

# **The Highland Council Pension Fund**

*Administered by The Highland Council*

## **Funding Strategy Statement**

## CONTENTS

1. [Overview](#)
  2. [Purposes of the Statement](#)
  3. [Consultation](#)
  4. [Purpose and Aims of the Fund](#)
  5. [Responsibilities of the key parties](#)
  6. [Solvency](#)
  7. [Funding Strategy](#)
  8. [Identification of risks and counter measures](#)
  9. [Links to investment policy as set out in the Statement of Investment Principles](#)
  10. [Future Monitoring](#)
- Appendix A [Minimum Contribution Rates by Group](#)

## **1. Overview**

- 1.1 This Funding Strategy Statement has been prepared in accordance with Regulation 75A (1) of the Local Government Pension Scheme (Scotland) Regulations 1998 (the Regulations) as amended by The Local Government Pension Scheme (Scotland) Amendment Regulations 2005. The Statement describes the strategy of The Highland Council acting in its capacity as Administering Authority (the Administering Authority) for the funding of the Highland Council Pension Fund (the Fund).
- 1.2 As required by Regulation 75A(2a), the Statement has been prepared having regard to guidance published by the Chartered Institute of Public Finance and Accountancy (CIPFA) in March 2004.
- 1.3 The Funding Strategy Statement is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues.

## **2. Purposes of the Statement**

The three main purposes of this Statement are:

- to establish a clear and transparent strategy, specific to the Fund, which will identify how employer's pension liabilities are best met going forward.
- to support the regulatory requirement in relation to the desirability of maintaining as nearly constant employer contribution rates as possible.
- to take a prudent long term view of funding the Fund's liabilities.

[Back to index](#)

### **3. Consultation**

- 3.1 In accordance with Regulation 75A(1), all employers participating in the Fund were consulted on the contents of this Statement and their views were taken into account in formulating the Statement. The Statement describes a single strategy for the Fund as a whole. Employers will be further consulted on any material changes affecting the Strategy Statement.
- 3.2 In addition, the Administering Authority has had regard to the Fund's Statement of Investment Principles published under the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 1999 (the Investment Regulations).
- 3.3 The Fund Actuary was also been consulted on the initial contents of this Statement and will be consulted on any proposed changes where material.

### **4. Purpose and Aims of the Fund**

- 4.1 The Purpose of the Fund is :
- To pay out monies in respect of Local Government Pension Scheme (Scheme) benefits, transfer values, costs, charges and expenses.
  - To receive monies in respect of contributions, transfer values and investment income

#### **The aims of the Fund in relation to the Funding Strategy**

- 4.2 The aims of the Fund in relation to the Funding Strategy are set out below.

#### **The first aim is to enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the Scheduled Bodies, Admitted Bodies and to the taxpayers**

- 4.3 The Administering Authority recognises that the requirement to keep employer contribution rates as nearly constant as possible can run counter to the following requirements:
- The regulatory requirement to secure solvency,
  - The requirement that the costs should be reasonable, and
  - Maximising income from investments within reasonable cost parameters ( see the fourth aim)

[Back to index](#)

- 4.4 Producing low volatility in employer contribution rates requires material investment in assets that ‘match’ the employer’s liabilities. In this context, ‘match’ means assets that behave in a similar manner to the liabilities as economic conditions alter. For the liabilities represented by benefits payable by the Scheme, such assets would tend to comprise gilt edged investments.
- 4.5 Other classes of assets, such as shares and property, are expected to offer higher long term rates of return, on average, and consistent with the requirement to maximise the returns from investments the Administering Authority invests a substantial proportion of the Fund in such assets. However, these assets are more risky in nature, and that risk can manifest itself in volatile returns over short term periods and a failure to deliver the expected return in the long term.
- 4.6 This short term volatility in investment returns can produce a consequent volatility in the measured funding position of the Fund at successive valuations, with knock on effects on employer contribution rates. The impact on employer rates can be mitigated by use of longer deficit spread periods or phasing in of contribution rates at each valuation.
- 4.7 The Administering Authority recognises that there is a balance to be struck between the investment policy adopted, and the resultant smoothness of employer contribution rates from one valuation period to the next.
- 4.8 The Administering Authority also recognises that the position is potentially more volatile for Admission Bodies with short term contracts where utilisation of longer deficit spread periods and phasing of contribution rises is less appropriate.

**The second aim is to ensure that sufficient resources are available to meet all liabilities as they fall due.**

- 4.9 The Administering Authority recognises the need to ensure that the Fund has, at all times, sufficient liquid assets to be able to pay pensions, transfer values, costs, charges and other expenses. It is the Administering Authority’s policy that such expenditure is met, in the first instance, from incoming employer and employee contributions to avoid the expense of disinvesting assets. The Administering Authority monitors the position on a monthly basis to ensure that all cash requirements can be met.

**The third aim is to manage employers’ liabilities effectively.**

- 4.10 The Administering Authority seeks to ensure that all employers’ liabilities are managed effectively. In a funding context, this is achieved by seeking regular actuarial advice, ensuring that employers and Pension Committee (Investment Advisory Group) members are properly informed, and through regular monitoring of the funding position.

**The fourth aim is to maximise the income from investments within reasonable risk parameters.**

4.11 The Administering Authority recognises the desirability of maximising investment income within reasonable risk parameters. Investment returns higher than those available on government stocks are sought through investment in other asset classes such as shares and property. The Administering Authority ensures that risk parameters are reasonable by:

- restricting investment to the levels permitted by the Investment Regulations
- restricting investment to asset classes generally recognised as appropriate to UK pension funds
- analysing the potential risk represented by those asset classes in collaboration with the Fund's Actuary, Investment Advisors and Fund Investment Managers.

## **5. Responsibilities of the key parties**

5.1 The three parties whose responsibilities to the Fund are of particular relevance are the Administering Authority, the Employers and the Fund Actuary.

### **Administering Authority**

5.2 The key responsibilities of the Administering Authority are set out below.

**The first key responsibility is to collect employer and employee contributions and, as far as the Administering Authority is able to, ensuring these contributions are paid by the due date.**

5.3 Individual employers must pay contributions in accordance with Regulations 78, 79 and 80 of the Regulations.

5.4 The Administering Authority has advised all employers of its policy on the remittance of pension contributions and the procedures which will be taken in the event of late or non payment.

5.5 It is a legal requirement that pension contributions be paid to the Fund by the 19th of the month following the month that they were deducted from employees' pay. Interest is charged on late payments.

- 5.6 The Administering Authority will ensure that action is taken to recover assets from Admission Bodies whose Admission Agreement has ceased by:
- requesting that the Fund Actuary calculates the assets and liabilities attributable to the Admission Body at the date of the closure of the Admission Agreement
  - Notifying the Admission Body that it must meet any deficit at the cessation of the Agreement

**The second key responsibility is to invest surplus monies in accordance with the Regulations.**

- 5.7 The Administering Authority will comply with the investment Regulations.

**The third key responsibility is to ensure that cash is available to meet liabilities as and when they fall due.**

- 5.8 The Administering Authority recognises this duty and discharges it in the manner set out in the Aims of the Fund in relation to the Funding Strategy.

**The fourth key responsibility is to manage the valuation process in consultation with the Fund Actuary.**

- 5.9 The Administering Authority ensures it communicates effectively with the Fund Actuary to:
- agree timescales for the provision of information and provision of valuation results,
  - ensure provision of data of suitable accuracy,
  - ensure that participating employers receive appropriate communication throughout the process,
  - ensure that reports are made available as required by Guidance and Regulation

**The fifth key responsibility is to prepare and maintain a Statement of Investment Principles and a Funding Strategy Statement after due consultation with interested parties.**

- 5.10 The Administering Authority will ensure that both documents are prepared and maintained in the required manner.

**The sixth key responsibility is to monitor all aspects of the Fund's performance and funding and amend these two documents if required.**

- 5.11 The Administering Authority monitors the funding position and the investment performance of the Fund on a quarterly basis.
- 5.12 The Statement of Investment Principles and Funding Strategy Statement will be fully reviewed every three years at the time of the triennial valuation, unless circumstances dictate earlier amendment.

**Individual employers**

- 5.13 Individual employers are responsible for:
- deducting contributions from employees' pay,
  - paying all contributions, including their employer contribution as determined by the Actuary, promptly by the due date,
  - exercising discretions within the regulatory framework and ensuring the Administering Authority has copies of current policies covering those discretions,
  - paying for added years in accordance with agreed arrangements,
  - paying the Strain of the Fund costs resulting from early retirements or exercises of discretion allowing the early payment of deferred benefits. Payment is due immediately unless it has been agreed that payment can be spread over the three years,
  - notifying the Administering Authority promptly of all changes to membership , or other changes which affect future funding.

[Back to index](#)

## The Fund Actuary

5.14 The key responsibilities of the Fund Actuary are set out below

### **The first key responsibility is to prepare valuations.**

5.15 The Fund Actuary will prepare valuations, including the setting of employers' contribution rates, after agreeing assumptions with the Administering Authority and having regard to the Funding Strategy Statement and relevant admission agreements.

5.16 Valuations will also be prepared in accordance with generally accepted actuarial methods and reported on in accordance with Guidance Note 9 issued by the Institute and Faculty of Actuaries, to the extent that the Guidance Note is relevant to the Scheme.

### **The second key responsibility is to prepare advice and calculations in connection with bulk transfers and individual benefit related matters.**

5.17 Such advice will take account of the funding position and Funding Strategy Statement, along with other relevant matters.

## **6. Solvency**

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

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

[Back to index](#)

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

6.4 Given the very long-term nature of the liabilities, a long-term view of prospective returns from equities is taken. For the 2008 valuation it is assumed that the Fund's equity investments will deliver an average additional return of 2.7% a year in excess of the return available from investing in index-linked government bonds at the time of valuation. The same financial assumptions are adopted for all ongoing employers.

Consistent with the aim of enabling employer contribution rates to be kept as nearly constant as possible, and having regard to risks inherent in such an approach, the Administering Authority has also agreed with the Fund Actuary the use of measures to mitigate the immediate contribution requirements, including longer deficit spread periods and phasing in of contribution rises. It is unlikely that use of these mitigating mechanisms will be extended to employers whose participation in the Fund is for a fixed period ( for example, an employer admitted by virtue of having been awarded a best value outsourcing contract).

## **7. Funding Strategy**

### **Valuation Methods**

7.1 Consistent with the aim of enabling employer contribution rates to be kept as nearly constant as possible, contribution rates are set by use of the Projected Unit valuation method for all employers.

7.2 The Projected Unit method produces contribution rates which target solvency over fixed periods in the future. It will tend to produce more stable contribution rates for those employers who expect a future flow of new entrants to the Fund, which would tend to keep the age distribution of members stable.

### **Recovery Period**

7.5 Where a valuation reveals that the Fund is in surplus or deficiency against the solvency measure, employer contribution rates will be adjusted to target restoration of the solvent position over a period of years (the recovery period). The recovery period applicable for each participating employer is set by the Administering Authority in consultation with the Fund Actuary and the employer, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.

7.6 The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefit payments over long periods of time. For employers of sound covenant, the Administering Authority is prepared to agree to recovery periods that are longer than the average future working lifetime of the membership of that employer.

The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible. However, the Administering Authority also recognises the risk in relying on long recovery periods and has agreed with the Fund Actuary a limit of 20 years.

The Administering Authority's policy is to set recovery periods for each employer that are as short as possible within this framework, whilst having regard to stability of contribution rates.

7.7 Where an admission body has a guarantee from a statutory body participating in the Fund, the Administering Authority will consider whether the guarantee can, with the agreement of the guarantor, be taken into account in assessing the recovery period to be used.

7.8 For employers whose participation in the Fund is for a fixed period it is unlikely that the Administering Authority and Fund Actuary would set a recovery period longer than the remaining term of participation.

## Grouping

7.9 Consistent with the requirement to keep employer contribution rates as nearly constant as possible, the Administering Authority permits some employers to be treated in a pool for the purposes of setting contribution rates. In particular, this approach is used for some smaller employers for whom contribution rates could otherwise be very volatile due to the increased likelihood that demographic movements would have a material effect.

7.10 The Administering Authority's policy is to consider the position carefully at each valuation. Employers with fewer than fifty contributing members may be considered in a pool for contribution rate purposes. Transferee admission bodies are generally ineligible for pooling.

7.11 The Common Rate of Contribution payable by each employing authority under Regulation 76 of the Local Government Pension Scheme Regulations (Scotland) 1998 for the period 1 April 2009 to 31 March 2012 is 250% of member contributions.

Individual adjustments payable by each employing authority under Regulation 77 of the Local Government Scheme Regulations (Scotland) 1998 are shown in [Appendix A](#).

[Back to index](#)

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

- 7.12 When an organisation participating in the Fund closes the Fund Actuary will carry out a terminal valuation. The Administering Authority will then pursue the recovery of any deficiency from that organisation. The only exception to this is where a successor organisation which is also a participating employer in the Fund formally adopts the deficiency of the closing organisation as their own.
- 7.13 If an employer (other than a transferee admitted body) fails and cannot pay the contributions due, Regulations require that all employers in the Fund must pay revised contributions to meet the shortfall.
- 7.14 In recent years the Administering Authority has adopted a policy of requiring transferee admitted bodies to obtain an indemnity or bond. Other admitted bodies are required to obtain a guarantor or indemnity bond. A guarantor is required to agree that it will meet the shortfall if the admission body closes and cannot pay the contributions due
- 7.15 Some longer standing admission bodies do not have a guarantor. If one of these were to close in circumstances where they could not pay the contributions due, then all employers in the Fund would be required to pay revised contributions to meet the shortfall.

## **Stepping**

- 7.16 Consistent with the requirement to keep employer contribution rates as nearly constant as possible, the Administering Authority will consider, at each valuation, whether new contribution rates should be payable immediately, or should be reached by a series of steps over future years.

The Administering Authority will discuss with the Fund Actuary the risks inherent in such an approach, and will examine the financial impact and risks associated with each employer. The Administering Authority's policy is generally to limit the number of permitted steps to three annual steps.

## **Monitoring of the Funding level between Valuations**

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

[Back to index](#)

## **8. Identification of risks and counter measures**

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

### **Demographic**

- 8.2 The main demographic risks include changing retirement patterns and longevity. The Administering Authority will ensure that the Fund Actuary investigates these matters at each valuation or, if appropriate, more frequently, and reports on developments. The Administering Authority will agree with the Fund Actuary any changes that are necessary to the assumptions underlying the measure of solvency to allow for observed or anticipated changes.
- 8.3 If significant demographic changes become apparent between valuations, the Administering Authority will notify all participating employers of the anticipated impact on costs that will emerge at the next valuation and will review the bonds that are in place for transferee admitted bodies.

### **Regulatory**

- 8.4 These risks relate to changes to regulations, national pension requirements or Inland Revenue rules. The Administering Authority will keep abreast of all proposed changes and, where possible and after careful consideration, express its opinion during consultation periods.

The Administering Authority's policy will be to ask the Fund Actuary to assess the impact on costs of any changes and, where these are likely to be significant, the Administering Authority will notify employers of this likely impact and the timing of any change.

### **Governance**

- 8.5 This covers the risk of unexpected structural changes in the Fund membership (for example the closure of an employer to new entrants or the large scale withdrawal or retirement of groups of staff) and the related risk of the Administering Authority not being made aware of such changes in a timely manner.
- 8.6 The Administering Authority's policy is to require regular communication between itself and employers and to ensure regular reviews of such items as bond arrangements, funding and contribution levels.

## **Statistical /Financial**

- 8.7 This covers items such as the performances of markets and the Fund's investment managers, asset reallocation in volatile markets, pay and price inflation varying from anticipated levels, or the effect of possible increases in employer contribution rates on service delivery and on employers.
- 8.8 The Administering Authority receives quarterly updates on the effect of market movements on the Fund's overall funding position, reviews each investment manager's performance quarterly and occasionally considers the asset allocation of the Fund by carrying out asset liability studies.

Where changes occur that could materially affect the solvency of the Fund, interim valuations are carried out between formal valuations to help to assess the impact of experience diverging from the assumptions used. These processes seek to ensure that the assumptions used remain justified

## **Solvency measure**

- 8.9 The Administering Authority recognises that allowing for future investment returns in excess of those available on government bonds introduces an element of risk, in that those additional returns may not materialise. The Administering Authority's policy will be to monitor the underlying position assuming no such excess returns are achieved to ensure that the funding target remains realistic relative to the risk position.

## **Recovery period**

- 8.10 The Administering Authority recognises that permitting deficiencies to be eliminated over a recovery period rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements. The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of recovery period to no longer than 20 years.

## **Stepping**

- 8.11 The Administering Authority recognises that permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient in the early years of the process. The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to generally limit the number of permitted steps to three annual steps.

[Back to index](#)

## **9. Links to investment policy as set out in the Statement of Investment Principles**

9.1 The Administering Authority has produced this Funding Strategy Statement having taken an overall view of the level of risk in the investment policy set out in the Statement of Investment Principles and the funding policy set out in this statement.

9.2 In order to assist in setting the Fund's investment policy, an asset liability modelling study is carried out. This study examines the Fund's financial position, the profile of its membership, the nature of its liabilities and includes an analysis of the expected ranges of outcomes from differing investment policies.

The study, which is subject to periodic review, is carried out at the Total Fund level, not at the level of each employer. The strategic asset allocation benchmark that is derived from the study is, therefore, set in the light of the overall liabilities of the Total Fund.

9.3 The current strategic asset allocation is based upon a review carried out in 2008 by the Fund's Investment Advisor, Hymans Robertson, based upon an Asset Liability Study carried out by them during 2008.

9.4 The strategic benchmark was implemented between November 2008 and February 2009.

9.5 The Administering Authority will continue to monitor the suitability of the investment policy in the light of the Fund's developing liabilities and finances.

9.6 The Administering Authority will continue to review the Funding Strategy Statement and the Statement of Investment Principles to ensure that the overall risk profile remains appropriate. Such reviews may use asset liability modelling or other analysis techniques.

## **10. Future Monitoring**

10.1 The Administering Authority plans to review formally this Statement as part of the triennial valuation process unless circumstances arise which require earlier action.

10.2 The Administering Authority will monitor the funding position of the Fund on an approximate basis at regular intervals between valuations, and will discuss with the Actuary whether any significant changes have arisen that require action.

A copy of this statement can be obtained from the address below:

Treasury, Leasing & Investments Section, Finance Service, The Highland Council,  
Glenurquhart Road, Inverness, IV3 5NX. or via e-mail on  
[Treasury.Team@highland.gov.uk](mailto:Treasury.Team@highland.gov.uk)

[Back to index](#)

## Appendix A Minimum Contribution Rates by Group

The Common Rate of Contribution payable by each employing authority for the period 1 April 2009 to 31 March 2012 is 250% of member contributions.

Individual adjustments payable by each employing authority under for the period 1 April 2009 to 31 March 2012 resulting in Minimum Total Contribution Rates are as set out below.

	<b>31 March 2010</b>	<b>Rate % 31 March 2011</b>	<b>31 March 2012</b>
The Highland Council	275	290	290
Bord Na Gaidhlig	275	290	290
Caledonia Community Leisure Limited	275	290	290
Comhairle Nan Eilean Siar	275	290	290
Cromarty Firth Port Authority	275	290	290
Highland & Islands Fire Board	275	290	290
Highland Blindcraft	275	290	290
Highland Opportunity Ltd	275	290	290
Inverness Harbour Trust	275	290	290
Northern Joint Police Board	275	290	290
Stornoway Port Authority	275	290	290
Highland & Western Isles Valuation Joint Board	275	290	290
Visual Impairment Services Highland	275	290	290
Western Isles Tourist Board	275	290	290
HIE Inverness & East Highland	250	250	250
HIE Lochaber	250	250	250
HIE Moray	250	250	250
HIE Skye & Western Ross	250	250	250
HIE Innse Gall	250	250	250
Scottish Police Services Authority	250	250	250
Inverness College	255	255	255
Lews Castle College	235	250	250
The North Highland College	280	280	280
University of the Highlands & Islands	220	220	220
Career Scotland	310	310	310
Highland of Scotland Tourist Board	310	325	325
Eden Court Theatre	200	225	225
HIE Structural Funds Partnership	220	235	235
Hebridean Housing Partnership	250	265	265
HITRANS	210	215	215
Richard Irvin & Sons Ltd	515	540	540
Stoneyhill Waste Management Ltd	370	490	490
Mitie PFI Limited	260	280	280
Morrison FM	235	255	255
Torvean Golf Club	435	435	435
VACMAN	305	325	325

[Back to index](#)