



West Midlands Pension Fund

87.75	1.00%	20.11	0.11	2.12	0.05
89.28	0.00%	822.22	0.30	2.91	0.01
91.45	3.33%	87.75	0.77	9.88	0.41
93.41	1.05%	36.11	0.49	1.78	0.07
	0.00%	56.49	0.20	0.73	0.03
92.10	0.20%	832.88	3.32	3.88	0.06
88.15	0.23%	83.88	0.17	1.43	0.03
7.73	8.80%	96.88	0.75	1.77	0.04
9.28	8.80%	27.78	1.11	1.77	0.04
1.45	9.33%	88.88	0.48	1.26	0.03
7.73	1.00%	84.88	0.80	0.32	0.01
9.28	9.33%	87.78	1.11	1.44	0.03
3.62	3.75%	88.88	0.48	1.77	0.04

10.00	0.00%	0.00	0.00	0.00	0.00
11.00	0.00%	0.00	0.00	0.00	0.00
12.00	0.00%	0.00	0.00	0.00	0.00
13.00	0.00%	0.00	0.00	0.00	0.00
14.00	0.00%	0.00	0.00	0.00	0.00
15.00	0.00%	0.00	0.00	0.00	0.00
16.00	0.00%	0.00	0.00	0.00	0.00
17.00	0.00%	0.00	0.00	0.00	0.00
18.00	0.00%	0.00	0.00	0.00	0.00
19.00	0.00%	0.00	0.00	0.00	0.00
20.00	0.00%	0.00	0.00	0.00	0.00
21.00	0.00%	0.00	0.00	0.00	0.00
22.00	0.00%	0.00	0.00	0.00	0.00
23.00	0.00%	0.00	0.00	0.00	0.00
24.00	0.00%	0.00	0.00	0.00	0.00
25.00	0.00%	0.00	0.00	0.00	0.00
26.00	0.00%	0.00	0.00	0.00	0.00
27.00	0.00%	0.00	0.00	0.00	0.00
28.00	0.00%	0.00	0.00	0.00	0.00
29.00	0.00%	0.00	0.00	0.00	0.00
30.00	0.00%	0.00	0.00	0.00	0.00
31.00	0.00%	0.00	0.00	0.00	0.00
32.00	0.00%	0.00	0.00	0.00	0.00
33.00	0.00%	0.00	0.00	0.00	0.00
34.00	0.00%	0.00	0.00	0.00	0.00
35.00	0.00%	0.00	0.00	0.00	0.00
36.00	0.00%	0.00	0.00	0.00	0.00
37.00	0.00%	0.00	0.00	0.00	0.00
38.00	0.00%	0.00	0.00	0.00	0.00
39.00	0.00%	0.00	0.00	0.00	0.00
40.00	0.00%	0.00	0.00	0.00	0.00
41.00	0.00%	0.00	0.00	0.00	0.00
42.00	0.00%	0.00	0.00	0.00	0.00
43.00	0.00%	0.00	0.00	0.00	0.00
44.00	0.00%	0.00	0.00	0.00	0.00
45.00	0.00%	0.00	0.00	0.00	0.00
46.00	0.00%	0.00	0.00	0.00	0.00
47.00	0.00%	0.00	0.00	0.00	0.00
48.00	0.00%	0.00	0.00	0.00	0.00
49.00	0.00%	0.00	0.00	0.00	0.00
50.00	0.00%	0.00	0.00	0.00	0.00



# Funding Strategy Statement 2014

April 2014

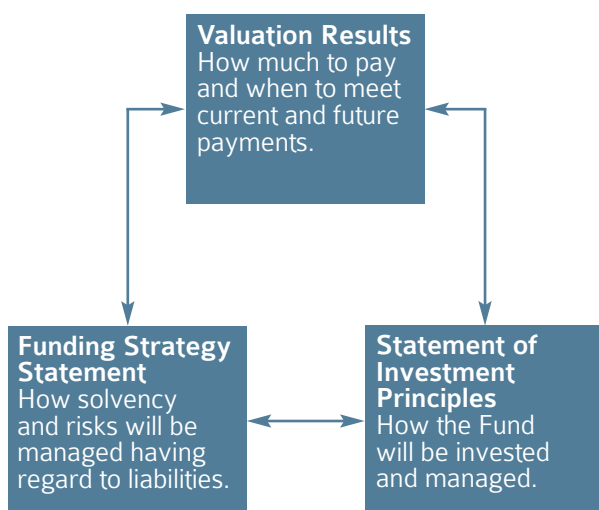
# Funding Strategy Statement 2014

## 1. Introduction

**1.1** The LGPS Regulations require funds to produce a Funding Strategy Statement (FSS) having regard to the guidance produced by CIPFA. This statement has been drawn up by the West Midlands Pension Fund in accordance with the regulations and following consultation.

**1.2** The FSS complements and adds to the Statement of Investment Principles (SIP); the actuarial valuation supports this.

**1.3** The statements relate as follows:



**1.4** The Fund's actuary takes account of the FSS in his actuarial work for the Fund, most notably, the actuarial valuation process.

**1.5** The FSS reflects the statutory nature of the Local Government Pension Scheme (LGPS), particularly the defined benefit nature and the benefit payable guarantee. The FSS sets out how benefits will be funded over the long term through an accountable, transparent process with full disclosure of relevant details and assumptions.

**1.6** The LGPS is currently a long-established, well-managed, funded final salary scheme. With effect from 1 April 2014 the LGPS will become a career-average revalued earnings scheme (CARE) and this has been allowed for when assessing the future service rate for employers.

**1.7** The Fund, like many other similar public and private sector funded schemes, has a gap between its assets and pension liabilities which this strategy addresses.

**1.8** A number of factors have contributed to the funding gap and contribution rates for employers:

- a) investment returns relative to movement in liabilities;
- b) increases in longevity of pensioners;
- c) falling long-term interest rates.
- d) change in CPI inflation expectations

There are some steps that the actuary can take to assist employing bodies. These include:

- a) recognising the long-term nature of local government, so that deficits are recovered over time. At the 2013 valuation this will be adjusted to a maximum of 22 years which compares to 25 years at the 2010 valuation. This is expected to reduce to 19 years at the 2016 valuation;
- b) phasing increases in contributions typically over three years where appropriate;
- c) recognising the changes to the LGPS with effect from 1 April 2014;
- d) recognising the changes in financial markets after the valuation;
- e) giving weight to a balanced investment strategy.

**1.9** The Fund, since it was established in 1974, has seen variations in its funding level as did the earlier district funds. Over this long period, there has been a consistent approach with the actuarial valuation process, the link to an investment strategy and balanced management of the risks. The current arrangements continue this approach. The critical element is securing diversified investment market returns from world markets. The Fund has a long record of achieving solid returns for all of its portfolios. The approach adopted is to ensure a priority is given to achieving at least a market return and, as recommended best practice indicates, use asset allocation to deliver a substantial part of the investment target.

**1.10** As the pursuit of returns becomes ever more complex, combined with the prospect of diminishing returns, the Fund is becoming increasingly aware of the need to balance the relationship between the different asset classes, their returns, their volatility and their correlation with equities. This constitutes the 'risk budget'.

## 2. Purpose of the Funding Strategy Statement in Policy Terms

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### 2.1 The purpose of this FSS is:

- To establish a clear and transparent fund-specific strategy which will identify how employers' liabilities are best met going forward.
- To support the regulatory requirement to maintain the common contribution rate as nearly constant as possible.
- To take a prudent longer term view of funding those liabilities.

**2.2** The Fund currently has a strong net cash inflow. The FSS supports the process of ensuring adequate funds are put aside on a regular basis to meet future benefit liabilities. The cashflow will be monitored regularly by officers. The LGPS regulations specify the approach and requirements, the implementation of the funding strategy is the responsibility of the Fund acting on expert advice and following consultation.

**2.3** The FSS is a comprehensive strategy for the whole Fund. It balances and reconciles the many direct interests that arise from the nature of the Scheme, and funding of the benefits now and in the future.

**2.4** The solvency of the Fund is a long-term management issue as required by the regulations in terms of setting the funding target. Currently, the net cash inflow is over £120m pa, but it is essential that funds are made available to ensure all future benefits payments can be met when they become due.

## 3. Consultation

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**3.1** The LGPS regulations require the administering authority to consult with such persons it considers appropriate in the maintenance and review of the FSS.

**3.2** CIPFA provides further guidance that this must include meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of participating employers.

**3.3** Employers participating in the Fund have been consulted on the contents of this FSS and consideration has been given to their views accordingly. However, the FSS represents a single strategy for the Fund as a whole, adjusting for individual employers based on the advice of the Fund actuary.

**3.4** In addition, the administering authority has had regard to the Fund's Statement of Investment Principles published in accordance with the LGPS regulations.

**3.5** The Fund actuary, Mercer, has also been consulted in the contents of this FSS.

## 4. Aims and Purposes of the Fund

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### 4.1 The aims of the Fund are to:

- Enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled and admitted bodies having regard to the liabilities.
- Manage employers' liabilities effectively through regular review of contributions and additional contributions for early retirements which lead to a strain on funding.
- Ensure that sufficient resources are available to meet all liabilities as they fall due.
- Maximise the returns from investments within reasonable risk parameters
- Minimise the risks to the Fund from its admission arrangements by strengthening its admission arrangements and pursuing a policy of positive engagement.

### 4.2 The purpose of the Fund is to:

- Receive and invest monies in respect of contributions, transfer values and investment income.
- Pay out monies in respect of Scheme benefits, transfer values, costs, charges and expenses. The Local Government Pension Scheme Regulations and, in particular, the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 define these purposes.

## 5. Responsibilities Of The Key Parties

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**5.1** The LGPS regulations set out the responsibilities of the key parties which are summarised below.

Further details are available on the Fund's website where operational and management arrangements are set out.

### 5.2 The administering authority (Wolverhampton City Council) through its Pensions Committee:

- Collects employer and employee contributions.
- Invests surplus monies in accordance with the regulations and agreed strategy.
- Ensures that cash is available to meet liabilities as and when they fall due.

- Manages the valuation process in consultation with the Fund's actuary.
- Prepares and maintains a FSS and a SIP.
- Monitors all aspects of the Fund's performance and funding. Amends the FSS and SIP as appropriate. The administering authority discharges its responsibilities with the active involvement from the major employers, the district councils and trade unions representatives combined with consultation with interested parties.

### 5.3 The individual employers:

- Deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the regulations).
- Pay all contributions, including their own as determined by the actuary, promptly by the due date.
- Exercise discretions within the regulatory framework.
- Make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Scheme benefits and early retirement strain.
- Notify the administering authority promptly of all changes to membership, or as may be proposed, which affect future funding.
- Will make significant progress in the transition to electronic data exchange with the submission of member data via bulk data imports (BDI), initially targeting new joiners, before extending to other processes.
- Discharge their responsibility for compensatory added years which the administering authority pays on their behalf and is subsequently recharged to them.

### 5.4 The Fund's actuary:

- Prepares valuations including the setting of employers' contribution rates after agreeing assumptions with the administering authority and having regard to the FSS.
- Sets employer's contribution rates in order to secure the Fund's solvency having regard to the aims of maintaining common contribution rates that are as constant as possible.
- Prepares advice and calculations in connection with bulk transfers and individual benefit-related matters.
- Minimise the risks to the Fund from its admission arrangements by strengthening its admission arrangements and pursuing a policy of positive engagement.

## 6. Solvency Issues and Target Funding Levels

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

**6.2** Nevertheless, the Fund recognizes the different characteristics of the variety of participating employer organisations, and will set funding strategy appropriately having regard to factors such as:

- strength of covenant, and security of future income streams;
- support or guarantor arrangements from Scheme employers;
- prospective period of participation in the Fund, and specifically the implications if the employer has closed membership of the Scheme to new employees.

Taking these factors into account, case-by-case assessment review of contribution requirements may, in some cases, prove necessary as part of the triennial valuation process.

**6.3** The Fund's policy as regards participation of non-scheduled Scheme employers, including termination issues, is set out in the comprehensive publication '*Policy on Termination Funding for Admission Bodies*'.

**6.4** The LGPS regulations require the long-term funding objectives to achieve and maintain assets sufficient to cover 100% of the projected accrued liabilities. The level of assets necessary to meet this 100% funding objective is known as the funding target. The role of the actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements.

The approach to the actuarial valuation process and key assumptions used at each three-yearly valuation are consulted upon and the valuation forms part of the consultation undertaken with the FSS.

### Determination of the Funding Target and Recovery Period

**6.5** The principal method and assumptions to be used in the calculation of the funding target are set out in the Appendix.

**6.6** Underlying these assumptions there are two tenets:

- that the Scheme is expected to continue for the foreseeable future; and
- favourable investment returns can play a valuable role in achieving adequate funding over the longer term.

**6.7** As part of each valuation, separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer (or employer grouping), following a principle of no cross-subsidy between the various employers in the Scheme. In attributing the overall investment performance obtained on the assets of the Scheme to each employer, a pro-rata principle is adopted. The general approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole.

**6.8** The administering authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates:

- As part of this valuation when looking to potentially stabilise contribution requirements we will consider whether we can build into the funding plan the following:
  - some allowance for interest rates and bond yields to revert to higher levels over the medium to long term; and
  - whether some allowance for increased investment return can be built into the funding plan over the agreed recovery period.

In considering this the administering authority, based on the advice of the actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful.

- A maximum deficit recovery period of 22 years will apply. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may be applied in respect of particular employers where the administering authority considers this to be warranted (see deficit recovery plan below).
- In current circumstances, as a general rule, the Fund does not believe it appropriate for contribution reductions to apply where substantial deficits apply. As a result in addition to the maximum deficit recovery period of 22 years, the Fund will operate standard deficit recovery periods aligned to strength of covenant based on defined employer groups subject to the maximum lengths set out below.
- For transferee admission bodies, where admission to the LGPS is via a contract or other arrangement, the maximum recovery period will be aligned to the contract length, capped at the maximum recovery period of 22 years, or as otherwise agreed with the ceding local authority
- For transferee admission bodies, where closed to new entrants, the maximum recovery period will be aligned to the future working lifetime of its

membership, if less than the contract length, capped at the maximum recovery period of 22 years, or as otherwise agreed with the ceding local authority.

- For community admission bodies, where closed to new entrants, the maximum recovery period will be aligned to the future working lifetime of its membership, capped at the maximum recovery period of 22 years, or such other period agreed by the employer and approved by the administering authority.
- Employer contributions will be expressed and certified as two separate elements:
  - a percentage of pensionable payroll in respect of future accrual of benefits
  - a schedule of fixed £s amounts, increasing annually in line with the valuation funding assumption for long-term pay growth (unless otherwise noted), in respect of deficit recovery subject to review from April 2017 based on the results of the 2016 actuarial valuation.
- Where increases in employer contributions are required from 1 April 2014, the increase from the contributions payable in the year 2013/14 may be implemented in steps, typically over a period of up to three years.
- Where an employer has a guarantee from a statutory body participating in the Fund, or from another organisation approved for that purpose by the administering authority, the administering authority will recognise the requirement for the guarantor to be kept abreast of the funding position of the relevant employer, unless the employer indicates otherwise in writing.
- On the cessation of an employer's participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer will be due to the Scheme as a termination contribution, unless it is agreed by the administering authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Scheme to another participating employer. Details of the approach to be adopted for such an assessment on termination are set out in the separate guidance published by the Fund.
- Any employing body with a surplus of assets over liabilities may have the surplus applied over a period that assists the process of smoothing or avoiding increases in contributions over a valuation cycle.
- The Fund's approach will reflect the ability of employing bodies to meet their pension liabilities and resources available to them when their circumstances have changed suddenly.

- Any employing bodies who have an improved funding position, may at some point, be presented with the option to de-risk via a lower risk investment strategy.
- In determining a contribution rate, a prudent approach will be taken to balancing any potential reductions in contributions with the strength of the employing body covenant risk.

Consequently, the administering authority may, at its discretion, levy contributions for a particular employer that are below, or above, those initially certified by the actuary, where it is deemed appropriate to assist with smoothing or control of contribution rates.

- Where the administering authority does levy an alternative contribution plan for a particular employer, as described above, this will represent an employer-specific funding plan, and will be agreed and documented separately.
- Academies will be treated in accordance with the factors and legislation that lead to their creation. All will be considered to have the same covenant strength as any scheduled body, and their contribution rates will be calculated to meet the broad intentions of ensuring they are in a similar financial position in respect of pension liabilities pre- and post-transfer to academy status at inception. The policy applied to academies will be reviewed from time to time or if any further guidance emerges.

**6.9** In determining the above objectives, the administering authority has had regard to:

- the responses made to the consultation with employers on the FSS principles;
- relevant guidance issued by the CIPFA Pensions Panel;
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose; and
- the administering authority's views on the strength of the participating employers' covenants in achieving the objective.

**6.10** There will be an overall reserve, established as a contingency to protect the Fund against funding shortfalls, where employers without a guarantor cease participation in the Fund and cannot pay to remove any deficit. The reserve is based upon a review of those employers without a guarantor and the associated liability exposure and the contributions required to establish this reserve have been built into rates assessed for all employers within the Fund at this valuation. This reserve is subject to review at subsequent actuarial valuations.

## The Normal Cost of the Scheme (Future Service Contribution Rate)

**6.11** In addition to any contributions required to rectify a shortfall of assets below the funding target, contributions will be required to meet the cost of future accrual of benefits for members after the valuation date (the 'normal cost'). The method and assumptions for assessing these contributions are also set out in the Appendix.

## 7. Links to Investment Policy Set Out in the Statement of Investment Principles (SIP)

**7.1** The Fund has, for many years regularly used an asset liability study or some other form of stochastic modelling in order to assist the process of formulating a strategic asset allocation. The outcomes are reflected in the Fund's SIP. The Fund's updated investment strategy has been supporting part of the consultation on the valuation and the FSS. A revised SIP has been produced to reflect the FSS and Investment Strategy.

## 8. The Identification of Risks and Countermeasures

**8.1** Evaluating risks that may impact on the funding strategy and expectations of future solvency is crucial to determining the appropriate measures to mitigate those risks. The FSS identifies those key risks specific to the Fund and the measures being taken or assumptions made to counter those risks.

**8.2** Some of the key risks taken into account and responses are:

### Financial

- Unexpected market-driven events.
- Investment markets fail to perform in line with expectations.
- Market yields move at variance with assumptions.
- Investment fund managers fail to achieve performance targets over the longer term.
- Asset allocations in volatile markets may lock in past losses.
- Pay and price inflation significantly more or less than anticipated.
- The effect of a possible increase in employer's contribution rate on service delivery and employers in general. The Fund has undertaken a regular review of its investment strategy taking into account investment risk and future benefit payments to determine a bespoke investment strategy that for a variety of future economic outcomes gives a high degree of certainty that the investment objectives will be achieved. The Fund has moved to a yearly

review from 2011. Short-term investment management decisions to reflect anticipated market changes are strictly controlled against the investment strategy or benchmark.

Investment management briefs reflect the importance of capturing at least a market rate of return and minimising the risk of significantly underperforming an investment market. Further information is available in the SIP and on the Fund's website.

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## Demographic

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- The longevity horizon of beneficiaries continues to expand.
- **Cost of early retirements**  
The Fund has in place policies and procedures to identify for employing bodies the impact of these factors and agrees how they will be managed in terms of special additional contributions.
- **Take-up of 50:50 option**  
The level of take-up of the 50:50 option at a higher or lower level than built into the actuarial assumptions.
- **Insurance of certain benefits**  
The Fund is still exploring insurance cover for some of the death in service and ill-health costs, with further detailed analysis to follow. The potential for the implementation of such insurance will be determined by the Fund, bearing in mind the associated risk mitigation and employer desirability across the Fund as a whole. The contributions for any employer may be varied as agreed by the actuary and administering authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund.

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## Regulatory

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- Changes to regulations, eg, more favourable benefits package, potential new entrants to Scheme, changes to the benefit structure etc.
- Changes to national pension requirements and/or Inland Revenue rules. These changes agreed and proposed are evaluated and taken into account in the actuarial valuation and closely monitored between valuations in case any action is required.

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## Governance

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- Administering authority unaware of structural changes in an employer's membership (eg, large fall in employee members, large number of retirements).
- Administering authority not advised of an employer closing to new entrants.
- An employer ceasing to exist with insufficient funding or adequacy of a bond.

The Fund has established inter-valuation monitoring and working relations with its employers to ensure changes are detected, discussed, evaluated and appropriate action agreed. This includes regular reviews of funding levels, bond arrangements where appropriate and the assessment of the financial standing of employers that are not tax-raising bodies.

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## Employers

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- Sustainability of an employer or their ability to meet their liabilities within the agreed funding strategy. The Fund's approach to the outcome of the valuation has had regard to balancing the needs of funding the liabilities and the cost to employers. This is reflected in the approach to the phasing of increase, the recovery period for meeting any funding gap, together with the risks associated with the investment strategy. It is considered the approach adopted represents an 'affordable' solution taking all factors into account.

A risk assessment of the sustainability of all employers has been undertaken seeking to establish the risk of an employer failing to meet their pension liabilities. The analysis has looked at the following levels of risk:

In determining the actual recovery period to apply for any particular employer to employer grouping, the administering authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of the employer;
- the assessment of the financial covenant of the employer; and the security of future income streams
- any contingent security available to the Fund or offered by the employer such as guarantor or bond arrangements, charge over assets, etc.
- length of expected period of participation in the Fund.

### Low risk

Scheduled and resolution bodies as statutory entities that are either required, or can choose to offer membership of the LGPS. This category would cover:

- a local authority, or equivalent.
- a body for which the Fund has a guarantee of liabilities from a local authority (or its equivalent).
- a body which receives funding from local or central government (eg, colleges and universities).
- a body which has a funding deficiency guarantee from local or central government.

- a best value-type body for which a local authority within the Fund effectively stands as the ultimate guarantor on the termination of the admission agreement as a result of Regulation 38.

### **Medium risk**

Scheduled bodies not considered as low risk and admitted bodies with no statutory underpin but:

- can provide satisfactory evidence of financial security (eg, parent company guarantee, bond, indemnity, insurance).
- is part of a group of related or pooled bodies which share funding on default.

### **High risk**

An admitted body:

- with no external funding guarantee or reserves.
- with a known limited lifespan or fixed contract term of admission to the Fund.
- which has no active contributors and/or is closed to new joiners.
- which relies on voluntary or charitable sources of income.

This analysis indicates the risk to the Fund's solvency and ability to meet prior liabilities to be low. It will, however, continue to be monitored. A number of small bodies have significant financial challenges due to falling revenues. The Fund will work with these bodies to ensure all interests are considered and an acceptable funding strategy for the pension liabilities is achieved that does not put the Fund's position at an increased risk. In respect of bodies that have fixed-term funding, the aim is that a fully funded position should be achieved with a high degree of certainty by the end of the funding period.



# Appendix

## Actuarial Valuation as at 31 March 2013

### Method and assumptions used in calculating the funding target method

The actuarial method to be used in the calculation of the funding target is the 'projected unit' method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the Scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted (the 'attained age' method), which makes advance allowance for the anticipated future aging and decline of the current closed membership group.

### Financial assumptions

- **Investment return (discount rate)**  
A yield based on market returns on UK government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an asset outperformance assumption (AOA) of 1.4%. The AOA represent the allowance made, in calculating the funding target, for the long-term additional investment performance on the assets of the Fund relative to the yields available on long-dated gilt stocks as at the valuation date.
- **Inflation (consumer prices index - CPI)**  
The inflation assumption will be taken to be the investment market's expectation for CPI as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities, less an adjustment. The adjustment is taken to be 1.0% pa and is in respect of two factors:
  - the perceived premium investors are prepared to pay to protect against future inflation rises (known as an inflation risk premium).
  - the expectation that CPI is expected to increase at a lower rate than the retail prices index (RPI).An adjustment is required in respect of this, as the index-linked investments used to determine the market rate of inflation are indexed with reference to the RPI, and so determine a 'market view' of RPI.
- **Salary increases**  
The assumption for long-term real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.75% pa over the inflation assumption as described above. This includes allowance for promotional increases.

To recognise the relatively low level of salary increases expected in local government in the near future, and as budgeted for in the short term by many employers, the Fund has applied an assumption of 1% pay growth over the next three years reverting to 4.35% (CPI plus 1.75%) thereafter.

For certain employers (typically with the strongest covenant and where evidence from an employer supports it), the Fund has applied an assumption of 1% pay growth over the next five years reverting to 4.35% (CPI plus 1.75%) thereafter.

- **Pension increases**  
Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with CPI (eg, guaranteed minimum pensions in respect of service prior to April 1997).
- **LGPS 2014 50:50 take-up**  
The assumed take-up of the 50:50 option, to be introduced with the LGPS 2014 scheme, has been set at 5% of the membership where justifiable by turnover of employers and size of employer.

Full details of the assumptions adopted are set out in the actuary's formal valuation report.

### Method and assumptions used in calculating the cost of future accrual

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target except that the financial assumptions adopted will be as described below.

The financial assumptions for assessing the future service contribution rate should take account of the following points:

- contributions will be invested in market conditions applying at future dates, which are unknown at the effective date of the valuation, and which are not directly linked to market conditions at the valuation date; and
- the future service liabilities for which these contributions will be paid have a longer average duration than the past service liabilities. The financial assumptions in relation to future service (ie, the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real return (ie, return in excess of price inflation) of 3.0% pa with a long-term average assumption for price inflation of 2.6% pa. These two assumptions give rise to an overall discount rate of 5.6% pa.

Adopting this approach the future service rate is not subject to variation solely due to different market conditions applying at each successive valuation, which reflects the requirement in the regulations for stability in the 'common rate' of contributions. In market conditions at the effective date of the 2013 valuation, this approach gives rise to a somewhat more optimistic stance in relation to the cost of accrual of future benefits compared to the market-related basis used for the assessment of the funding target. At each valuation, the cost of the benefits accrued since the previous valuation will become a past service liability. At that time, any mismatch against gilt yields and the AOA used for the funding target is fully taken into account in assessing the funding position.

**Summary of key whole Fund assumptions used for calculating funding target and cost of future accrual (the 'normal cost') for the 2013 actuarial valuation**

<b>Long-term gilt yields</b>		
Fixed interest		3.2% pa
Index-linked		(0.4)% pa
Implied RPI inflation		3.6% pa
Adjustment for inflation risk premium and CPI		(1.0)% pa
Implied CPI price inflation		2.6% pa
<b>Past service funding target financial assumptions</b>		
Investment return/discount rate		4.6% pa
Salary increases		4.35% pa
Pension increases		2.6% pa
<b>Future service accrual financial assumptions</b>		
Investment return/discount rate		5.6% pa
Salary increases		4.35% pa
Pension increases		2.6% pa
<b>Principal demographic assumptions</b>		
Mortality assumptions	Table	Adjustment
Male normal health pensioners	S1PMA CMI 2012 M (1.5%)	99%
Female normal health pensioners	S1PFA CMI 2012 F (1.5%)	96%
Male ill-health pensioners	As for male normal health pensioners + 3 years (+4 for future ill-health pensioners)	
Female ill-health pensioners	As for female normal health pensioners + 3 years (+4 for future ill-health pensioners)	
Male dependants	S1PMA CMI 2012 M (1.5%)	160%
Female dependants	S1DFA CMI 2012 F (1.5%)	114%
Male future dependants	S1PMA CMI 2012 M (1.5%)	106%
Female future dependants	S1DFA CMI 2012 F (1.5%)	95%

Commutation : 50% take 3/80ths and 50% take maximum lump sum.

## Assumptions Used in Calculating Contributions Payable

### Under the recovery plan

The contributions payable under the recovery plan are calculated using the same assumptions as those used to calculate the funding target.

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