local Government Pension Scheme (LGPS).
- Any document recording policy about the administration of the LGPS which is for the time being adopted by the Isle of Wight Council Pension Fund.

ii) A member of the Pension Board must have knowledge and understanding of –
- The law relating to pensions
- The Pension Regulator's code of practice, and
- Any other matters which are prescribed in regulations.

iii) It is for individual Pension Board members to be satisfied that they have the appropriate degree of knowledge and understanding to enable them to properly exercise their functions as a member of the Pension Board.

iv) In line with this requirement Pension Board members are required to be able to demonstrate their knowledge and understanding and to refresh and keep their knowledge up to date. Pension Board members are therefore required to maintain a written record of relevant training and development.

v) Pension Board members will undertake a personal training needs analysis and regularly review their skills, competencies and knowledge to identify gaps or weaknesses.

vi) Pension Board members will comply with the Scheme Manager's training policy. Members of the Pension Board will be expected to attend training sessions held before each Pension Fund Committee meeting, to support the development of their knowledge and skills, as well as any other training sessions held specifically for Board members.

**1.9. Board Meetings – Notice and Minutes**

i) The Scheme Manager shall give notice to all Pension Board members of every meeting of the Pension Board. The Scheme Manager shall ensure that a formal record of Pension Board proceedings is maintained. Following the approval of the minutes by the Chair of the Board or Board committee, they shall be circulated to all members and posted on the Isle of Wight Council website.

ii) There will be at least 1 Pension Board meeting a year, to be held between the May and July meetings of the Isle of Wight Pension Fund Committee. Other meetings may be convened with due notice as the Board determines.

**1.10. Remit of the Board**

i) The Pension Board must assist the Scheme Manager with such other matters as the scheme regulations may specify. It is for scheme regulations and the Scheme Manager to determine precisely what the Pension Board's role entails.

**1.11. Standards of Conduct**

i) The role of Pension Board members requires the highest standards of conduct and therefore the "seven principles of public life" will be applied to all Pension Board members together with the code of conduct as contained within the constitution of the Isle of Wight Council.

**1.12. Decision making**

i) Each member of the Pension Board will have an individual voting right but it is expected the Pension Board will as far as possible reach a consensus. If there are equal numbers of votes for and against the Chair of the Pension Board will have a second or casting vote which will be reported to the Scheme Manager.

**1.13. Publication of Pension Board information**

i) Scheme members and other interested parties will want to know that the Isle of Wight Council Pension Fund is being efficiently and effectively managed. They will also want to be confident that the Pension Board is properly constituted, trained and competent in order to comply with scheme regulations, the governance and administration of the scheme and requirements of the Pension Regulator.

ii) Up to date information will be posted on the section relating to the Isle of Wight Council Pension Fund on the Isle of Wight Council website showing:

- The names and information of the Pension Board members
- How the scheme members are represented on the Pension Board
- The responsibilities of the Pension Board as a whole
- The full terms of reference and policies of the Pension Board and how they operate
- The Pension Board appointment process
- Who each individual Pension Board member represents
- Any specific roles and responsibilities of individual Pension Board members.

iii) Pension Board papers, agendas and minutes of meetings will be published on the Isle of Wight Council Pension Fund website. These may at the discretion of the Scheme Manager be edited to exclude items on the grounds that they would either involve the likely disclosure of exempt information as specified in Part 1 of Schedule 12A of the Local Government Act 1972 or it being confidential for the purposes of Section 100A(2) of that Act and/or they represent data covered by the Data Protection Act 1998.

iv) The Scheme Manager will also consider requests for additional information to be published or made available to individual scheme members to encourage scheme member engagement and promote a culture of openness and transparency.

**1.14. Accountability**

i) The Pension Board will be collectively and individually accountable to the Scheme Manager.

**1.15. Expense Reimbursement**

i) Only expenses incurred by a Board member in attending an activity approved by the Board will be paid by the Council.

**1.16. Reporting Breaches**

i) Any breach brought to the attention of the Pension Board, whether potential or actual, shall be dealt with in accordance with the procedure set out in a separate policy document.

**1.17. Definitions**

i) The undernoted terms shall have the following meaning when used in this document:

| | |
|---|---|
| *"Chair"* | Reference to duties to be performed, or authorities exercised, by the Chair |
| *"Elected member"* | A councillor of the Isle of Wight Council, elected by due democratic process. |
| *"Employer"* | Organisations external to the Council whose employees are eligible to be members of the Isle of Wight Council Pension Fund, either under Schedule 2, part 1 of Local Government Pension Scheme (Administration) Regulations 2008, or by virtue of an admission agreement with the administering authority. |
| *"LGPS"* | The Local Government Pension Scheme as constituted by the Local Government Pension Scheme Regulations 2013, the Local Government Pension Scheme Transitional Provisions, Savings and Amendment) Regulations 2014 and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 |

| | |
|---|---|
| "*Pension Board"* or *"Board"* | Means the local Pension Board for the Isle of Wight Council administering authority for the Isle of Wight Council Pension Fund as required under the Public Service Pensions Act 2013 |
| *"Scheme"* | Means the Local Government Pension Scheme as defined under "LGPS" |
| *"Scheme Manager"* | Means Isle of Wight Council as administering authority of the Isle of Wight Council Pension Fund. |
| *"Scheme member"* | A person who has been admitted to membership of a pension scheme and is entitled to benefit under the scheme.<br>Such a person may be "Active" (paying contributions), "Deferred" (no longer paying contributions, but entitled to future benefit), or "Retired" (in receipt of benefit) |

**1.18. Interpretation**

i) Any uncertainty or ambiguity or interpretation required relating to any matters contained in this document shall be resolved by reference to the Scheme Manager.

## APPENDIX A – Glossary of Terms

Accrual rate
The proportion of earnings that a defined benefit pension scheme pays as pension for each year of membership.

Accrued liabilities
A measure of the value in today's money of all pension entitlements to be paid in the future that have been earned to date.

Accrued income
The amount of dividend income declared on a shareholding but not paid at the accounting date.

Active members
Current employees who are contributing to an organisations pension scheme.

Actuarial assumptions
The assumptions that an actuary must make in order to arrive at a valuation for a pension fund. These include life expectancy, rates of inflation, expected earnings and the income that will be received from pension scheme investments.

Actuarial liability
The value placed on the accrued benefits of the fund using actuarial methods and assumptions for outgoings, including expenses, expected to fall on the fund after the valuation date based on benefits accrued for service up to the valuation date.

Actuarial valuation
A review of the pension fund, which takes place every three years, to ensure that employers' contributions are sufficient to maintain the solvency of the fund.

Actuary
An independent consultant who carries out the actuarial valuation and may also advise on changes in benefit structure and on investment strategies. The actuary will perform calculations based on information about prevailing circumstances and analysis of statistics.

Additional voluntary contributions (AVCs)
An extra pension contribution which can be made by a member of an occupational pension scheme. AVCs can be made into the occupational scheme or to a standalone product called a freestanding AVC plan.

Administering authority
A local authority required to maintain a pension fund under the local government pension scheme regulations.

Admitted bodies/transferee admission bodies
Bodies, including those from the voluntary and charitable sectors and contractors, whose staff can become members of an LGPS fund by virtue of an admission agreement between the administering authority and the relevant body.

All Share Index
Properly the FTSE All Share Index which summarises the state of the UK equity market. It covers around 900 of the major UK industrial, commercial and financial companies.

Asset allocation
The apportionment of a fund's assets between asset classes and/or markets (also see Bet). Asset allocation may be strategic, i.e. long-term, or tactical, i.e. short-term, aiming to take advantage of relative market movements.

Asset classes
A specific category of assets or investments, such as stocks, bonds, cash, international securities and real estate. Assets within the same class generally exhibit similar characteristics, behave similarly in the marketplace and are subject to the same laws and regulations.

Asset/liability modelling
A statistical tool designed to help establish the most appropriate asset mix for a pension fund, in the context of its liabilities.

Automatic enrolment
A pension scheme where an individual is made a member by default and has actively to decide to leave the scheme.

Authorised Unit trusts
A unit trust which is approved by the Financial Services Authority (FSA) to be sold to members of the public.

Benchmark
A "notional" fund or model portfolio which is developed to provide a standard against which a manager's performance is measured.
A target return is generally expressed as some margin over the benchmark.

Bond
A security issued by a corporate or government body borrowing in the capital markets. Bonds promise to pay interest (coupons) during the life of the bond plus the main amount borrowed. Bonds may be secured over assets of the firm or they can be unsecured.

Bonus issue
Bonus, scrip or free issue mean the same thing. Free shares are issued to existing shareholders out of company reserves.

Career average revaluation of earnings scheme (CARE)
A defined benefit scheme that gives individuals a pension based on a percentage of the salary earned in each year of their working life.

Cash
Cash is defined as cash instruments (e.g. money market deposits) and cash in bank and in hand.

Corporate governance
Governance for local authorities is defined as how they ensure that they do the right things, in the right way, for the right people in a timely, inclusive, open, honest and accountable manner. It comprises the systems processes, culture and values, by which local government bodies are directed and controlled, and through which they account to, engage with and where appropriate lead their communities.

Coupon
The interest payments on bonds.

Currency hedging
An approach aimed at eliminating or reducing foreign exchange risks.

Custody/custodian
Safe-keeping of securities by a financial institution. The custodian keeps a register of holdings and will collect income and distribute monies according to client instructions.

Deferred members
Scheme members who have left employment or ceased to be an active member of the scheme while remaining in employment, but retain an entitlement to a pension from the scheme.

Defined benefit scheme
A scheme where the benefits are defined and paid, irrespective of contributions or investment performance.

Defined contribution scheme
A scheme where the benefits paid are dependent on contributions paid and investment performance. These are also called money purchase schemes.

Discount rate
Future benefit payments due need to be discounted to give the present value of the liabilities. A discount rate is chosen to reflect the investment return that is expected on the pension fund.

Diversification
The spreading of a fund's investments among different asset classes, markets and geographical areas in order to reduce risk. Diversification is a basic principle of multi-asset management.

Dividend
A payment distributed by a company to equity shareholders

Equities
The general term for ordinary shares issued in UK and overseas companies.

Ethical investment
Where investment is restricted to companies undertaking business in accord with an ethical definition. This could cover companies not engaging in arms manufacture.

Ex
Without. If a share is sold ex-dividend, the buyer does not get the last dividend that was declared.

Financial Services Authority (FSA)
The lead regulator. An agency which is not a government department.

Fund managers
Firms of investment professionals appointed by an investments or pensions committee to make day-to-day investment decisions for the fund within the terms of an investment management agreement (IMA).

Funding Strategy Statement (FSS)
The funding strategy statement provides a clear and transparent fund specific strategy for meeting an employer's pension liabilities in the future. It also defines a prudent longer term view of funding these liabilities while keeping within the regulatory framework to maintain a constant stable employer's contribution rate.

FTSE
A company that specialises in index calculation. Although not part of a stock exchange, co-owners include the London Stock Exchange and the Financial Times. They are best known for the FTSE 100, an index of the top 100 UK companies (ranked by size).

Futures
The right to buy a fixed quantity of a commodity on a date in the future at a price fixed earlier

Gilts
Fixed or index linked securities issues by the UK government (bonds).

Hedging
A strategy which aims to eliminate the possibility of loss in an investment transaction or to minimise a risk by offsetting the exposure to a risk by entering into an investment with the exact opposite pay off pattern. Often used in the context of overseas investments to eliminate any potential currency loss (or profit).

IAS 19
An international accounting standard that sets out the accounting treatment for employee benefits, including post-employment benefits such as pensions.

Index-linked securities
UK government issued stocks on which the interest and eventual repayment of the loan are based on movements in the retail price index.

Investment adviser
A professionally qualified individual or company whose main livelihood is derived from providing objective, impartial investment advice to companies, pension funds or individuals, for a stated fee.

Listed security
A security (a share) that is quoted on a major stock exchange.

Mandate
Instructions given to the manager by the client on the performance target, restrictions on stocks etc.

Market value
The price at which an investment can be bought or sold at a given date.

Maturity
The maturity of a pension scheme indicates the number of active members relative to the number receiving pensions.

Member
A person who has been admitted to membership of a pension scheme and is entitled to benefit under the scheme.

Mid price
Halfway between the bid price and the offer price

Mortality assumptions
One of the greatest unknowns for a pension fund is how long benefits will be paid for. People are currently living longer than they did in the past. Actuaries assess future mortality, using tables based on research and additionally can access databases which enable mortality to be analysed and modelled at a detailed level within employer's geographical areas. Club Vita is an example of such a database.

Pooled fund
A fund managed by a fund manager in which investors hold units. Stocks, bonds, properties etc. are not held directly by each client, but as part of a "pool". This contrasts with a segregated fund.

Realised
This is when the value of loss or profit is received when an investment is sold

Return
This is the percentage change of the total value invested over a set period.

Rights issue
An issue of new shares by a company, offered to existing shareholders in proportion to their holdings. The new shares are usually offered at a discount to encourage shareholders to buy. However, this can cause the existing

price to fall.

Risk

Generally taken to mean the variability of returns. Investments with a greater perceived risk must usually promise a higher return than a more stable investment before rational investors will consider buying them. Generally the higher the potential return the higher the associated risk.

Scheduled bodies

These are the organisations listed in the Local Government Pension Scheme (Administration) Regulations 2008 (Schedule 2, Part 1) and include county councils and district councils.

Scrip dividend

A dividend paid in the form of additional shares rather than cash.

Securities

Investments in company shares, fixed interest or index-linked stocks.

Socially responsible investment (SRI)

Investment where social, environmental or ethical considerations are taken into account in the selection, retention and realisation of the investment, and the responsible use of rights (such as voting rights) attached to investments.

Stock

Commonly used as a name for ordinary shares (common stock in the US) More correctly it is the name for UK gilts.

Strategic asset allocation

Long-term allocation between the main asset classes with the aim of meeting the investors risk and return objectives.

Transfer value

The amount of the transfer payment which is made to another pension arrangement.

Unit trust

An open ended trust investing in a wide spread of stocks, shares and cash (depending on FSA limits) Investors buy units directly from the fund manager.

Unquoted security

A security which is not quoted on stock exchange

Unrealised Gains/(Losses)

The increase/(decrease) at year end in the market value of investments held by the fund since the date of their purchase

Withholding tax

A tax deducted from overseas investment income.

Yield

A measure of the return earned on an investment.

## APPENDIX B – Analysis of market value by Industrial Sector

| | Majedie UK Equities £000 | Majedie Overseas Equities £000 | Newton Global Equities £000 | Schroder Property £000 | Schroder Bonds £000 | Baillie Gifford Diversified Growth £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| **Banking** | 15,193 | 1,642 | - | - | - | - | 16,835 |
| **Basic Resources** | 6,796 | 5,147 | - | - | - | - | 11,943 |
| **Construction** | 424 | - | - | - | - | - | 424 |
| **Financial Services** | 344 | - | - | - | - | - | 344 |
| **Healthcare** | 5,427 | - | - | - | - | - | 5,427 |
| **Ind Goods & Services** | 11,801 | 883 | - | - | - | - | 12,684 |
| **Insurance** | 2,533 | - | - | - | - | - | 2,533 |
| **Media** | 1,483 | - | - | - | - | - | 1,483 |
| **Oil & Gas** | 17,906 | - | - | - | - | - | 17,906 |
| **Personal & Household Goods** | 1,088 | 184 | - | - | - | - | 1,272 |
| **Real Estate** | 176 | - | - | - | - | - | 176 |
| **Retail** | 16,783 | 239 | - | - | - | - | 17,022 |
| **Technology** | 1,749 | 603 | - | - | - | - | 2,352 |
| **Telecoms** | 7,237 | 6,053 | - | - | - | - | 13,290 |
| **Travel & Leisure** | 3,014 | 1,697 | - | - | - | - | 4,711 |
| **Utilites** | 3,453 | - | - | - | - | - | 3,453 |
| | 95,407 | 16,448 | - | - | - | - | 111,855 |
| **Pooled Funds** | | | | | | | |
| Bonds Managed Fund | - | - | - | - | 108,739 | - | 108,739 |
| Managed Funds | 11,540 | - | - | - | - | - | 11,540 |
| Overseas Equities Managed Fund | - | - | 219,561 | - | - | - | 219,561 |
| Property Managed Fund | - | - | - | 30,304 | - | - | 30,304 |
| Diversified Growth Fund | - | - | - | - | - | 78,020 | 78,020 |
| **Pooled Funds subtotal** | 11,540 | - | 219,561 | 30,304 | 108,739 | 78,020 | 448,164 |
| **Grand total** | 106,947 | 16,448 | 219,561 | 30,304 | 108,739 | 78,020 | 560,019 |

## APPENDIX C – Investment Strategy Statement

Dated: March 2017

## INVESTMENT STRATEGY STATEMENT ('ISS')

## ISLE OF WIGHT COUNCIL PENSION FUND – MARCH 2017

### *1. Introduction*

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities to formulate and to publish a statement of its investment strategy, in accordance with guidance issued from time to time by the Secretary of State.

This ISS has been designed to be a living document and is an important governance tool for the Fund. This document sets out the investment strategy of the Fund, provides transparency in relation to how the Fund investments are managed, acts as a risk register, and has been designed to be informative but reader focused. This document replaces the Fund's Statement of Investment Principles.

This statement will be reviewed by the Committee at least triennially or more frequently should any significant change occur.

### *2. Investment Beliefs and Objectives*

The Fund has the following investment beliefs which help to inform the investment strategy derived from the decision making process:

- Funding, investment strategy and contribution rates are linked
- The strategic asset allocation is the key factor in determining the risk and return profile of the Fund's investments
- Investing over the long term provides opportunities to improve returns
- Diversification across asset classes can help to mitigate against adverse market conditions and assist the Fund to produce a smoother return profile due to returns coming from a range of different sources
- Managing risk is a multi-dimensional and complex task
- Risk mitigation will be prioritised according to size of potential impact and risks will only be taken where they are expected to be rewarded
- Environmental, Social and Governance considerations are important factors for the sustainability of investment returns over the long term
- Value for money from investments is important, not just absolute costs. Asset pooling will help reduce costs whilst providing more choice of investments and will therefore be additive to Fund returns.
- High conviction active management can add value to returns

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, in accordance with the Local Government Pension Scheme ("LGPS") regulations and statutory provisions.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing.

### *3. Investment strategy and the process for ensuring suitability of investments.*

As noted above, the Fund's objective is to pay benefits as they fall due and this requires the build-up of sufficient reserves in advance. The Fund is currently assessed to have a deficit in terms of the reserves needed and so the asset strategy is focused on achieving returns in excess of gilts, without taking undue risk. Having a thorough understanding of the risks facing the Fund is crucial and these are covered later in this statement.

The asset strategy, along with an overview of the role each asset plays in achieving the Fund's objectives is set out in the table below:

| Asset class | Allocation % | Allowable ranges % | Role (s) within the strategy |
|---|---|---|---|
| Equity | 55.0 | +/-6% | Long term growth in excess of inflation expected |
| Diversified Growth Fund | 15.0 | +/-4% | Diversification and Tactical Asset Allocation |
| Fixed Income | 22.0 | +/-4% | Diversified source of return from a range of sources.<br>Not specifically income generating |
| Property | 8.0 | +/-4% | Diversification.<br>Generates investment income; Returns expected to be inflation-sensitive<br>Exposure to Illiquidity premium |

The Pensions Committee is responsible for the Fund's asset allocation which is determined via a triennial strategy review as part of the valuation process, but is kept under constant review; noting that strategic changes are an evolutionary process.

The triennial review looks at both qualitative and quantitative analysis, covering:

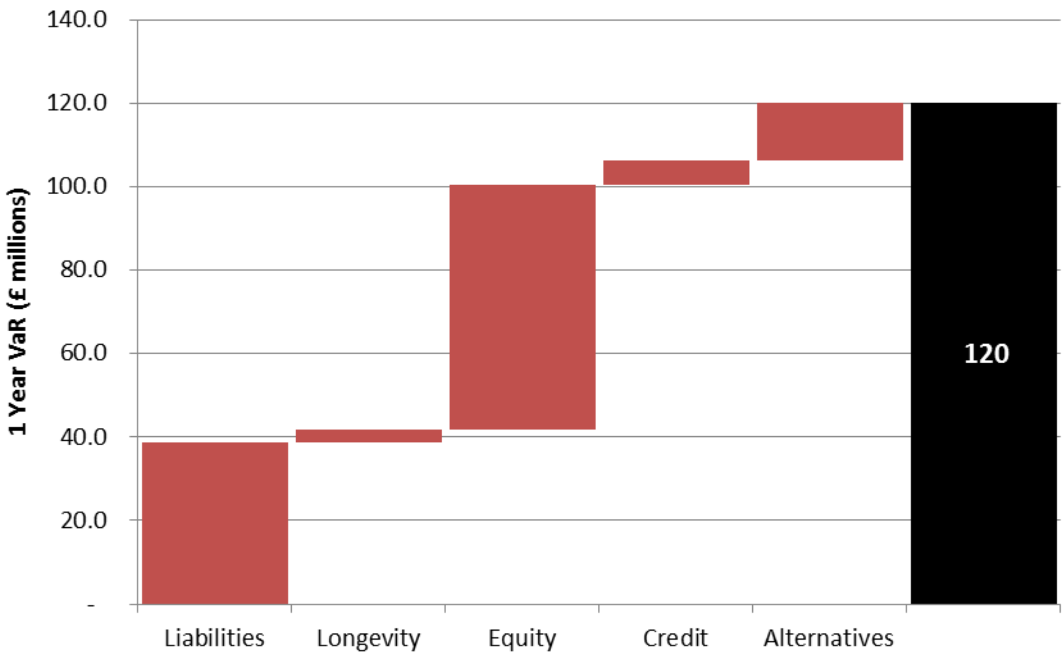
- The required level of return that will mean the Fund can meet its future benefit obligations as they fall due
- The level of risk that the Fund can tolerate in absolute terms, and in relation to its funding level and deficit
- An analysis of the order of magnitude of the various risks facing the Fund is established in order that a priority order for mitigation can be determined
- The desire for diversification across asset class, region, sector, and type of security

### *4. Risk measurement and management*

The Committee assesses risks both qualitatively and quantitatively, with the starting point being the triennial strategy review. Risks are considered, understood and then prioritised accordingly.

## A Investment Risks

The Committee uses Risk Attribution Analysis to determine the order of magnitude of the main investment risks the Fund is facing. The chart below shows the VaR (Value at Risk, essentially the losses that would occur in a 1-in-20 event) facing the Fund, split into major risk categories.




As an additional illustration of risk, the table below shows how a range of events could impact the Fund:

| Event | Event movement | Impact on Deficit |
|---|---|---|
| Fall in equity markets | 20% fall in equities | £56m |
| Rise in Inflation | 1% increase in inflation | £75m |
| Fall in interest rates | 1% fall in interest rates | £75m |
| Active Manager underperformance | 3% underperformance from all active managers | £14m |

As shown in both the Value-at-Risk attribution chart and the table above, the most significant risk that the Fund is running is in relation to equities. Whilst not immaterial the risks being run by the use of active management is far smaller.

**Equities** – One of the largest risks that the Fund is running is in relation to its equity holdings. Should equity market conditions deteriorate significantly this will have a negative impact on the funding level. The Fund holds equities in order to provide the necessary returns to ensure that the Fund remains affordable. The Committee believes that the extra returns that are expected to be generated by equities compensates the level of risk equities bring to the Fund, but does believe in diversification, and looks to mitigate equity risk by investing significantly in bonds and alternatives. The Fund is a long term investor but does require income over and above contributions received in order to pay pensions. A strategy is therefore being developed that would seek income from alternative assets and bonds, rather than from equities, in order to avoid being a forced seller at a low point in the market.

**Liabilities** – The other major risk the Fund is running is in relation to its unhedged liabilities which are impacted by changes in real gilt yields. The Fund's liabilities are sensitive to inflation as future pensions are linked to inflation and the cashflow out of the Fund will increase as inflation increases. The liabilities are sensitive to changes in gilt yields as these are used to place a current value on the future payments, as this yield falls the present value of the liabilities increases.

**Alternatives** – The Fund has a significant amount of assets allocated to a range of alternatives, with allocations to property and diversified growth. The risks that these investments bring at an individual level is not insignificant however the Committee believe that over the long term alternatives will provide returns that compensate for the risks being run. Additionally the level of diversification the assets provide helps to reduce the Funds reliance on returns from equities. Illiquid assets such as property are also a valuable source of income.

**Active Manager Risk** – Investment Managers are appointed to manage the Fund's investments on its behalf. This risk is small relative to other risks; however the Fund still addresses this risk. Extensive due diligence is used before managers are selected, with a number of different managers chosen to prevent concentration risk The investment managers are also monitored regularly by the Committee, Officers and by the Fund's Advisors.

The Fund's portfolio is well diversified across asset classes, geography and asset managers. As different asset classes have varying correlations with other asset classes, the Fund by investing in a range of different investments can minimise the level of risk run to a degree.

## B Demographic Risks

The Fund is subject to a range of demographic risks, but with particular reference to investment strategy, the Committee is aware of the potential for the Fund to mature over time as the pensioner liability increases. A mature pension fund is likely to take less investment risk over time and this is considered at each strategy review. The more mature a pension fund, the more likely it is that disinvestments would need to be made to pay benefits. The Fund is not in that situation at present as income from contributions and investments are greater than benefit payments. However, this situation is monitored regularly and formally as part of the actuarial valuation and strategy review.

## C Cashflow Management Risks

As noted above, the Fund is marginally cash flow positive after taking investment income into account. However, this position will be reviewed regularly and is a factor that is incorporated into the Fund's investment strategy reviews in order that a portfolio of income generating assets is built up over time.

## D Governance Risks

The Fund believes that there is a benefit to the Fund to be gained from good governance in the form of either or both of an increased return and/or decreased risk. Poor governance can lead to opportunities and risks being missed, and have a detrimental effect on the funding level and deficit.

Details of the Fund's governance structure can be found in the Governance Compliance Statement in the Fund's annual report and accounts.

## E Environmental, Social & Governance ('ESG') Risks

The committee recognises that social, environmental and ethical considerations are among the factors which investment managers will take into account, where relevant, when selecting investments for purchase, retention or sale. Each of the Fund Managers has produced a statement setting out its policy in this regard. The managers have been delegated by the committee to act accordingly.

## *4. Approach to asset pooling*

Isle of Wight is a member of the ACCESS pool along with the following 10 other pension funds:

East Sussex
Essex
Hampshire
Hertfordshire
Cambridgeshire
Kent
Norfolk
Northamptonshire
Suffolk
West Sussex

All eleven funds are committed to collaboratively working together to meet the criteria for pooling and have signed a Memorandum of Understanding to underpin their partnership (this will be updated for the proposed Inter Authority Agreement, once concluded). ACCESS is working to a project plan in order to create the appropriate means to pool investments. The first investments to be pooled in 2017 will be passively managed investments.

The ACCESS Funds have set out how they meet the pooling criteria, the pool's structure, governance arrangements and services to be shared is set out in the submission made to the Government in July 2016, which is available on ACCESS's website http://www.accesspool.org/

All 11 ACCESS funds are working in the expectation that all investments will be pooled apart from a minority of investments where there is a no value for money benefit to pooling a specific investment as identified and agreed by an individual fund.

## *5. Voting Rights*

The Committee has delegated the exercise of voting rights to the investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the managers have produced written guidelines of their process and practice in this regard. Copies of the Fund Managers' latest corporate governance reports are available from the Technical Finance Manager. The managers are encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies.

## *6. Environmental, Social and Corporate Governance policy and policy of the exercise of rights (including voting rights) attaching to investments*

The Pension Fund Committee must act with the best financial interests of the beneficiaries, present and future, in mind. The Pension Fund Committee believes that companies should be aware of the potential risks associated with adopting practices that are socially, environmentally or ethically unacceptable. As part of the investment decision-making process, Investment Managers are required to consider such practices and assess the extent to which this will detract from company performance and returns to shareholders.

Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. The quarterly report from investment managers should include details of voting activity.

The Fund has never sought to implement a policy that explicitly excludes certain types of investments, companies or sectors except where they are barred by UK law. The Fund believes that its influence as a shareholder is better deployed by engaging with companies, in order to influence behaviour and enhance shareholder value. The Fund believes that this influence would be lost through a divestment or screening approach. The Fund actively engages with companies through its investment managers.

Ultimately the Fund will always retain the right to disinvest from certain companies or sectors in the event that all other approaches are unsuccessful and it is determined that the investment is no longer aligned with the interests of the Fund or that the issue poses a material financial risk.

The Fund is committed to the UK Stewardship Code and is developing a statement of compliance for assessment by the Financial Reporting Council.

## Myners Principles

Although not specifically referenced in the Regulations, the Committee feels that assessment of compliance with the Myners Principles is a valuable governance tool. A copy of the Fund's Myners Compliance Statement can be found in the appendix.

**Advice Taken**

In creating this statement, the Fund has taken advice from its Investment Consultant. Also, in relation to each of the constituent parts, such as the asset allocation and risk mitigation, the Fund has taken advice from its Investment Consultant, Mercer, and the Scheme Actuary, Hymans Robertson. In providing investment advice, Mercer is regulated by the Financial Conduct Authority.

## **Appendix A** – Myners Principles

**Response on Adherence**

**Principle 1 Effective Decision Making:**
Administering authorities should ensure:

- That decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and
- That those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

**Compliant**
Decisions are taken by the Committee which is responsible for the management of the Fund.
The Committee has support from council officers with sufficient experience to assist them. The Committee also seeks advice from professional actuarial and investment advisers to ensure it can be familiar with the issues concerned when making decisions.
A training needs analysis was undertaken by the Committee in January 2012, resulting in a training plan being developed and delivered for the financial year 2012-2013.
The training needs analysis was refreshed to inform a new training delivery plan for 2013-14 and beyond.
The Committee hold a one hour training session before every Committee meeting.
The Committee is able to make robust challenges to advice and is aware of where potential conflicts of interest may reside within the Committee and in relation to service providers.

**Principle 2 Clear objectives:**
An overall investment objective should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.

**Compliant**
The Committee has established objectives for the Fund which takes account of the nature of fund liabilities and the contribution strategy. This involved discussions with the actuary to enable the Committee to set the overall risk budget for the Fund. This is reflected in the investment mandates awarded to the asset managers.
There is dialogue with admitted bodies within the fund in relation to the contributions they pay, their capacity to pay these contributions and the level of guarantees they can provide.

**Principle 3 Risk and liabilities:**

- In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.
- These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

**Compliant**
The investment strategy is considered in the light of the nature of the fund liabilities, the timescale over which benefits will be paid, and financial and demographic factors affecting the liabilities, such as inflation and improving longevity.
The Committee and council officers have discussed the contribution strategy with the actuary taking account of the strength of covenant of the council and its long term horizon. Discussions have also taken place with admitted bodies in relation to the affordability of contributions and the strengths of their covenants.

| Principle | Response on Adherence |
| --- | --- |
| **Principle 4 Performance assessment:**<br>• Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.<br>• Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members. | **Partially Compliant**<br>The performance of the Fund and its individual managers are monitored on a regular basis.<br>The quality of advisers is assessed on a qualitative basis but is not formally measured. Advisers are subject to periodic re-tender.<br>The Committee is developing formal processes to measure its own effectiveness. |
| **Principle 5 Responsible Ownership:**<br>Administering authorities should<br>• Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents.<br>• Include a statement of their policy on responsible ownership in the Statement of Investment Principles.<br>• Report periodically to scheme members on the discharge of such responsibilities. | **Partially Compliant**<br>The Committee encourages its Investment Managers to adopt the ISC Statement of Principles on the responsibilities of shareholders and agents on the Fund's behalf<br>This Statement of Investment Principles includes a statement on the fund's policy on responsible ownership.<br>The Committee needs to consider the implications of the UK Stewardship Code (issued in September 2012) to ensure it is fully compliant with the new requirements. |
| **Principle 6 Transparency and Reporting:**<br>Administering authorities should<br>• Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.<br>• Should provide regular communication to scheme members in the form they consider most appropriate. | **Compliant**<br>The Committee maintains minutes of meetings which are available on the council website.<br>The Committee holds a formal annual meeting for members and also meets periodically with sponsoring employer bodies. An Admitted Bodies representative and a Member representative attend Committee meetings.<br>The Statement of Investment Principles is published on the council website and is available to members on request. Other information on the scheme is available to members on the council website. |

**APPENDIX D – Funding Strategy Statement**

# 1 Introduction

### 1.1 What is this document?

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

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser. It is effective from 1 April 2017

### 1.2 What is the Isle of Wight Council Pension Fund?

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the Isle of Wight Council Pension Fund, in effect the LGPS for the Isle of Wight area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth; and
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

### 1.3 Why does the Fund need a Funding Strategy Statement?

Employees' benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees' contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in Appendix A.

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- the Fund's practices regarding admissions, cessations and bulk transfers (were the Fund's practices to change during the period of the FSS, the appropriate stakeholders would be communicated with accordingly);
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Investment Strategy Statement (see Section 4)

### 1.4 How does the Fund and this FSS affect me?

This depends who you are:

- a member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;
- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, and in what circumstances you might need to pay more. Note that the FSS applies to all employers participating in the Fund;
- an Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- a Council Tax payer: your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

### 1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- not to restrain unnecessarily the Investment Strategy of the Pension Fund so that the Administering Authority can seek to maximise investment returns (and hence meet the costs of benefits) for an appropriate level of risk;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (**NB** this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and

- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

### 1.6 How do I find my way around this document?

In Section 2 there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In Section 3 we outline how the Fund calculates the contributions payable by different employers in different situations.

In Section 4 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail if you are interested:

A. the regulatory background, including how and when the FSS is reviewed,

B. who is responsible for what,

C. what issues the Fund needs to monitor, and how it manages its risks,

D. some more details about the actuarial calculations required,

E. the assumptions which the Fund actuary currently makes about the future,

F. a glossary explaining the technical terms occasionally used here.

If you have any other queries please contact Jo Thistlewood, Technical Finance Manager, in the first instance at e-mail address jo.thistlewood@iow.gov.uk or on telephone number 01983 821000 extension 6371.

# 2 Basic Funding issues

(More detailed and extensive descriptions are given in Appendix D).

### 2.1 How does the actuary measure the required contribution rate?

In essence this is a three-step process:

- Calculate the ultimate funding target for that employer, i.e. the ideal amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;
- Determine the time horizon over which the employer should aim to achieve that funding target. See the table in 3.3 and Note (c) for more details;
- Calculate the employer contribution rate such that it has at least a given probability of achieving that funding target over that time horizon, allowing for different likelihoods of various possible economic outcomes over that time horizon. See 2.3 below, and the table in 3.3 Note (e) for more details.

### 2.2 What is each employer's contribution rate?

This is described in more detail in Appendix D. Employer contributions are normally made up of two elements:

a) the estimated cost of benefits being built up each year, after deducting the members' own contributions and including administration expenses. This is referred to as the "*Primary rate*", and is expressed as a percentage of members' pensionable pay; plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, payment of the Secondary rate will aim to return the employer to full funding over an appropriate period (the "time horizon"). The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of any higher rate will be taken by the Fund actuary at subsequent valuations, i.e. will be reflected as a credit when next calculating the employer's contributions.

### 2.3 What different types of employer participate in the Fund?

Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate. There are currently more employers in the Fund than ever before, a significant part of this being due to new academies.

In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: academy schools, contractors, housing associations, charities, etc.

The LGPS Regulations define various types of employer as follows:

**Scheduled bodies** - councils, and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such **academies (or Multi Academy Trusts)**, as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as "Scheduled Bodies", the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the DCLG regarding the terms of academies' membership in LGPS Funds.

**Designating employers** - employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

Other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer – **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer – **transferee admission bodies** ("TAB"). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements of the Fund's admission practices are not met. (NB The terminology CAB and TAB has been dropped from recent LGPS Regulations, which instead combine both under the single term 'admission bodies'; however, we have retained the old terminology here as we consider it to be helpful in setting funding strategies for these different employers.

### 2.4 How does the measured contribution rate vary for different employers?

All three steps above are considered when setting contributions (more details are given in Section 3 and Appendix D).

1. The **funding target** is based on a set of assumptions about the future, (e.g. investment returns, inflation, pensioners' life expectancies). However, if an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation;

2. The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and

3. The **probability of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

For some employers it may be agreed to pool contributions, see 3.4.

Any costs of non ill-health early retirements must be paid by the employer, see 3.6.

Costs of ill-health early retirements are covered in 3.7 and 3.8.

.

### 2.5 How is a deficit (or surplus) calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see Appendix D, section D5, for further details of how this is calculated), to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

It is important to note that the deficit/surplus and funding level are only measurements at a particular point in time, on a particular set of assumptions about the future. Whilst we recognise that various parties will take an interest in these measures, for most employers the key issue is how likely it is that their contributions will be sufficient to pay for their members' benefits (when added to their existing asset share and anticipated investment returns).

In short, deficits and funding levels are short term measures, whereas contribution-setting is a longer term issue.

### 2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher Pension Fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;
- Contributions which Academies pay to the Fund will therefore not be available to pay for providing education; and
- Other employers will provide various services to the local community, perhaps through housing associations, charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services at a reasonable cost.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;

- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible. However, a recent shift in regulatory focus means that solvency within each generation is considered by the Government to be a higher priority than stability of contribution rates;

- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result;

- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see 3.1). In deciding which of these techniques to apply to any given employer, the Fund will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc. This helps the Fund establish a picture of the financial standing of the employer, i.e. its ability to meet its long term Fund commitments.

For instance, where an employer is considered relatively low risk then the Fund will permit options such as stabilisation (see 3.3 Note (b)), a longer time horizon relative to other employers, and/or a lower probability of achieving their funding target. Such options will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, an employer whose risk assessment indicates a less strong covenant will generally be required to pay higher contributions (for instance, with a higher funding target, and/or a shorter deficit recovery period relative to other employers, and/or a higher probability of achieving the target). This is because of the higher probability that at some point it will fail or be unable to meet its pension contributions, with its deficit in the Fund then falling to other Fund employers.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see Appendix A.

# 3 Calculating contributions for individual Employers

## 3.1 General comments

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, the Fund's three-step process identifies the key issues:

1. What is a suitably (but not overly) prudent funding target?

2. How long should the employer be permitted to reach that target? This should be realistic but not so long that the funding target is in danger of never actually being achieved.

3. What probability is required to reach that funding target? This will always be less than 100% as we cannot be certain of future market movements. Higher probability "bars" can be used for employers where the Fund wishes to reduce the risk that the employer ceases leaving a deficit to be picked up by other employers.

These and associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

## 3.2 The effect of paying lower contributions

There are a number of methods which the Administering Authority may permit, in order to improve the stability of employer contributions. These include, where circumstances permit:-

- capping of employer contribution rate changes within a pre-determined range ("stabilisation");
- the use of extended time horizons;
- adjusting the required probability of meeting the funding target;
- the phasing in of contribution rises or reductions;
- the pooling of contributions amongst employers with similar characteristics; and/or
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than the measured contribution rate. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the pace of paying contributions;
- lower contributions in the short term will be assumed to incur a greater loss of investment returns on the deficit. Thus, deferring a certain amount of contribution may lead to higher contributions in the long-term; and
- it may take longer to reach their funding target, all other things being equal.

Overleaf (3.3) is a summary of how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

Section 3.4 onwards deals with various other funding issues which apply to all employers.

### 3.3 The different approaches used for different employers

| Type of employer | Scheduled Bodies | | | Community Admission Bodies and Designating Employers | | Transferee Admission Bodies |
|---|---|---|---|---|---|---|
| **Sub-type** | **Local Authority** | **College** | **Academies** | **Open to new entrants** | **Closed to new entrants** | **(all)** |
| **Funding Target Basis used** | Ongoing, assumes long-term Fund participation (see Appendix E) | | | Ongoing, but may move to "gilts basis" - see Note (a) | | Ongoing, assumes fixed contract term in the Fund (see Appendix E) |
| **Primary rate approach** | (see Appendix D – D.2) | | | | | |
| **Stabilised contribution rate?** | Yes - see Note (b) | No | No | No | No | No |
| **Maximum time horizon – Note (c)** | 20 years | 15 years | 15 years | 15 years | 15 years | Outstanding contract term |
| **Secondary rate – Note (d)** | % of payroll or monetary amount | % of payroll or monetary amount | % of payroll or monetary amount | % of payroll or monetary amount | Monetary amount | Monetary amount |
| **Treatment of surplus** | Covered by stabilisation arrangement | Contributions at least at primary rate | Contributions at least at primary rate | Preferred approach: contributions kept at Primary rate. However, reductions may be permitted by the Admin. Authority | | Reduce contributions by spreading the surplus over the remaining contract term |
| **Probability of achieving target – Note (e)** | 67% | 75% | 75% | 75% | 75% | 75% |
| **Phasing of contribution changes** | Covered by stabilisation arrangement | At the discretion of the Administering Authority. May be 3 years. | | | | None |
| **Review of rates – Note (f)** | Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations | | | | | Particularly reviewed in last 3 years of contract |
| **New employer** | n/a | n/a | Note (g) | Note (h) | | Notes (h) & (i) |
| **Cessation of participation: cessation debt payable** | Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt principles applied would be as per Note (j). | | | Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (j). | | Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising. |

**Note (a) (Basis for CABs and Designating Employers closed to new entrants)**

In the circumstances where:

- the employer is a Designating Employer, or an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may set a higher funding target (e.g. using a discount rate set equal to gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Designating Employers and 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 or the Designating Employer alters its designation.

**Note (b) (Stabilisation)**

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" (and may therefore be 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.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority (see below) and;
- there are no material events which cause the employer to become ineligible, e.g. significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring), or changes in the security of the employer.

On the basis of extensive modelling carried out for the 2016 valuation exercise (see Section 4), the stabilised details are as follows:

| **Type of employer** | **Council** |
|---|---|
| **Max cont. increase** | +0% |
| **Max cont. decrease** | +0% |

The stabilisation criteria and limits will be reviewed at the 31 March 2019 valuation, to take effect from 1 April 2020. However the Administering Authority reserves the right to review the stabilisation criteria and limits at any time before then, on the basis of membership and/or employer changes as described above.

**Note (c) (Maximum time horizon)**

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2017 for the 2016 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative time horizons, for example where there were no new entrants.

**Note (d) (Secondary rate)**

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

- the employer is relatively mature, i.e. has a large Secondary contribution rate (e.g. above 15% of payroll), or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed the Fund to new entrants.

**Note (e) (Probability of achieving funding target)**

Each employer has its funding target calculated, and a relevant time horizon over which to reach that target. Contributions are set such that, combined with the employer's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum probability. A higher required probability bar will give rise to higher required contributions, and vice versa.

The way in which contributions are set using these three steps, and relevant economic projections, is described in further detail in Appendix D.

Different probabilities are set for different employers depending on their nature and circumstances: in broad terms, a higher probability will apply due to one or more of the following:

- the Fund believes the employer poses a greater funding risk than other employers,
- the employer does not have tax-raising powers;
- the employer does not have a guarantor or other sufficient security backing its funding position; and/or
- the employer is likely to cease participation in the Fund in the short or medium term.

**Note (f) (Regular Reviews)**

Such reviews may be triggered by significant events including but not limited to: significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

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

**Note (g) (New Academy conversions)**

At the time of writing, the Fund's policies on academies' funding issues are as follows:

i. The new academy will be regarded as a separate employer in its own right and will not be pooled with other employers in the Fund. The only exception is where the academy is part of a Multi Academy Trust (MAT) in which case the academy's figures will be calculated as below but can be combined with those of the other academies in the MAT;

ii. The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status;

iii. The new academy will be allocated an initial asset share from the ceding council's assets in the Fund. This asset share will be calculated using the estimated funding position of the ceding council at the date of academy conversion. The share will be based on the active members' funding level, having first allocated assets in the council's share to fully fund deferred and pensioner members. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion;

iv. The new academy's initial contribution rate will be calculated using market conditions, the council funding position and, membership data, all as at the day prior to conversion;

v. As an alternative to (iv), the academy will have the option to elect to pay contributions initially in line with the ceding LEA instead. However, this election will not alter its asset or liability allocation as per (ii) and (iii) above. Ultimately, all academies remain responsible for their own allocated deficit.

The Fund's policies on academies are subject to change in the light of any amendments to DCLG guidance. Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS. In particular, policies (iv) and (v) above will be reconsidered at each valuation.

**Note (h) (New Admission Bodies)**

With effect from 1 October 2012, the LGPS 2012 Miscellaneous Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date. Under these Regulations, all new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit.

Transferee Admission Bodies: For all TABs, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis. The details of the required security will be specified in the employer's admission agreement. See also Note (i) below.

Community Admission Bodies: The Administering Authority will only consider requests from CABs (or other similar bodies, such as section 75 NHS partnerships) to join the Fund if it is required by the terms of their contract with the relevant letting authority. Details of security will be specified in the employer's admission agreement

The above approaches reduce the risk, to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

**Note (i) (New Transferee Admission Bodies)**

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council or academy) to another organisation (a "contractor"). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees' Fund benefits. The quid pro quo is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see Note (j).

Employers which "outsource" have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) <u>Pooling</u>

Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which may be under a stabilisation approach.

ii) <u>Letting employer retains pre-contract risks</u>

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor's contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) <u>Fixed contribution rate agreed</u>

Under this option the contractor pays a fixed contribution rate and does not pay any cessation deficit.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from:

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above; and
- redundancy and early retirement decisions.

**Note (j) (Admission Bodies Ceasing)**

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund (NB recent LGPS Regulation changes mean that the Administering Authority has the discretion to defer taking action for up to three years, so that if the employer acquires one or more active Fund members during that period then cessation is not triggered. The current Fund policy is that this is left as a discretion and may or may not be applied in any given case);
- 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 an appropriate alternative guarantor, as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

(a) 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", which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

(b) Where there is a guarantor for future deficits and contributions, the details of the guarantee will be considered prior to the cessation valuation being carried out. In some cases the guarantor is simply guarantor of last resort and therefore the cessation valuation will be carried out consistently with the approach taken had there been no guarantor in place. Alternatively, where the guarantor is not simply guarantor of last resort, the cessation may be calculated using the ongoing basis as described in Appendix E;

(c) Again, depending on the nature of the guarantee, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee.

Under (a) and (b), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund would spread the payment subject to there being some security in place for the employer such as a bond indemnity or guarantee or look to the security itself as a means of full or partial payment.

In the event that the Fund is not able to recover the required payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

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

### 3.4 Pooled contributions

From time to time, with the advice of the Actuary, the Administering Authority may set up pools for employers with similar or complementary characteristics. This will always be in line with its broader funding strategy. At the present time the only pool in operation is the Council pool, which includes various legacy bodies and employers associated with the Council.

Academies will be regarded as separate employers in their own right and will not be pooled with other employers in the Fund, the only possible exception being when the Academy is part of a Multi-Academy Trust (MAT). However,

Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not usually permitted to participate in a pool.

Transferee Admission Bodies are usually also ineligible for pooling. Smaller Transferee Admission Bodies may be pooled with the letting employer, provided all parties (particularly the letting employer) agree.

Employers who are permitted to enter (or remain in) a pool at the 2016 valuation will not normally be advised of their individual contribution rate unless agreed by the Administering Authority.

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

### 3.5 Academy contribution rates

The Administering Authority permits an academy to elect to pay a contribution rate in line with that paid by the Isle of Wight Council. An academy electing for this option will be paying contributions that may be more or less than required to meet their funding target, over the appropriate time horizon with the required likelihood of success. An academy electing to pay a lower contribution rate than their individually assessed rate should note the comments made in 3.2 above.

### 3.6 Non ill health early retirement costs

It is assumed that members' benefits 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). (**NB** the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014).

Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. These contributions may, at the absolute discretion of Administering Authority, be spread over an appropriate period of time to be advised by the Administering Authority. In any event the spread period cannot exceed the period to the member's normal retirement date.

The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

### 3.7 Ill health early retirement costs

In the event of a member's early retirement on the grounds of ill-health, a funding strain will usually arise, which can be very large. Such strains are currently met by each employer, although individual employers may elect to take external insurance (see 3.8 below).

Admitted Bodies will usually have an 'ill health allowance'; Scheduled Bodies may have this also, depending on their agreement terms with the Administering Authority. The Fund monitors each employer's ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis as apply for non ill-health cases. Details will be included in each separate Admission Agreement.

### 3.8 External Ill health insurance

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

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged, and

- there is no need for monitoring of allowances.

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

### 3.9 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis (see 3.3, Note (j)) and consequently have no further obligation to the Fund. Thereafter it is expected that one of three situations will eventually arise:

a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;

b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the remaining assets would be apportioned pro-rata by the Fund's actuary to the other Fund.

c) In exceptional circumstances the Fund may permit an employer with no remaining active members to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases, as the employer would have no contributing members.

### 3.10 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended time horizon, or permission to join a pool with another body (e.g. the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may 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; and
- whether the admission agreement is likely to be open or closed to new entrants.

### 3.11 Policies on bulk transfers

Each case will be treated on its own merits, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities; and
- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.

# 4 Funding strategy and links to investment strategy

## 4.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (being replaced by an Investment Strategy Statement under new LGPS Regulations), which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out as part of each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

## 4.2 What is the link between funding strategy and investment strategy?

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa

Therefore, the funding and investment strategies are inextricably linked.

## 4.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The asset outperformance assumption contained in the discount rate (see Appendix E3) is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government (see Appendix A1).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this 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.

## 4.4 How does this differ for a large stable employer?

The Actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

- Prudence - the Fund should have a reasonable expectation of being fully funded in the long term;
- Affordability – how much can employers afford;
- Stewardship – the assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position; and
- Stability – employers should not see significant moves in their contribution rates from one year to the next, to help provide a more stable budgeting environment.

The key problem is that the key objectives often conflict. For example, minimising the long term cost of the scheme (i.e. keeping employer rates affordable) is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down fairly frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

Therefore, a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling: this is a set of calculation techniques applied by the Fund's actuary to model the range of potential future solvency levels and contribution rates.

The Actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach (see 3.3 Note (b)). The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes as described in 3.3 Note (b), struck an appropriate balance between the above objectives. In particular the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Fund.

Whilst the current stabilisation mechanism is to remain in place until 2020, it should be noted that this will need to be reviewed following the 2019 valuation.

### 4.5 Does the Fund monitor its overall funding position?

The Administering Authority monitors the relative funding position, i.e. changes in the relationship between asset values and the liabilities value, quarterly. It reports this to the Pensions Committee quarterly.

# 5 Statutory reporting and comparison to other LGPS Funds

## 5.1 Purpose

Under Section 13(4)(c) of the Public Service Pensions Act 2013 (“Section 13”), the Government Actuary’s Department (GAD) must, following each triennial actuarial valuation, report to the Department of Communities & Local Government (DCLG) on each of the LGPS Funds in England & Wales. This report will cover whether, for each Fund, the rate of employer contributions are set at an appropriate level to ensure both the solvency and the long term cost efficiency of the Fund.

This additional DCLG oversight may have an impact on the strategy for setting contribution rates at future valuations.

## 5.2 Solvency

For the purposes of Section 13, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

(a) the rate of employer contributions is set to target a funding level for the Fund of 100%, over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds); and either

(b) employers collectively have the financial capacity to increase employer contributions, and/or the Fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or

(c) there is an appropriate plan in place should there be, or if there is expected in future to be, a material reduction in the capacity of fund employers to increase contributions as might be needed.

## 5.3 Long Term Cost Efficiency

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long term cost efficiency if:

i. the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual,

ii. with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, DCLG may have regard to various absolute and relative considerations. A relative consideration is primarily concerned with comparing LGPS pension funds with other LGPS pension funds. An absolute consideration is primarily concerned with comparing Funds with a given objective benchmark.

Relative considerations include:

1. the implied deficit recovery period; and
2. the investment return required to achieve full funding after 20 years.

Absolute considerations include:

1. the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;
2. how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy;
3. the extent to which contributions actually paid have been in line with the expected contributions based on the extant rates and adjustment certificate; and
4. the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual Fund experience.

DCLG may assess and compare these metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

# Appendix A – Regulatory framework

### A1 Why does the Fund need an FSS?

The Department for Communities and Local Government (DCLG) has 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.

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2016) and to its Statement of Investment Principles / Investment Strategy Statement.

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

### A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to "consultation with such persons as the authority considers appropriate", and should include "a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers".

In practice, for the Fund, the consultation process for this FSS was as follows:

a) A draft version of the FSS was issued to all participating employers on 23 December 2016 for comment;

b) Comments were requested by 31 January 2017;

c) Following the end of the consultation period the FSS was updated where required and then published, on 31 March 2017.

### A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website, at http://www.iwight.com/council/OtherServices/Pensions-IWC
- A copy sent by e-mail to each participating employer in the Fund;
- A full copy included in the annual report and accounts of the Fund;
- Copies sent to investment managers and independent advisers;
- Copies made available on request.

### A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2019.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Isle of Wight Council Pension Fund Committee and would be included in the relevant Committee Meeting minutes.

### A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Statement of Investment Principles/Investment Strategy Statement, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at [https://www.iwight.com/council/OtherServices/Pensions-IWC](https://www.iwight.com/council/OtherServices/Pensions-IWC).

# Appendix B – Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to each play their part.

### B1 The Administering Authority should:-

- operate the Fund as per the LGPS Regulations;
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
- collect employer and employee contributions, and investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles/Investment Strategy Statement (SIP/ISS) and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the Fund's actuary;
- provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
- prepare and maintain a FSS and a SIP/ISS, after consultation;
- notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the fund's performance and funding and amend the FSS and SIP/ISS as necessary and appropriate.

### B2 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;
- have a policy and 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 Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

### B3 The Fund Actuary should:-

- prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
- provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);

- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
- advise on the termination of employers' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

**B4 Other parties:-**

- investment advisers (either internal or external) should ensure the Fund's SIP/ISS remains appropriate, and consistent with this FSS;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the SIP/ISS;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures;
- the Department for Communities and Local Government (assisted by the Government Actuary's Department) and the Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

# Appendix C – Key risks and controls

## C1 Types of risk

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

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

## C2 Financial risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities over the long-term. | Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing.<br><br>Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.<br><br>Analyse progress at three yearly valuations for all employers.<br><br>Inter-valuation roll-forward of liabilities between valuations at whole Fund level. |
| Inappropriate long-term investment strategy. | Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes.<br><br>Chosen option considered to provide the best balance. |
| Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities. | Stabilisation modelling at whole Fund level allows for the probability of this within a longer term context.<br><br>Inter-valuation monitoring, as above.<br><br>Some investment in bonds helps to mitigate this risk. |
| Active investment manager under-performance relative to benchmark. | Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark. |
| Pay and price inflation significantly more than anticipated. | The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.<br><br>Inter-valuation monitoring, as above, gives early warning.<br><br>Some investment in bonds also helps to mitigate this risk.<br><br>Employers pay for their own salary awards and should |

| Risk | Summary of Control Mechanisms |
|---|---|
| | be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees. |
| Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies | An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions. |
| Orphaned employers give rise to added costs for the Fund | The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.<br><br>If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 3.9). |

### C3 Demographic risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Pensioners living longer, thus increasing cost to Fund. | Set mortality assumptions with some allowance for future increases in life expectancy.<br><br>The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.<br><br>If deemed to be worthwhile, the possibilities of mortality hedging may be investigated. |
| Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees. | Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies. |
| Deteriorating patterns of early retirements | Employers are charged the extra cost of non ill-health retirements following each individual decision.<br><br>Employer ill health retirement experience is monitored, and insurance is an option. |
| Reductions in payroll causing insufficient deficit recovery payments | In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:<br><br>Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (b) to 3.3).<br><br>For other employers, review of contributions is permitted in general between valuations (see Note (f) to 3.3) and may require a move in deficit contributions from a percentage of payroll to fixed monetary |

| Risk | Summary of Control Mechanisms |
|---|---|
| | amounts. |

## C4 Regulatory risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform. | The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.<br><br>The results of the most recent reforms were built into the 2013 valuation. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions. |
| Time, cost and/or reputational risks associated with any DCLG intervention triggered by the Section 13 analysis (see Section 5). | Take advice from Fund Actuary on position of Fund as at prior valuation, and consideration of proposed valuation approach relative to anticipated Section 13 analysis. |
| Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies. | The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.<br><br>Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate. |

## C5 Governance risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants. | The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.<br><br>The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions between triennial valuations<br><br>Deficit contributions may be expressed as monetary amounts. |
| Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way | The Administering Authority maintains close contact with its specialist advisers.<br><br>Advice is delivered via formal meetings involving Elected Members, and recorded appropriately.<br><br>Actuarial advice is subject to professional requirements such as peer review. |

| Risk | Summary of Control Mechanisms |
|---|---|
| Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body. | The Administering Authority requires employers with Best Value contractors (Transferee Admission Bodies) to inform it of forthcoming changes.<br><br>Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken. |
| An employer ceasing to exist with insufficient funding or adequacy of a bond. | The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.<br><br>The risk is mitigated by:<br><br>Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see Notes (h) and (j) to 3.3).<br><br>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.<br><br>Vetting prospective employers before admission.<br><br>Where permitted under the regulations requiring a bond to protect the Fund from various risks.<br><br>Requiring new Community Admission Bodies to have a guarantor.<br><br>Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to 3.3).<br><br>Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to 3.3). |

# Appendix D – The calculation of Employer contributions

In Section 2 there was a broad description of the way in which contribution rates are calculated.  This Appendix considers these calculations in much more detail.

All three steps above are considered when setting contributions (more details are given in Section 3 and Appendix D:

1. The **funding target** is based on a set of assumptions about the future, e.g. investment returns, inflation, pensioners' life expectancies. However, if an employer is approaching the end of its participation in the Fund then it's funding target may be set on a more prudent basis, so that it's liabilities are less likely to be spread among other employers after it's cessation of participation;

2. The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform;

3. The required **probability of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

### D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

a) the estimated cost of ongoing benefits being accrued,  referred to as the "Primary contribution rate" (see D2 below); plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "Secondary contribution rate" (see D3 below).

The contribution rate for each employer is measured as above, appropriate for each employer's funding position and membership. The whole Fund position, including that used in reporting to DCLG (see section 5), is calculated in effect as the sum of all the individual employer rates. DCLG currently only regulates at whole Fund level, without monitoring individual employer positions.

### D2 How is the Primary contribution rate calculated?

The Primary element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members' **future** service in the Fund.  This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

The Primary rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole.  The Primary rate is calculated such that it is projected to:

1. meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets,

2. within the determined time horizon (see note 3.3 Note (c) for further details),

3. with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

* The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The projections are carried out using an economic modeller developed by the Fund's actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (by the end of the time horizon) is equal to the required probability.

The approach includes expenses of administration to the extent that they are borne by the Fund, and includes allowances for benefits payable on death in service and on ill health retirement.

### D3 How is the Secondary contribution rate calculated?

The combined Primary and Secondary rates aim to achieve the employer's funding target, within the appropriate time horizon, with the relevant degree of probability.

For the funding target, the Fund actuary agrees the assumptions to be used with the Administering Authority – see Appendix E. These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer's current and former employees, based on pensionable service to the valuation date only (i.e. ignoring further benefits to be built up in the future).

The Fund operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see Section 3).

The Secondary rate is calculated as the balance over and above the Primary rate, such that the total is projected to:

- meet the required funding target relating to combined past and future service benefit accrual, including accrued asset share (see D5 below)
- within the determined time horizon (see 3.3 Note (c) for further details)
- with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

The projections are carried out using an economic modeller developed by the Fund Actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes with at least 100% solvency (by the end of the time horizon) is equal to the required probability.

### D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

1. past contributions relative to the cost of accruals of benefits;

2. different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);

3. the effect of any differences in the funding target, i.e. the valuation basis used to value the employer's liabilities;

4. any different time horizons;

5. the difference between actual and assumed rises in pensionable pay;

6. the difference between actual and assumed increases to pensions in payment and deferred pensions;
7. the difference between actual and assumed retirements on grounds of ill-health from active status;
8. the difference between actual and assumed amounts of pension ceasing on death;
9. the additional costs of any non ill-health retirements relative to any extra payments made; and/or
10. differences in the required probability of achieving the funding target.

### D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus".

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

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

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

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

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification but not to audit standard. The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

# Appendix E – Actuarial assumptions

### E1 What are the actuarial assumptions?

These are expectations of future experience used to place a value on future benefit payments ("the liabilities"). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

Changes in assumptions will affect the measured funding target. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower funding targets and lower employer costs. A more prudent basis will give higher funding targets and higher employer costs.

### E2 What basis is used by the Fund?

The Fund's standard funding basis is described as the "ongoing basis", which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term, a more prudent basis applies: see Note (a) to 3.3.

### E3 What assumptions are made in the ongoing basis?

**a) Investment return / discount rate**

The key financial assumption is the anticipated return on the Fund's investments. This "discount rate" assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds ("gilts"). There is, however, no guarantee that Fund returns will out-perform 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.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2016 and setting contribution rates effective from 1 April 2017, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.8% per annum greater than gilt yields at the time of the valuation (this is a 0.2% increase to the 1.6% per annum used at the 2013 valuation). In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

**b) Salary growth**

Pay for public sector employees is currently subject to restriction by the UK Government until 2020. Although this “pay freeze” does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards. Based on long term historical analysis of the membership in LGPS funds, and continued austerity measures, the salary increase assumption at the 2016 valuation has been set to be a blended rate combined of:

1. 1% p.a. until 31 March 2020, followed by

2. The retail prices index (RPI) per annum p.a. thereafter.

This is a change from the previous valuation, which assumed a flat assumption of RPI plus 1.0% per annum. The change has led to a reduction in the funding target (all other things being equal).

**c) Pension increases**

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the “formula effect” of the difference between RPI and CPI. At this valuation, we propose a reduction of 1.0% per annum. This is a larger reduction than at 2013, which will serve to reduce the funding target (all other things being equal). (Note that the reduction is applied in a geometric, not arithmetic, basis).

**d) Life expectancy**

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of “VitaCurves”, produced by the Club Vita’s detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with the 2013 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.25% per annum minimum underpin to future reductions in mortality rates. This is a similar allowance for future improvements than was made in 2013.

**e) General**

The same financial assumptions are adopted for most employers, in deriving the funding target underpinning the Primary and Secondary rates: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer’s circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

# Appendix F – Glossary

| | |
|---|---|
| **Actuarial assumptions/basis** | The combined set of assumptions made by the actuary, regarding the future, to calculate the value of **the funding target**. The main assumptions will relate to the **discount rate**, salary growth, pension increases and longevity. More prudent assumptions will give a higher target value, whereas more optimistic assumptions will give a lower value. |
| **Administering Authority** | The council with statutory responsibility for running the Fund, in effect the Fund's "trustees". |
| **Admission Bodies** | Employers where there is an Admission Agreement setting out the employer's obligations. These can be Community Admission Bodies or Transferee Admission Bodies. For more details (see 2.3). |
| **Covenant** | The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term. |
| **Designating Employer** | Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund. |
| **Discount rate** | The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day. This is necessary to provide a **funding target** which is consistent with the present day value of the assets. A lower discount rate gives a higher target value, and vice versa. It is used in the calculation of the **Primary and Secondary rates**. |
| **Employer** | An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **funding target** values for each employer are individually tracked, together with its **Primary rate** at each **valuation**. |
| **Funding target** | The actuarially calculated present value of all pension entitlements of all **members** of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the **deficit**. It is calculated on a chosen set of **actuarial assumptions**. |
| **Gilt** | A UK Government bond, i.e. a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency. |
| **Guarantee / guarantor** | A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's. |
| **Letting employer** | An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS |

| | |
|---|---|
| | benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority, but can sometimes be another type of employer such as an Academy. |
| **LGPS** | The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 101 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers. |
| **Maturity** | A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy. |
| **Members** | The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees). |
| **Primary contribution rate** | The employer contribution rate required to pay for ongoing accrual of active members' benefits (including an allowance for administrative expenses). See Appendix D for further details. |
| **Profile** | The profile of an employer's membership or liability reflects various measurements of that employer's **members**, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also. |
| **Rates and Adjustments Certificate** | A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal **valuation**. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed. |
| **Scheduled Bodies** | Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, police and fire authorities etc., other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers). |
| **Secondary contribution rate** | The difference between the employer's actual and **Primary contribution rates**. In broad terms, this relates to the shortfall of its asset share to its **funding target**. See Appendix D for further details. |
| **Stabilisation** | Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit |

recovery periods; higher discount rates; or some combination of these.

**Valuation** An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is normally carried out in full every three years (last done as at 31 March 2016), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date also.

**APPENDIX E - Governance Compliance Statement**
**As at 31 March 2017**
Dated:

The Governance Compliance Statement will follow

## Independent auditor’s statement to the Members of Isle of Wight Council on the pension fund financial statements

This will be inserted once the audit has been completed and the auditor’s statement has been issued.