



Annual Report and Financial Statements

for the year ending 31 March 2020



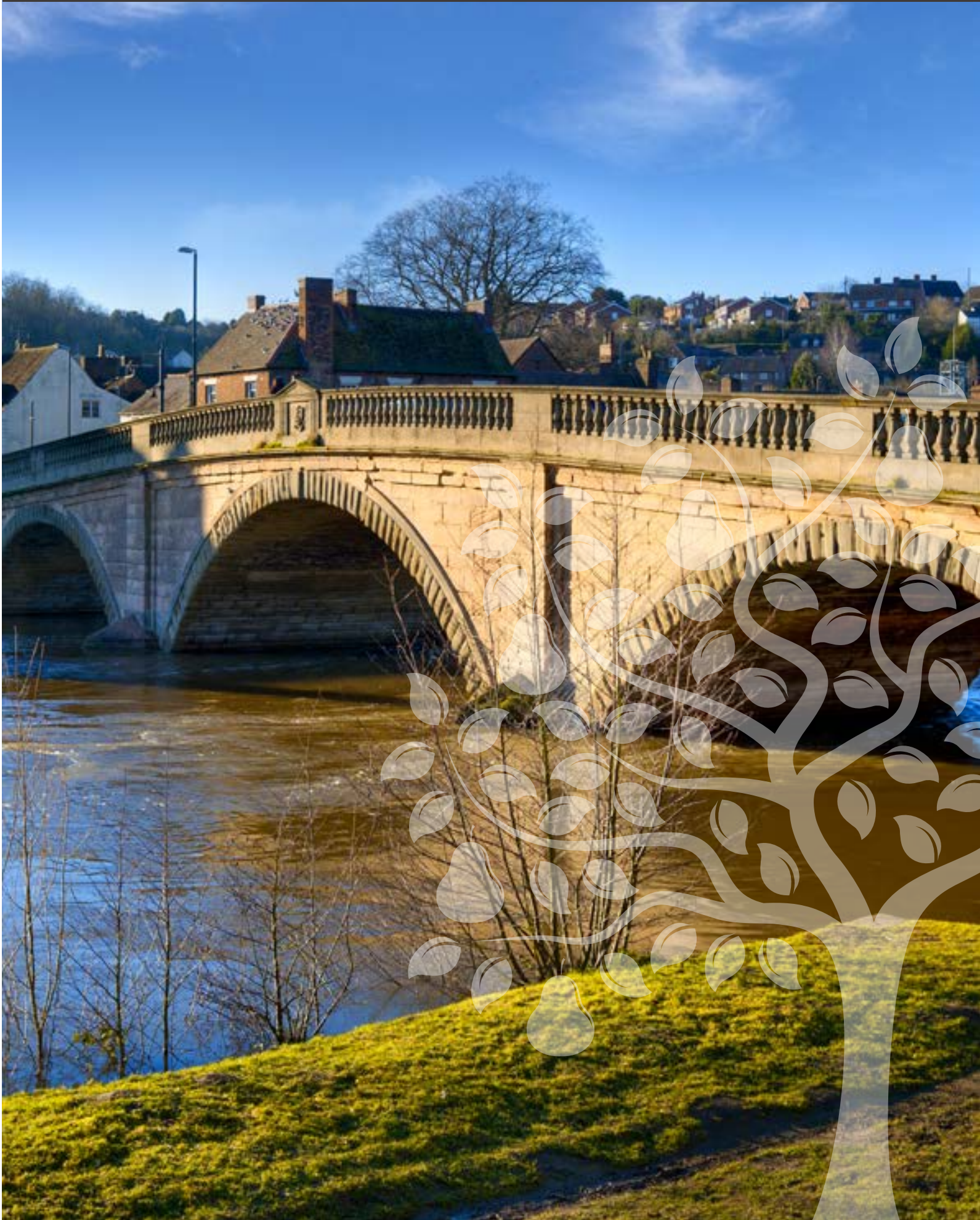
Contents

| | |
|---------------------------------------|-----|
| 1. Chair’s Foreword | 3 |
| 2. Management & Financial Performance | 6 |
| 3. Risk Management | 10 |
| 4. Financial Performance | 12 |
| 5. Administration Report 2019/20 | 18 |
| 6. Investment Policy & Performance | 25 |
| 7. Governance Arrangements | 38 |
| 8. Governance Compliance Statement | 42 |
| 9. Local Pension Board Annual Report | 48 |
| 10. Statement of Accounts 2019/20 | 50 |
| Contacts and Further Information | 178 |

Appendices

| | |
|---|-----|
| Appendix A Funding Strategy Statement | 95 |
| Appendix B Policy Statement on Communications | 141 |
| Appendix C Investment Strategy Statement 2020 | 147 |

1. Chair’s Foreword



1. Chair’s Foreword

Welcome to the annual report for the Worcestershire Pension Fund (‘the Fund’) for the year ending 31 March 2020.

On behalf of the Pensions Committee, I am pleased to introduce an annual report which looks back on a scheme year of significant activity, continuing growth and considerable achievement. The most notable achievements were:

- At the year-end our assets under management totalled £2.635 billion a decrease of 6.0% on the previous year due mainly to the impact of Covid-19 on market valuations.
- The overall funding level has improved from 75% (at the last valuation on 31 March 2016), to around 90% based on the 31 March 2019 valuation.
- Investment returns for the year were – 3.7%, 3.2% above the benchmark return of -6.9%, bolstered somewhat by the equity protection strategy in place and the diversification in the Fund’s assets. This has continued the Fund’s track record of out-performance over 3, 5 and 10-year time periods.
- Management of risk through equity protection and our reviews of investment strategy and asset allocation.
- The actuarial valuation as at 31 March 2019, setting the contribution rates for employers for the next three years 2020/21 to 2022/23.
- Expanding our responsible investment activities.
- Transitioning emerging markets and corporate bond mandates to LGPS Central Limited (LGPSCL).
- Strengthening our management of and working with individual employers, for example by the introduction of new training and development material.
- Improving governance including changing the role and membership of the Pension Board.
- Delivering our first pensioners newsletter and a stand-alone website.

In the course of the year, the highlights of what was agreed by the Committee were:

- A revised Funding Strategy Statement and Investment Strategy Statement.
- A revision to our strategic asset allocation aimed at increasing our investments in property and infrastructure and decrease our equity investments by 5% over the medium term.
- A £50m investment with the British Strategic Investment Fund being a mix of sustainable housing and infrastructure.
- A restructure of the Fund’s equity protection strategy.
- External procurement of an Environmental, Social and Governance (ESG) Audit of the Fund’s assets and development of a climate risk platform by LGPSCL for which the output should be available to Committee later in 2020.
- The introduction of a rolling quarterly Business Plan and further development of the Fund’s Training Policy and Plan, Risk Register and Pension Administration Strategy.
- Development of the Fund’s position statement in relation to the Scheme Advisory Board Good Governance Review and the setting of objectives for the Fund’s investment advisor

Scheme membership has also continued to grow and is now just under 64,000.

As readers will be aware, the Fund primarily exists to pay pensions. This core activity of pension scheme administration was again delivered successfully throughout the year. From a Fund management perspective it is worth noting that the increase in pensioners since 2009 reflects the fact that people are living longer these days. This in turn means that the Fund needs to have more money available for longer to meet the ‘guaranteed pension for life’ promises made to its pensioners compared to what was needed in the past.

The year saw the total employers increase from 196 to 202 despite a number of schools merging together as multi academy trusts and thus being treated as one employer, rather than as individual school employers as they were previously. We anticipate that the total number of employers will continue to increase over the next few years due to further outsourcing of services and schools converting to academy status.

Whilst this annual report by its nature looks back on 2019/2020, our Business Plan is provided at each Pensions Committee meeting. It reviews our ongoing progress in our key target areas and towards achieving our aspirations. It details our latest investment performance v benchmark and our latest performance against our target turnarounds for our key pension administration processes.

I’d like to finish my foreword by thanking all new and continuing members of the Committee, the Chair and members of the Pension Board, our advisers, staff at the Fund and our employers for all their continuing hard work for the Fund and its members. I would particularly like to thank Keith Bray who chaired the Pension board for 4 years.



Councillor Paul Middlebrough
Chair
Worcestershire Pension Fund Pensions Committee

2. Management & Financial Performance

2. Management & Financial Performance

Scheme Management and Advisors (as at 31 March 2020)

Administering Authority: Worcestershire County Council
Address: County Hall, Spetchley Road, Worcester WR5 2NP
Scheme Manager: Michael Hudson LLB (Hons), LLM, CPFA Chief Financial Officer

Pensions Committee as at 31 March 2020

| Representative | Meetings attended in 19/20 | | | | | Training received | | | | |
|---|----------------------------|-------|-------|-------|-------|-------------------|-------|-------|-------|-------|
| | 21/06 | 16/10 | 13/12 | 31/01 | 17/03 | 19/06 | 08/07 | 28/11 | 31/01 | 04/02 |
| Cllr B Banks | ✓ | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | ✓ |
| Cllr R Lunn | ✓ | ✓ | ✓ | | ✓ | | | | ✓ | ✓ |
| Cllr P Middlebrough (Chair) | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Cllr A Hardman | | ✓ | | ✓ | ✓ | | | | ✓ | |
| Cllr P Tuthill | ✓ | ✓ | ✓ | ✓ | ✓ | | | | ✓ | ✓ |
| T Fagan / P Marsh | | ✓ | | ✓ | | | | | ✓ | |
| Jim Price – Unison (Employee Representative) | | ✓ | ✓ | | ✓ | | | ✓ | | |
| Vic Allison / T Southall (Employee Representative) | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |

Pension Board as at 31 March 2020

| Representative | Meetings attended in 19/20 | | Training received | | | | |
|-------------------------------------|----------------------------|-------|-------------------|-------|-------|-------|-------|
| | 25/04 | 27/09 | 19/06 | 08/07 | 28/11 | 31/01 | 04/02 |
| Roger Phillips (Keith Bray) (Chair) | ✓ | ✓ | ✓ | | ✓ | | |
| Lyn-Marie Chapman | ✓ | | | | | | |
| Kim Wright | ✓ | | ✓ | ✓ | | ✓ | ✓ |
| Phil Grove | | ✓ | | | ✓ | | |
| Nigel Shaw | ✓ | | ✓ | ✓ | | | ✓ |
| Pat Agar | | | | | | | |
| Steven Howarth | | | | | | | |
| Paul Ferrett | | ✓ | | ✓ | ✓ | | ✓ |

Notes:

- (1) The training on 19 June covered actuarial valuations, funding strategy, risk strategy and benchmarking.
- (2) The training on 8 July covered fixed income investments and the administration lifecycle (AVCs, nominations, divorce, decisions and appeals and the Pensions Ombudsman).
- (3) The training on 28 November covered investing in infrastructure/property and risk considerations in investment strategy.
- (4) The training on 31 Jan 2020 covered the spectrum of capital.
- (5) The training on 4 February 2020 covered responsible investment and engagement.

Pension Investment Sub-Committee as at 31 March 2020

Councillor A I Hardman (Chair) Councillor R W Banks
Councillor M Jenkins
Councillor L Mallet
Councillor P Middlebrough
Mrs D Duggan – Unison
T Fagan
Michael Hudson LLB (Hons), LLM, CPFA Chief Financial Officer
Rob Wilson, Pensions and Treasury Management Manager

LGPS Central Limited Shareholder Representative

Councillor A I Hardman

Investment Managers as at 31 March 2020

LGPS Central Ltd
Nomura Asset Management UK Ltd
Legal & General Investment Management
Venn Partners
Hermes Investment Management Invesco Real Estate
UK Green Investment Bank Walton Street Capital, LLC First State Investments
Stonepeak Infrastructure partners AEW
EQT
River & Mercantile

Global Custodian (2019/2020)

BNY Mellon

Independent Investment Adviser (2019/2020)

M J Hudson Allenbridge

Actuary

Mercer Human Resource Consulting

Environmental Social Governance (ESG) Adviser

LGPS Central Limited

Bankers

Barclays

Auditors to the Fund

Grant Thornton UK LLP

Legal Adviser

Worcestershire County Council

In-house AVC Provider

Scottish Widows and Utmost Life

LGPS Central Ltd

Mike Weston Chief Executive

Pension Administration Advisory Forum

All employers were invited to the 19 June 2019, 14 October 2019 and 23 March 2020 forums.

3. Risk Management



3. Risk Management

Risk management is the process of identifying risks, evaluating their likelihood and potential impact and determining the most effective methods for controlling or responding to them.

The Fund has a dedicated Risk Register that is regularly reviewed by the pension's leadership team in light of new information and updated quarterly. The Pensions Committee receives regular updates on the key risks facing the Fund and the latest Risk Register is reported to each regular Committee meeting.

Each risk is initially assigned a score designed to reflect the likelihood of it occurring and impacts faced by the Fund if it were to occur.

Risks are then categorised against a series of mitigations designed to reduce the likelihood and/or impact. Risks are colour coded and assigned a red, amber or green status according to the degree of risk posed.

As at 31 March 2020 the Fund's most significant risks were:

- Mismatch in asset returns and liability movements.
- Pandemic.

The nature and extent of risks arising from financial instruments are detailed in note 16 of the accounts further on in this document.

Further assurance is provided by the work of internal audit who audit a number of key aspects of the Fund.

4. Financial Performance



4. Financial Performance

Triennial Valuation

Every three years the Fund commissions a formal valuation from the Fund’s actuary which produces two key outputs.

Firstly, it quantifies the funding level, i.e. the level to which the Fund’s pension liabilities for the accrued benefits of current employees, deferred pensioners and pensions in payment are matched by the market value of the Fund’s assets. A funding level of less than 100% implies that there is a deficit between the Fund’s assets and liabilities at that date.

Secondly, it also sets the rate at which employers should contribute to the Fund for the following three years along with any deficit recovery payments.

The table summarises the funding position as at the 31 March 2019 compared to the funding position of the last formal valuation as at the 31 March 2016.

Summary Valuation Results

| £m | 31 March 2016 | 31 March 2019 |
|------------------------------|---------------|---------------|
| Total past service liability | 2,606 | 3,090 |
| Fund assets | 1,952 | 2,795 |
| Surplus/(deficit) | (654) | (295) |
| Funding Level | 75% | 90% |

As at 31 March 2020 we estimate that the Fund was 81% funded due to the impact of Covid-19.

To meet the requirements of the regulations, we have set a clear long-term funding objective; to achieve and then maintain assets equal to 100% of projected accrued liabilities, assessed on an ongoing basis.

In tandem with the actuarial valuation the actuary helps us to produce a Funding Strategy Statement that is available from our website. This focuses on the pace at which future benefits will be funded and on practical measures to ensure that employers pay for their own liabilities.

Contribution Rates

Members’ contributions are set at a rate which covers only part of the cost of accruing benefits after the valuation date. Employers pay the balance of the cost of delivering future benefits to members.

At the 2019 actuarial valuation a common rate of contribution of 17.5% of pensionable pay per annum was set for employers from 1 April 2020.

As the actuary assessed the particular circumstances of each employer, including the strength of its covenant and its individual membership experience within the Fund, the actuary applied individual adjustments to each employer to reflect these circumstances.

This resulted in a higher contribution rate than the baseline percentage and/or an annual cash contribution at a fixed amount being set for many employers.

The next actuarial valuation and review of the Funding Strategy Statement will be carried out as at 31 March 2022, with any changes to employers’ contribution rates being implemented with effect from

1 April 2023. Our Funding Strategy Statement is available in **Appendix A** and the **2019 Actuarial Valuation Report** is on our website.

Analytical Review of Fund Account and Net Assets Movement

The following table provides a brief overview of the major movements in the Fund account and net assets statement for the financial year 2019/2020. The full statement of accounts is included from page 50 of this report.

| Fund Account | 2018/19 £m | 2019/20 £m | Notes |
|---------------------------------|---------------|----------------|--|
| Net Contributions | 33.4 | (38.7) | Mainly due to major employers prepaying their contributions for 3 years in 2017/2018 and some increase in management fees as a result of divesting into infrastructure and property in line with the Fund's strategic asset allocation |
| Return on Investments | 127.7 | (111.2) | Negative return due to the impact of Covid-19 on asset valuations |
| Net Increase in the Fund | 94.3 | (149.9) | |

Operational Expenses – Comparison of 2019/20 forecast to actual

| | 2019/20 Budget £000 | 2019/20 Actual £000 | 2019/20 Variance £000 |
|---|------------------------|------------------------|--------------------------|
| Administration, Oversight & Governance | | | |
| Employees | 702 | 640 | -62 |
| Supplies & Services | 40 | 31 | -9 |
| Actuarial Fees | 400 | 413 | 13 |
| Investment Advisor expenses | 93 | 99 | 6 |
| IT Costs | 366 | 299 | -67 |
| External Audit Fees | 28 | 24 | -4 |
| Legal Fees | 34 | 10 | -24 |
| Total | 1,663 | 1,516 | -147 |
| Investment Management | | | |
| External Fund Managers | 10,599 | 13,536 | 2,937 |
| Transaction Costs | 760 | 658 | -102 |
| Custodian | 367 | 293 | -74 |
| Total | 11,726 | 14,487 | 2,761 |

Administration and Management costs per member past 5 years

| Process | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---------------------------------------|------------|------------|------------|------------|------------|
| Investment Management Expenses | | | | | |
| Total cost (£m) | 6.7 | 7.1 | 8.9 | 11.9 | 14.4 |
| Total membership (Nos) | 57,821 | 59,196 | 60,336 | 62,254 | 63,635 |
| Cost per member (£) | 116 | 120 | 148 | 191 | 226 |
| Administration Costs | | | | | |
| Total cost (£m) | 1.2 | 1 | 0.8 | 1.1 | 1.5 |
| Total membership (Nos) | 57,821 | 59,196 | 60,336 | 62,254 | 63,635 |
| Cost per member (£) | 21 | 17 | 13 | 18 | 24 |
| Oversight and Governance Costs | | | | | |
| Total cost (£m) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Total membership (Nos) | 57,821 | 59,196 | 60,336 | 62,254 | 63,635 |
| Cost per member (£) | 1.7 | 1.7 | 1.7 | 1.6 | 1.6 |
| Total cost per member (£) | 138 | 139 | 162 | 210 | 251 |

The increase in investment management expenses is due mainly to diversifying asset allocation into property and infrastructure assets where management fees tend to be higher in line with the Investment Strategy Statement.

The table below outlines the Fund's performance for key financial variables for the past 5 years

| | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---|---------------|---------------|---------------|---------------|---------------|
| | £m | £m | £m | £m | £m |
| Contributions and Benefits | | | | | |
| Contributions receivable | 104.3 | 107.8 | 185.2 | 81.8 | 87.5 |
| Individual Transfers | 5.4 | 8.0 | 10.4 | 12.9 | 12.9 |
| | 109.7 | 115.8 | 195.6 | 94.7 | 100.4 |
| Benefits Payable | -93.9 | -95.5 | -98.0 | -106.3 | -111.9 |
| Payments to and on account of leavers | -7.3 | -7.0 | -8.8 | -8.7 | -11.2 |
| | -101.2 | -102.5 | -106.8 | -115.0 | -123.1 |
| Management & Admin expenses | -8.0 | -8.2 | -9.8 | -13.1 | -16.0 |
| | 0.5 | 5.1 | 79.0 | -33.4 | -38.7 |
| Return on Investments | | | | | |
| Investment income | 38.1 | 29.4 | 35.8 | 50.2 | 47.9 |
| Change in market value of investments | -73.6 | 494.1 | 105.3 | 77.5 | (159.1) |
| Net return on investments | -35.5 | 523.5 | 141.1 | 127.7 | -111.2 |
| Net increase in the Fund during the year | -35.0 | 528.6 | 220.1 | 94.3 | -149.9 |

3 year forecast management expenses 2020-21 to 2022-23

| | 2020/21 Budget £000 | 2021/22 Budget £000 | 2022/23 Budget £000 |
|--|------------------------|------------------------|------------------------|
| Administration / Oversight & Governance | | | |
| Pension scheme Administration recharge | 996 | 974 | 996 |
| Actuarial services | 240 | 240 | 300* |
| Audit | 27 | 27 | 28 |
| Legal Fees | 33 | 33 | 33 |
| Committee and Governance recharge | 11 | 11 | 11 |
| Total | 1,307 | 1,284 | 1,368 |
| Investment Administration Costs | | | |
| Investment Administration Recharge | 142 | 145 | 148 |
| Investment Custodial and related services | 367 | 374 | 382 |
| Investment Professional fees | 81 | 72 | 72 |
| Performance Measurement | 15 | 16 | 16 |
| Total | 605 | 607 | 618 |
| Investment Management | | | |
| External Fund Managers** | 11,383 | 12,190 | 13,123 |
| Transaction Costs | 810 | 840 | 870 |
| Total | 12,193 | 13,030 | 13,993 |
| Overall Total | 14,105 | 14,921 | 15,980 |

* Actuarial Fees are higher in 2022/23 due to this being a valuation year

** External Managers fees are subject to market valuations

5. Administration Report 2019/20



5. Administration Report 2019/20

As usual, paying pensions, processing retirements, processing deaths, processing refunds, delivering our year end and issuing annual benefit statements were our major administration deliverables. New employers, employer restructures and delivering training for Pensions Committee and Pension Board members also required significant resource.

We deliver our service using:

- The Altair pensions administration system.
- Our stand-alone website that we launched on 22 October. Its page views averaged 7,264 in 2019/2020.
- Dedicated resource for each member requirement.
- An Engagement Manager to support employer relationships including monthly employer newsletters and online training.
- Computer hardware, software and the Council's computer network.

We have arrangements in place to ensure the accuracy and confidentiality of personal data. The Fund conforms with Worcestershire County Council's (WCC) breach notification process and WCC's data policy, for example through the use of data encryption and password protection. Systems are reviewed by internal and external audit and set up in line with data protection regulations. A complete address update is done regularly by employers. Mitigating processes include the Business Continuity Plan (BCP), data breach, addresses being checked by a dedicated checker and communication taking place with member/ employer before a payment is made.

The major one-off and annually recurring administration large pieces of work or projects that we undertook during the year included:

- The actuarial valuation as at 31 March 2019.
- The annual employer covenant assessment.
- Guaranteed Minimum Pension (GMP) rectification.
- Providing data for The Pensions Regulator (TPR)/the LGPS Scheme Advisory Board/ for the Occupational Pension Schemes survey.
- Annual benefit statements for employee and deferred members.
- Pensioner P60s and pay slips.
- FRS information to employers.
- Pension savings statements.
- Improving the quality of data held and actions required to improve it.
- Launching a stand-alone website.
- Newsletters for employee, deferred and pensioner members.

Internal Disputes Resolution Procedure (IDRP)

There are times when members, employers and the Fund may find themselves in disagreement about a pension issue. The first approach in these situations is for those involved to talk to each other to reach resolution. However, should this not prove possible, the Fund has an IDRP. Our appeals procedure is detailed on our [website](#).

Policy Statement on Communications

The Statement provides an overview of how the Fund will communicate with its stakeholders. An effective communications strategy is vital for the Fund to meet its objective of providing a high quality and consistent service. Scheme communications are a critical activity; they are the external face of the Fund and provide a key link with its stakeholders. The Fund continuously looks at ways to enhance its communication offering to the various audiences and the Policy Statement will be reviewed annually and a revised version will be published following any material change. Our Policy Statement on Communication is at **Appendix B** below.

Membership and Employer Movement and Scheme complexity

The Fund continues to experience a year on year increase in the number of members across all categories (Active, Deferred and Pensioners).

Number of Pensioners and Contributors

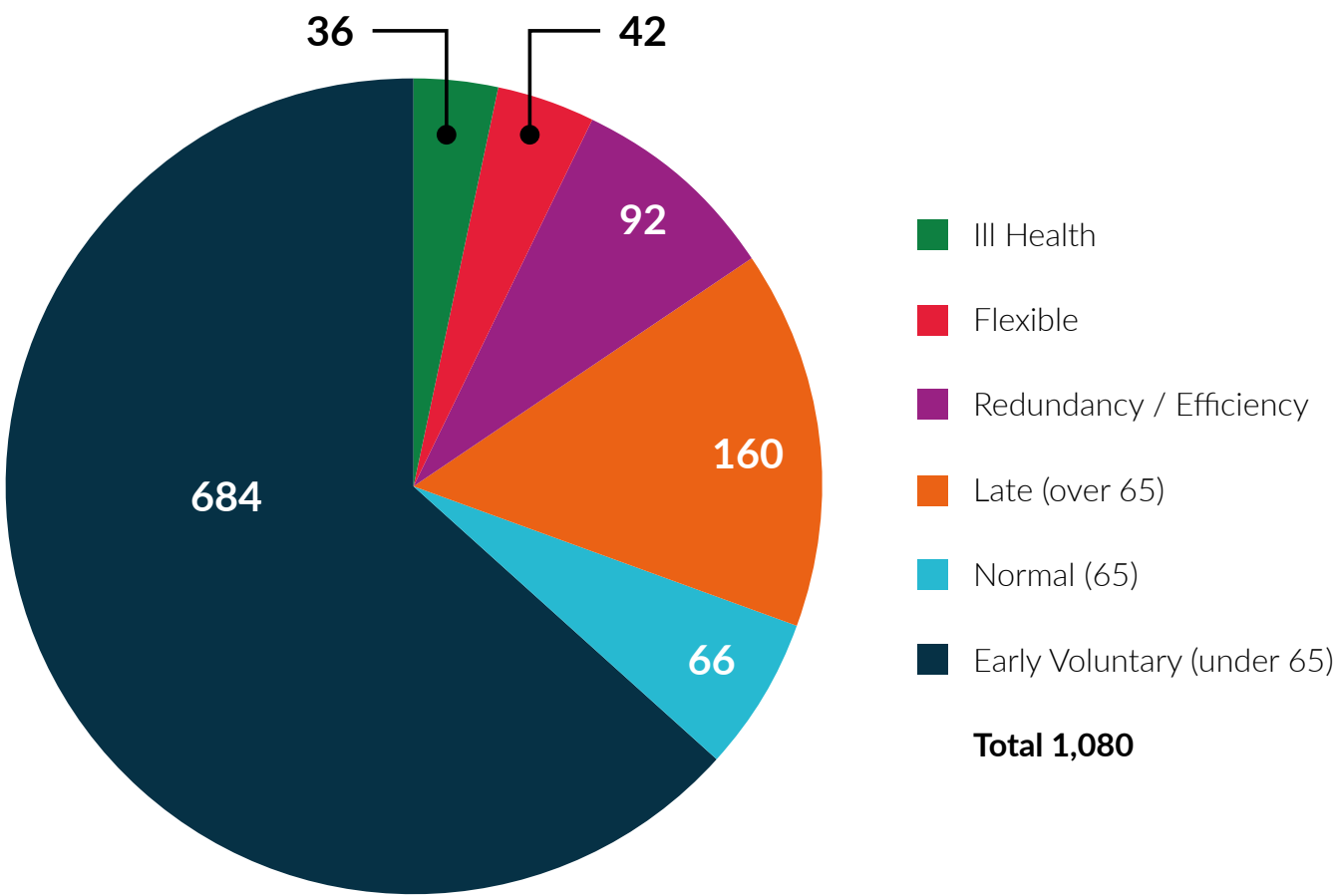


The table below summarises the age ranges of the membership as at 31 March 2020:

| Age Group | Active | Pensioner | Deferred | Total | % |
|-----------|--------|-----------|----------|--------|---------|
| 0-20 | 24 | 75 | 16 | 332 | 0.5% |
| 21-25 | 1,069 | 9 | 221 | 1,299 | 2.0% |
| 26-30 | 1,420 | 2 | 1,073 | 2,495 | 3.9% |
| 31-35 | 1,975 | 4 | 1,935 | 3,914 | 6.1% |
| 36-40 | 2,405 | 14 | 2,411 | 4,830 | 7.5% |
| 41-45 | 2,827 | 30 | 2,721 | 5,578 | 8.8% |
| 46-50 | 3,770 | 62 | 3,872 | 7,704 | 12.1% |
| 51-55 | 3,973 | 198 | 4,599 | 8,770 | 13.9% |
| 56-60 | 3,219 | 1,214 | 3,614 | 7,957 | 12.6% |
| 61-65 | 1,845 | 3,479 | 999 | 6,323 | 10.0% |
| 66-70 | 311 | 4,496 | 102 | 4,909 | 7.7% |
| 71-75 | 78 | 3,990 | 22 | 4,090 | 6.4% |
| 76-80 | 0 | 2,370 | 0 | 2,370 | 3.7% |
| 81-85 | 0 | 1,628 | 0 | 1,628 | 2.6% |
| 86-90 | 0 | 934 | 0 | 934 | 1.5% |
| 91-95 | 0 | 409 | 0 | 409 | 0.6% |
| 96-100 | 0 | 83 | 0 | 83 | 0.1% |
| 101+ | 0 | 10 | 0 | 10 | 0.0% |
| Total | 23,133 | 18,917 | 21,585 | 63,635 | 100.00% |

Retirements during 2019/20

There were 1,080 retirements during 2019/20 as summarised in the chart below:



The Fund has 202 employers whose employees are members of the LGPS:

| | Active employers as at 31/03/2020 |
|-------------------|-----------------------------------|
| Scheduled bodies | 128 |
| Designated bodies | 30 |
| Admitted bodies | 44 |
| Total | 202 |

Notes:

- Scheduled (in the regulations) bodies are organisations whose employees qualify to become members of the LGPS by right. These include county councils, district councils, foundation schools/colleges and academies.
- Designated bodies are organisations that have passed resolutions with town or parish councils to offer the LGPS to their employees.
- Admitted bodies are organisations that fall into none of the previous 2 categories. Admitted bodies are voluntary/charitable bodies and other organisations to whom local government employees have been transferred under the outsourcing of local government services whose staff can, at the discretion of their employer, become members of the LGPS.

Our Performance

The Fund benchmarks its performance on administration casework using the CIPFA benchmarks as outlined in the table below. The Fund achieved 100% compliance. We measure how we perform against our target turnarounds for our key processes:

| Activity / Process 2019/20 | Average Turnaround Achieved (working days) | Target Turnaround (working days) |
|--|--|----------------------------------|
| Joiners notification of date of joining | 10 | 40 |
| Process and pay refund | 2 | 10 |
| Calculate and notify deferred benefits | 26 | 30 |
| Letter notifying actual retirement benefits | 3 | 15 |
| Letter notifying amount of dependant's benefits | 3 | 10 |
| Letter acknowledging death of member | 3 | 5 |
| Letter detailing CETV for divorce | 2 | 45 |
| Letter notifying estimate of retirement benefits | 4 | 15 |
| Letter detailing transfer in quote | 3 | 10 |
| Process and pay lump sum retirement grant | 15 | 23 |
| Letter detailing transfer out quote | 3 | 10 |
| Letter detailing PSO implementation | n/a | 15 |

We continue to monitor this and improve our data capturing of the information against the CIPFA benchmarks.

The administration team comprises of 16.7 full time equivalent (FTE) staff. The Fund therefore has a ratio of one full time equivalent member of the team for every 3,810 Fund members.

In 2019/2020 we had 3 data breaches, 5 IDRPCs and 0 complaints.

Value for Money

At £1.5m our administration costs for 19/20 were £0.4m more than the previous year due mainly to the one off Guaranteed Minimum Pension (GMP) rectification exercise. However our costs per member continue to be lower than average when compared to other LGPS Funds. In 2019/20 our administration team of 16.7 FTE achieved the average CIPFA benchmark turnaround target for all 12 standard processes.

Following the Pensions Regulator’s (TPR) guidance, we measured the quality of our data on 8 July 2019. The percentage of our member records without a single ‘common data’ failure was 92.1% compared to our 2018 score of 92.6%. In the core list of TPR ‘common data’ tests our pass rates were: National Insurance

Number 100%; Name 100%; Sex and Date of Birth 100%; Date Commenced and Normal Retirement Date 99.9%; Status 100%; and Address 95.1%. The percentage of our member records without a single 'scheme-specific data' failure was 86.6% compared to our 2018 score of 62.2%. In the core list of TPR 'scheme-specific data' tests our pass rates were: Member Benefits 99.9%; Member Details 99.9%; CARE benefits 98.4%; HMRC 99.6%; and Contracted Out 90.6%.

Looking ahead, we are committed to delivering an even more modern and efficient value for money service.

6. Investment Policy & Performance



6. Investment Policy & Performance

Investment Management

Subject to the LGPS regulations on allowable investments, the Fund may invest in a wide range of assets including quoted equity, government bonds, corporate bonds, money markets, traded options, financial futures/derivatives and alternative strategies including infrastructure/property pooled funds.

The Fund's investment objective is to support the funding strategy by adopting an investment strategy and structure which incorporate an appropriate balance between risk and return. Our Investment Strategy Statement is available at **Appendix C**.

The Pensions Committee has responsibility for the investment strategy of the Fund but has established a Pension Investment Sub-Committee and delegated oversight of its implementation to the Chief Financial Officer. The Committee regularly reviews the Fund's investment management arrangements. In broad terms, at 31 March 2020 the Fund's strategic allocation was to be invested 75% in equities, 10% in fixed income and 15% in property/alternatives. The Fund's assets are managed day to day by the Fund's appointed specialist, external investment managers.

Strategic Asset Allocation

The table below shows the actual distribution of assets across the main asset categories which change year on year as a result of the strategic asset allocation, the performance of the underlying asset classes, managers' performance, rebalancing across managers and asset classes.

Strategic Actual and Target Asset Allocations

| Asset Class | Actual Portfolio Weight | Actual Portfolio Weight | Target Portfolio Weight |
|----------------|-------------------------|-------------------------|-------------------------|
| | 31.03.19 | 31.03.20 | 31.03.20 |
| Total Equities | 83.0% | 75.7% | 75.0% |

| | | | |
|---------------------------------|-------|-------|-------|
| Total Actively Managed Equities | 27.3% | 23.4% | 20.0% |
| Far East Developed | 14.3% | 12.5% | 10.0% |
| Emerging Markets | 13.0% | 10.9% | 10.0% |

| | | | |
|--|-------|-------|-------|
| Total Passively Managed Equities – Market Capitalisation Indices | 31.5% | 28.0% | 40.0% |
| United Kingdom | 13.8% | 11.0% | 23.5% |
| North America | 11.3% | 11.0% | 9.0% |

| Asset Class | Actual Portfolio Weight | Actual Portfolio Weight | Target Portfolio Weight |
|--------------|-------------------------|-------------------------|-------------------------|
| | 31.03.19 | 31.03.20 | 31.03.20 |
| Europe ex UK | 6.4% | 6.0% | 7.5% |

| | | | |
|--|-------|-------|-------|
| Passively Managed Equities – Alternative Indices | 15.3% | 14.9% | 15.0% |
|--|-------|-------|-------|

| | | | |
|-------------------|------|------|------|
| Equity Protection | 8.9% | 9.4% | 0.0% |
|-------------------|------|------|------|

| | | | |
|---|------|------|-------|
| Total Fixed Interest | 5.9% | 6.5% | 10.0% |
| Actively Managed Bonds & Corporate Private Debt | 5.9% | 6.5% | 10.0% |

| | | | |
|---|-------|-------|-------|
| Total Actively Managed Alternative Assets | 11.1% | 17.8% | 15.0% |
| Property | 5.1% | 6.4% | 15.0% |
| Infrastructure | 6.0% | 11.4% | |

| | | | |
|-------|--------|--------|--------|
| TOTAL | 100.0% | 100.0% | 100.0% |
|-------|--------|--------|--------|

The equity protection strategy applies to the Passively Managed Equities – Market Capitalisation Indices

There are still a number of undrawn capital commitments related to Property and Infrastructure. These take a number of years and are being funded from disinvestments in the equity portfolio to meet the strategic target allocations.

Details of the Largest Equity investments as at 31 March 2020

| Top 10 Direct Equity Investments | Market Value of holding as at 31 March 2020 (£) | Percentage of Total Fund Assets |
|-------------------------------------|---|---------------------------------|
| Sony Corp | 10,592,327 | 1.3% |
| Honda Motor Co Ltd | 9,836,820 | 1.2% |
| Nitori Holding Ltd | 9,164,347 | 1.1% |
| TDK Corp | 8,171,133 | 1.0% |
| Samsung Electronics Co Ltd | 8,071,665 | 1.0% |
| Apple Inc Com NPV | 7,970,745 | 1.0% |
| BHP Group Ltd | 7,959,044 | 1.0% |
| Microsoft Corp Com | 7,864,053 | 1.0% |
| Daikin Industries Ltd | 7,675,040 | 0.9% |
| Chugai Pharmaceutical Co Ltd | 7,608,279 | 0.9% |

Global Overview from the Fund's Investment Advisor

It ended in a Crash

As we started the new decade it all seemed to be going so well; Fund valuations were looking good, agreement had been reached with the actuary about contribution rates and Brexit was finally well on the way to being sorted. Then coronavirus arrived on our shores and from mid-February markets went into freefall. Sentiment was made even worse by one of the largest ever percentage falls in oil prices, sparked by a dispute between Saudi Arabia (OPEC) and Russia. Thankfully markets started to pull out of their nose-dive in mid-March so that our year end was not quite at the low point, but some damage had been done.

At that point in mid-February when markets were riding high the Fund value will have been hovering around the £3bn mark, and then came the fall. The total value of the Worcestershire Pension Fund at 31 March 2020 was £2,635m, compared to £2,795m at the end of March 2019, a decrease of 7%. The Fund outperformed its bespoke benchmark performance target over the last year by 3.1%. The Fund also outperformed its benchmark by 1.0% over 3 and 5 years. It is gratifying to note that the ten-year performance figure has now moved to a positive position against the benchmark, by 0.3%.

Over the course of the year, markets generally had been climbing to ever higher levels, continuing into January and February 2020. The exception to this was the UK market, which traded in a relatively tight range but without the same upwards trend. This was caused in main by the uncertainties that surrounded our Brexit negotiations, including concerns about future trading arrangements. From the high point markets fell by as much as 35%. However, even as the UK and other countries were going into Covid-19 lockdown towards the end of March, markets had started to recover sharply, taking reassurance from the

unprecedented scale of support provided by central banks though a massive programme of quantitative easing. The recovery continued after the year end to such an extent that markets seem to be looking through the economic damage that has been done over recent months and the likelihood that the recovery from that will be prolonged.

Recent events surrounding Covid-19, including the enormous upheaval that has been caused both at the economic level but more importantly at the human level, has served to consign what was going on prior to the pandemic to history rather more quickly than usual. It was a year ago in July that Theresa May packed her bags and vacated Downing Street, making way for Boris Johnson to take Britain forward through the turgid Brexit negotiations. Ultimately, he needed to strengthen his position in the House of Commons and a General Election was held in December, and, whereas Mrs May failed to achieve this in 2017, the new Prime Minister succeeded in gaining a considerable majority and was thus able to see Brexit finally happen on 31 January. Although much remains to be done to sort out the detail of the new relationship with Europe, at least some degree of certainty now seemed to be available to UK plc. Little did we realise at this stage what lay just around the corner. Given the sheer scale of the disruption caused by Covid-19 it is hard to have a clear view of what lies ahead. Some sections of the economy have been relatively unaffected; others have been hit extremely hard, including sectors such as food and beverage hospitality, leisure and travel. It will take time for these to recover, some will have changed forever. In some cases what is happening globally will determine the speed of recovery, such as overseas tourism. Other countries have responded in different ways to Covid-19, in some cases not seeking to contain the spread of the coronavirus in the interests of maintaining economic activity, at least in the short term. The USA is an example of this, where lockdowns have been eased while the rate of infection in some States is still rising dramatically. It is Presidential election year, so the American people will have the opportunity to vote about how they view this strategy. Watch this space.

There is rarely, if ever, a dull moment in the management of the Fund. This past year has been no exception, starting with the triennial valuation which was rapidly followed by the strategic asset allocation review. The Fund's actuary undertakes the triennial valuation, which provides some idea of the Fund's liabilities, which in simple terms equates to the pensions that will be paid to members, now and in the future. They also determine the discount rate, which is their expectation of how much the value of the Fund's assets will rise by each year. They always take a very prudent approach and in my experience the value of Fund assets tend to rise much more than the discount rate over time. The strategic asset allocation review includes an analysis of the Fund's assets to ensure that they are invested in a manner such as to be able to meet the liabilities identified by the triennial valuation.

The strategic asset allocation review also takes into account the health or otherwise of the funding level (which is a measure of the Fund's assets measured against the expected liabilities). The ultimate aim is to be in a fully funded position, but this target can be hard to hit and maintain, given that liabilities are constantly rising, and asset values can rise and fall. In recent times the funding level has improved considerably, in major part due to the large allocation to equities which have risen substantially in value. However, as we have seen recently, investing in equities carries the risk of significant falls in value which can have a seriously detrimental impact on the funding level. Over time the Fund has diversified away from equities to some degree into other investments, such as property and infrastructure, which tend to be much less volatile in valuation terms. The Fund has also moved some of the passive equity investments away from traditional market capitalisation indices into funds which follow other characteristics, such as low volatility, value and quality, and tend to provide some downside protection in falling markets. Despite these changes the Fund is still exposed to the risk of major falls in equity markets and to help manage this risk an equity protection strategy was put in place in February 2018 to mitigate some of that risk. This covers approximately one third of total Fund assets. While it is acknowledged that, in times when equity markets are rising rapidly, the strategy has provided some drag on performance against the total Fund benchmark, the benefit of having this strategy in place can be clearly seen from the outperformance

highlighted at the start of this report. Although the funding level fell to 81% at the end of March, the fall would have been greater without the protection strategy in place. For peace of mind, this had recovered to 88% by the end of May. To give some historic context, the funding level fell from 72% in 2007 to 48% in 2008, and it took until 2016 to recover to the previous level. One of the outcomes from the recent strategic asset allocation review will see a further move from equities to alternatives, such that the allocation to equities will fall from 75% to 70% of total Fund assets. This still leaves a comparatively high exposure to equities compared to other similar LGPS funds, a risk that still needs to be recognised and managed effectively.

As part of the consultation with employers during the triennial valuation process and the possible changes required to contribution rates it was acknowledged that, although the Fund must consider the overall funding level, each employer will also have their own specific funding level, some better than the Fund, some worse. In recognition of this, and in line with evolving good practice, three investment strategies within the Fund will be developed to better reflect employer risk appetite and the strength of their covenant. These will be labelled as Growth (the main strategy), Medium and Cautious.

In addition to the work that Officers have undertaken in connection with the triennial valuation and the strategic asset allocation review, various other initiatives have taken place over the year under review. In furtherance of the objective to ensure that the Fund has the highest governance standards, the Pension Investment Advisory Panel has now become a formal Council body, as the Pension Investment Sub-Committee. Membership has been enlarged to incorporate a wider cross section of experience. The Pension Board has also seen a reorganisation of their remit, also including an increase in membership to widen the representation of Fund stakeholders. The provision of training has been increased and broadened, reflecting the increased membership of the Board and committees, but also to acknowledge the requirement that members and officers should have appropriate skills and knowledge to undertake their duties.

The strategic asset allocation review highlighted the increasing importance of ensuring that the Fund adopts a responsible and sustainable approach to investment strategy. Many of the Fund investments already fulfil these criteria, while acknowledging that the primary objective is to achieve the appropriate rate of return. Work has commenced on a full review of the Economic, Social and Governance (ESG) attributes of all the Fund’s existing investments and to formulate future policy in this area. Key stakeholders have been invited to attend training and to help shape the scope of the review, which will be based on some of the UN Sustainable Development Goals (SDGs). An external consultant will be appointed to undertake this study. It is expected that this review will be completed within the current financial year. In the meantime, the Fund’s Investment Strategy Statement has been updated to reflect the Fund’s commitment to invest in a responsible manner, incorporating ESG factors which make up the core principles of investment. Full details can be found on the Fund’s website.

The Fund is a member of LGPS Central Limited which will ultimately be responsible for managing the Fund assets for Cheshire, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands and Worcestershire Pension Funds. During the last financial year, the management of the Fund’s emerging markets portfolio has been transitioned to LGPS Central Limited and the process of transitioning the corporate bond mandate commenced. For the time being the Fund retains the responsibility for monitoring their other existing managers and making short term changes to the management arrangements as necessary. Worcestershire Pension Fund retains responsibility for asset allocation decisions, which research shows forms the major part of the contribution to Fund performance over time. Crucially the Fund will also still be responsible for meeting the liabilities to our members, namely paying their pensions.

Philip Hebson
Independent Investment Advisor
June 2020

Investment Monitoring and Performance

The Pension Investment Sub-Committee monitors external managers’ performance and makes investment manager and asset allocation recommendations. The Fund does not automatically rebalance mandates in line with the long-term investment policy as set out in the Investment Strategy Statement. Therefore portfolio weights may vary compared to their long-term strategic total Fund weight. The Fund’s actual asset valuations across UK, Non UK and Global as at 31 March 2020 are shown below.

| | UK £m | Non-UK £m | Global £m | Total £m |
|-----------------------------------|----------|--------------|--------------|-------------|
| Equities | 294.7 | 1,035.4 | 389.0 | 1,719.1 |
| Bonds | 211.2 | 0 | 143.8 | 355.0 |
| Pooled Property Investments | 75.2 | 74.6 | 0 | 149.8 |
| Pooled Infrastructure Investments | 299.1 | 0 | 0 | 299.1 |
| Pooled Debt Investments | 38.0 | 0 | 0 | 38.0 |
| Cash and Cash Equivalents | 25.5 | 11.0 | 0 | 36.5 |
| Other | 6.5 | 0 | 0 | 6.5 |
| Total | 950.2 | 1,121.0 | 532.8 | 2,604.0 |

The Fund’s investment performance is measured quarterly by Portfolio Evaluation Ltd. against a number of benchmarks. The table below details the Fund’s performance against these benchmarks for 1-year, 3-years and 5-years to 31 March 2020.

Fund Performance by Asset Class

| Asset Class | 1 Year Actual | 1 Year Benchmark Return | 3 Year Actual | 3 Year Benchmark | 5 Year Actual | 5 Year Benchmark |
|------------------------------|------------------|-------------------------------|------------------|---------------------|------------------|---------------------|
| | Return | Return | Return | Return | Return | Return |
| | % | % | % p.a. | % p.a. | % p.a. | % p.a. |
| Active Equities | -9.9 | -10.7 | -0.6 | -0.8 | 5.6 | 4.7 |
| Passive Equities | -10.6 | -12.0 | -0.3 | -1.0 | 5.9 | 5.2 |
| Alternative Passive Equities | -4.7 | -5.4 | 3.0 | 3.0 | 8.9 | 9.0 |
| Bonds | 7.6 | 7.0 | 4.6 | 4.1 | 3.7 | 3.3 |

| Asset Class | 1 Year Actual | 1 Year Benchmark Return | 3 Year Actual | 3 Year Benchmark | 5 Year Actual | 5 Year Benchmark |
|-----------------------|---------------|-------------------------|---------------|------------------|---------------|------------------|
| | Return | Return | Return | Return | Return | Return |
| | % | % | % p.a. | % p.a. | % p.a. | % p.a. |
| Pooled Private Debt | 5.6 | 6.5 | N/A | N/A | N/A | N/A |
| Pooled Property | 4.3 | 7.4 | 5.5 | 7.1 | 7.3 | 7.1 |
| Pooled Infrastructure | 8.3 | 9.0 | 7.0 | 8.5 | 7.3 | 8.4 |
| TOTAL FUND | -3.7 | -6.9 | 1.9 | 0.9 | 5.7 | 4.7 |

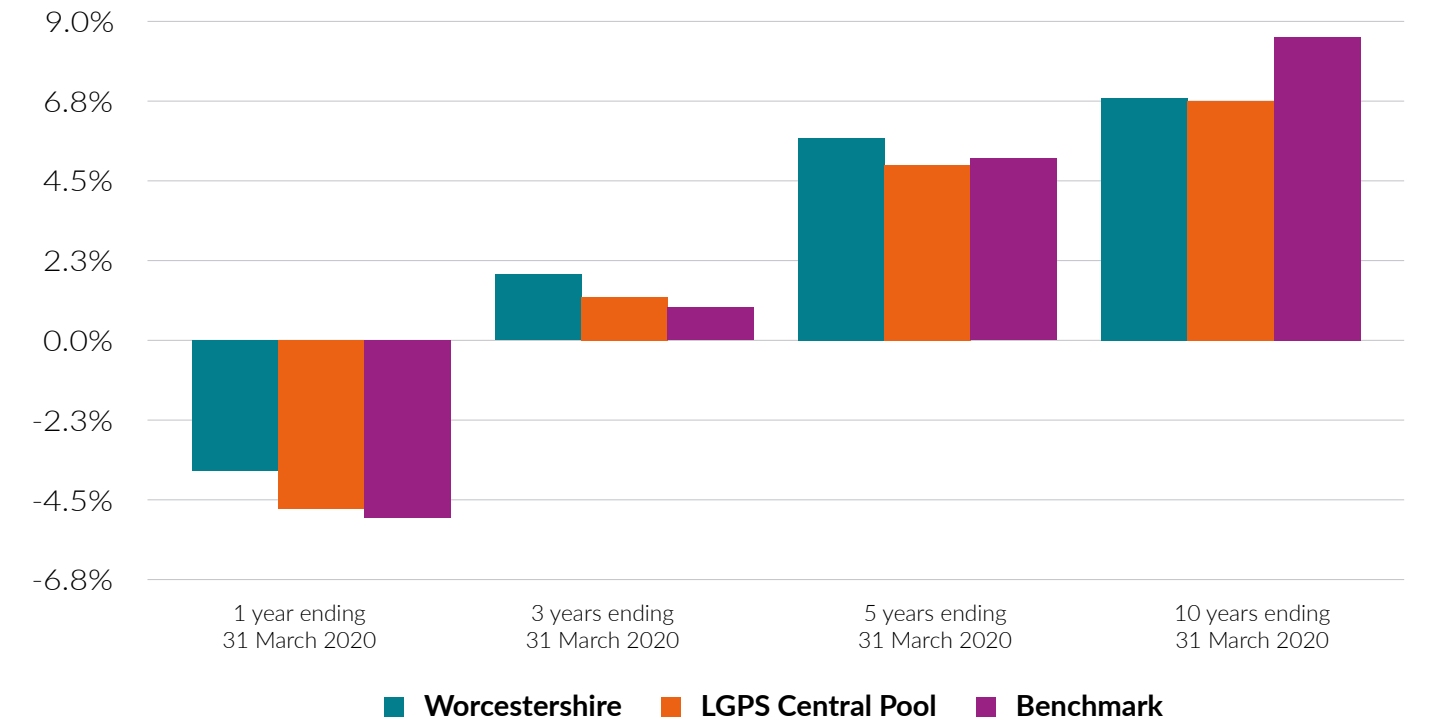
The Fund produced a return of -3.7% for the year, which gave an outperformance against the benchmark of 3.2%. This was mainly attributable to a positive contribution from the equity protection strategy and stock selection which cushioned the significant falls in market valuations seen in Q1 2020. The Fund’s performance continued to be strong over the 3-year and 5-year periods compared to the Benchmark.

As the majority of the improvement in the Fund’s assets since the 2016 valuation was attributable to the rally in equity markets over the period, in late February/early March 2018 the Fund implemented an equity protection strategy using a ‘static’ options hedge solution to:

- Manage the risk of markets falling.
- Reduce the likelihood that further deficit contributions will be required at the 2019 valuation.
- Seek to ‘bank’ some of the recent upside with a view to potentially reducing contributions at future valuations.

The following chart shows the performance of the Fund relative to its strategic benchmark, and LGPS Central Limited pool partners. Although the performance was lower than the benchmark and LGPS Central Limited pool partners this year, the Fund has outperformed both the benchmark and LGPS Central Limited pool partners over 3, 5 and 10-year periods.

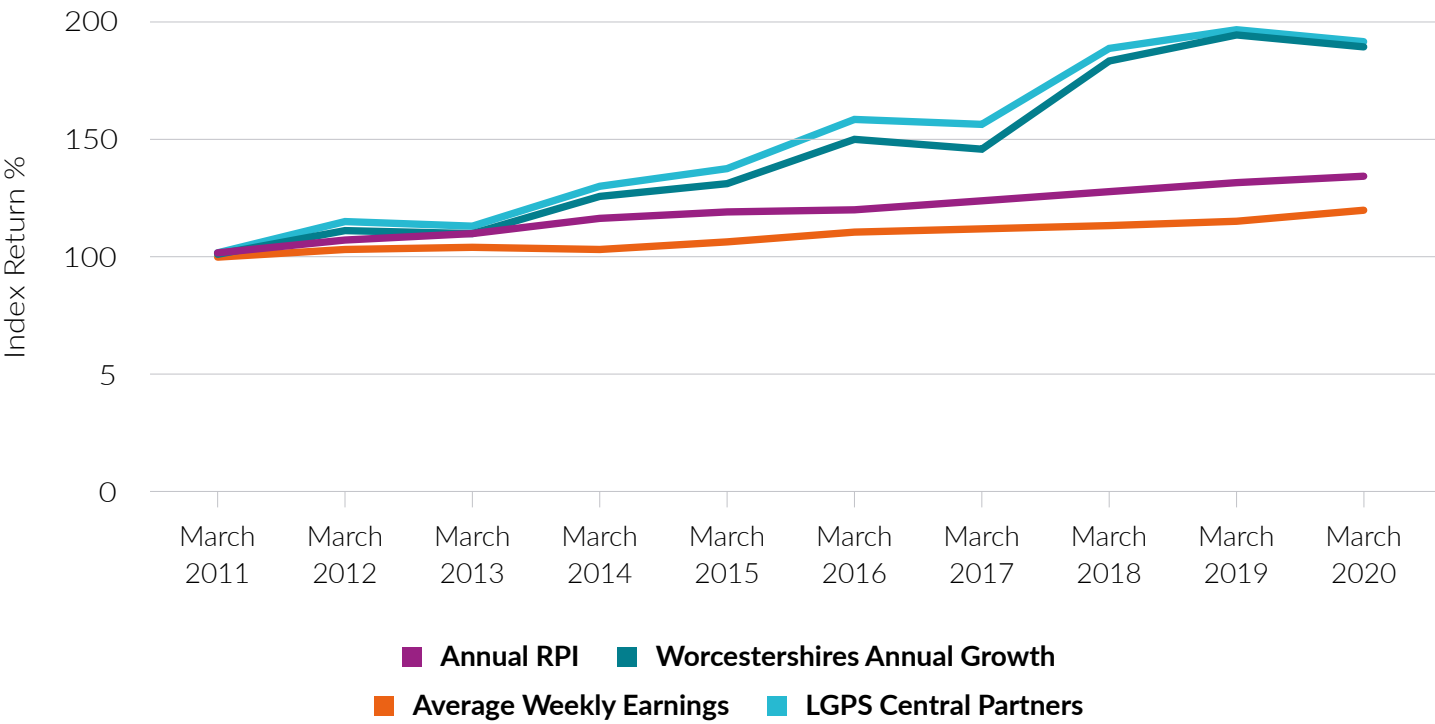
Comparison of Average Annual Performance of the Fund with the LGPS Central Fund’s Median Return and the Funds Composite Index Benchmark



The following chart tracks the cumulative impact of long-term Fund performance since 2009/10 relative to the following key measures, the West Midlands Local Authority Universe, the Retail Prices Index (RPI) and annual average weekly earnings.

Funds Annual Growth Compared to Retail Price Index, National Average Weekly Earnings and WM Local Authority Universe Returns

2010/11 = 100



Investment Fees

The Fund generally has an ad-valorem fee scale applied in respect of the investment management services it receives. This is generally accepted practice for passive tracking mandates and is easily understood. A performance related fee basis is sometimes set. However, if it is believed to be in the overall financial interests of the Fund, particularly for active mandates where higher fees are paid for more consistent outperformance of market indices. The approach taken varies depending on the type of investment and the target being set.

The Fund is required to report in line with the CIPFA requirements under the Transparency Code and requires its investment managers to provide sufficient information to fulfil this requirement. Further detailed work is being undertaken in 2019/20. The table below shows the fees paid to managers in each asset class.

| | Management Fees £000 | Performance & Other Fees £000 | Total Fees £000 |
|-----------------------------------|----------------------|-------------------------------|-----------------|
| Fixed interest Securities | 296 | 0 | 296 |
| Equities | 2,624 | 0 | 2,624 |
| Pooled Investment Vehicles | 572 | 0 | 572 |
| Pooled Property Investments | 1,310 | 0 | 1,310 |
| Pooled Infrastructure Investments | 7,272 | 0 | 7,272 |
| Private Debt | 477 | 0 | 477 |
| Pool Company | 665 | 0 | 665 |
| Other | 320 | 0 | 320 |
| TOTAL FUND | 13,536 | 0 | 13,536 |

Custodial Arrangements

Custody of the Fund's assets is provided by the Global Custodian, BNY Mellon Asset Servicing.

In addition to the custodian's role in the safe-keeping of the Fund's total assets, the custodian also provides settlement and income collection services, the exercise of voting rights and the execution of corporate actions in conjunction with the investment managers. The appointment of a global custodian also secures an independent confirmation of the Fund's assets and their value.

Asset Pooling

The Fund is a partner Fund of LGPS Central Limited (LGPSC) pool. During 2019/2020 emerging market and corporate bond assets were transitioned to LGPSC and costs were incurred by all the partner Funds under a cost sharing agreement with our contribution being as follows:

Governance, Operator and Product Development Charged by LGPSC to Partner Fund

| | At 1 April 2019 £000 | Recharges in Year £000 | Settled in Year £000 | At 31 March 2020 £000 |
|---------------------------|-------------------------|---------------------------|-------------------------|--------------------------|
| Governance Costs | 16 | 216 | (192) | 40 |
| Operator Costs | 23 | 296 | (209) | 110 |
| IMMC | 0 | 21 | (9) | 12 |
| Product Development Costs | 6 | 85 | (59) | 32 |
| Sub Total | 45 | 618 | (469) | 194 |
| ACS | 0 | 0 | 0 | 0 |
| LP | 0 | 0 | 0 | 0 |
| Pensions Entry Debt | 24 | 0 | (24) | 0 |
| Other Recharges | 0 | 23 | (23) | 0 |
| Total | 69 | 641 | (516) | 69 |

Statement of Responsible Investment

The Fund is a long-term investor aiming to deliver a sustainable pension fund for all stakeholders.

Worcestershire County Council as the administering authority has a fiduciary duty to act in the best long-term interests of the Fund’s employers and scheme members. The Fund believes that in order to fulfil this duty, it must have a clear policy on how it invests in a responsible manner.

Responsible investment is a fundamental part of the Fund’s overarching investment strategy as set out in the Investment Strategy Statement. That is, to maximise returns subject to an acceptable level of risk whilst increasing certainty of cost for employers and minimising the long-term cost of the LGPS. The Fund believes that consideration of environmental, social and corporate governance (ESG) factors are fundamental to this, particularly where they are likely to impact on the overarching investment objective.

The Fund is committed to ensuring that the companies in which it invests have good corporate governance, adopt a responsible attitude towards the environment and adopt high ethical standards.

The Fund’s approved policy on responsible investment is contained within its Investment Strategy Statement which is appended to this document.

Policies Adopted

The Fund adopts a positive engagement with the companies in which it invests engagement in order to promote high standards of corporate governance. It believes that this will help to raise standards across all markets and that this is in the long-term interests of the Fund and its stakeholders.

Investment performance is monitored on a quarterly basis and the Fund expects investment managers to engage with companies to address concerns affecting performance.

The Fund believes that the greatest impact on behaviour can be achieved when working together with others. It is a member of the Local Authorities Pension Fund Forum (LAPFF), to enable it to act collectively with other local authorities on corporate governance issues. The Forum currently has over 70 member Funds representing assets of more than £200 billion. LAPFF’s mission is to protect the long-term investment interests of beneficiaries by promoting the highest standards of corporate governance and corporate responsibility amongst investee companies.

The Fund continues to exercise its ownership rights by adopting a policy of voting stocks it holds. The Fund made a decision earlier in the year that it would be beneficial for Worcestershire Pension Fund to take the voting decisions away from our active fund managers and have the votes executed in line with LGPS Central Limited’s voting principles which were in line with our own. This enabled improved monitoring and reporting to the Pensions Committee. Wherever practicable votes must be in accordance with industry best practice as set out in the combined code of corporate governance with a clear focus on enhancing long-term shareholders value.

In order to ensure that the governance practices employed by the Fund’s investment managers are aligned to that of the Fund, investment managers’ quarterly performance reports are required to include specific briefing in corporate governance detailing all votes cast on the Fund’s behalf as detailed in the table below.

| Resolutions | Total | % |
|---------------------------------|-------|-----|
| Votes Cast in Favour | 458 | 57 |
| Votes Cast Against or Abstained | 348 | 43 |
| Total number of Resolutions | 806 | 100 |

| Company Engagement by Region | Total | % |
|-----------------------------------|-------|-----|
| Environmental | 35 | 28 |
| Social and Ethical | 27 | 21 |
| Governance | 31 | 24 |
| Strategy, Risk and Communications | 35 | 27 |
| Total number of Resolutions | 128 | 100 |

Note the 2 tables above only cover the last 3 quarters of 2019/2020 when transfer to LGPS Central was conducted.

Statement of Compliance with the UK Stewardship Code for Institutional Investors

The introduction of the Stewardship Code in July 2010 by the Financial Reporting Council strongly encouraged best practice in respect of investor engagement. The expectation is that institutional investors should publish a statement in respect of their adherence to the Code. Compliance with the Code is currently on a voluntary basis and we have completed our **Statement of Compliance** in line with the UK Stewardship Code for Institutional Investors. All our global equity managers comply fully with the Code.

7. Governance Arrangements



7. Governance Arrangements

Our governance arrangements take account of:

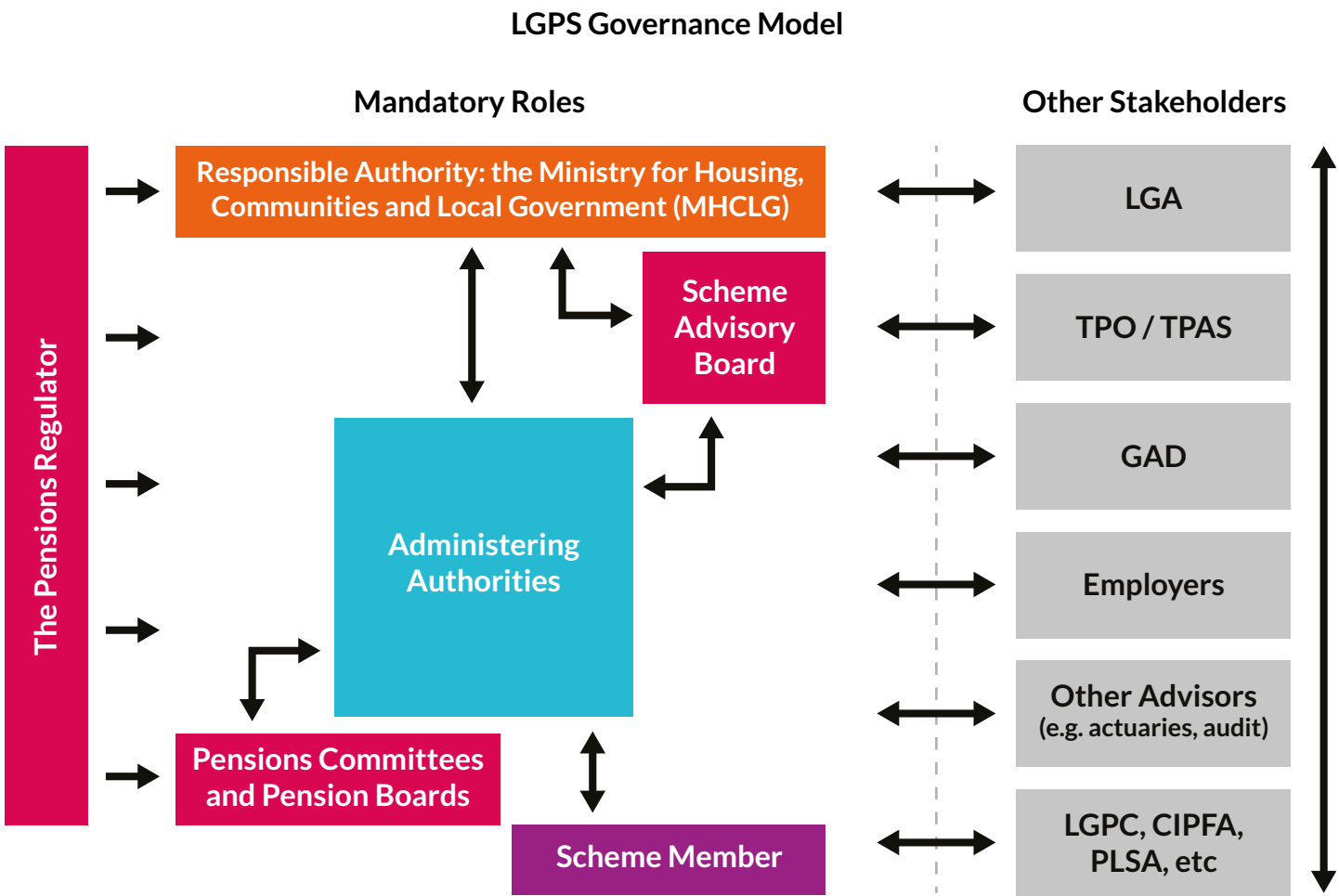
- The way in which the LGPS is governed.
- The governance arrangements of LGPS Central Limited.
- The guidance issued by The Pensions Regulator.

Overall responsibility for managing the Fund lies with the full council of Worcestershire County Council who have delegated the management and administration of the Fund to the Section 151 Officer. The full council reviews the discharge of its responsibilities through the Council’s Audit and Governance Committee. The Pension Board assists the Council to deliver efficient governance and administration of the Fund’s responsibilities through the Council’s Audit and Governance Committee.

The Section 151 Officer is advised by the Pensions Committee and also takes appropriate advice from the Fund actuary and the Fund’s appointed investment advisor. The Pensions Committee receives recommendations from the Pension Investment Sub-Committee to enable it to discharge its responsibilities effectively. The current governance arrangements and terms of reference for the Pensions Committee and the Pension Investment Sub-Committee have been updated to take on board LGPS Central Limited and details are contained in our [Governance Policy Statement](#).

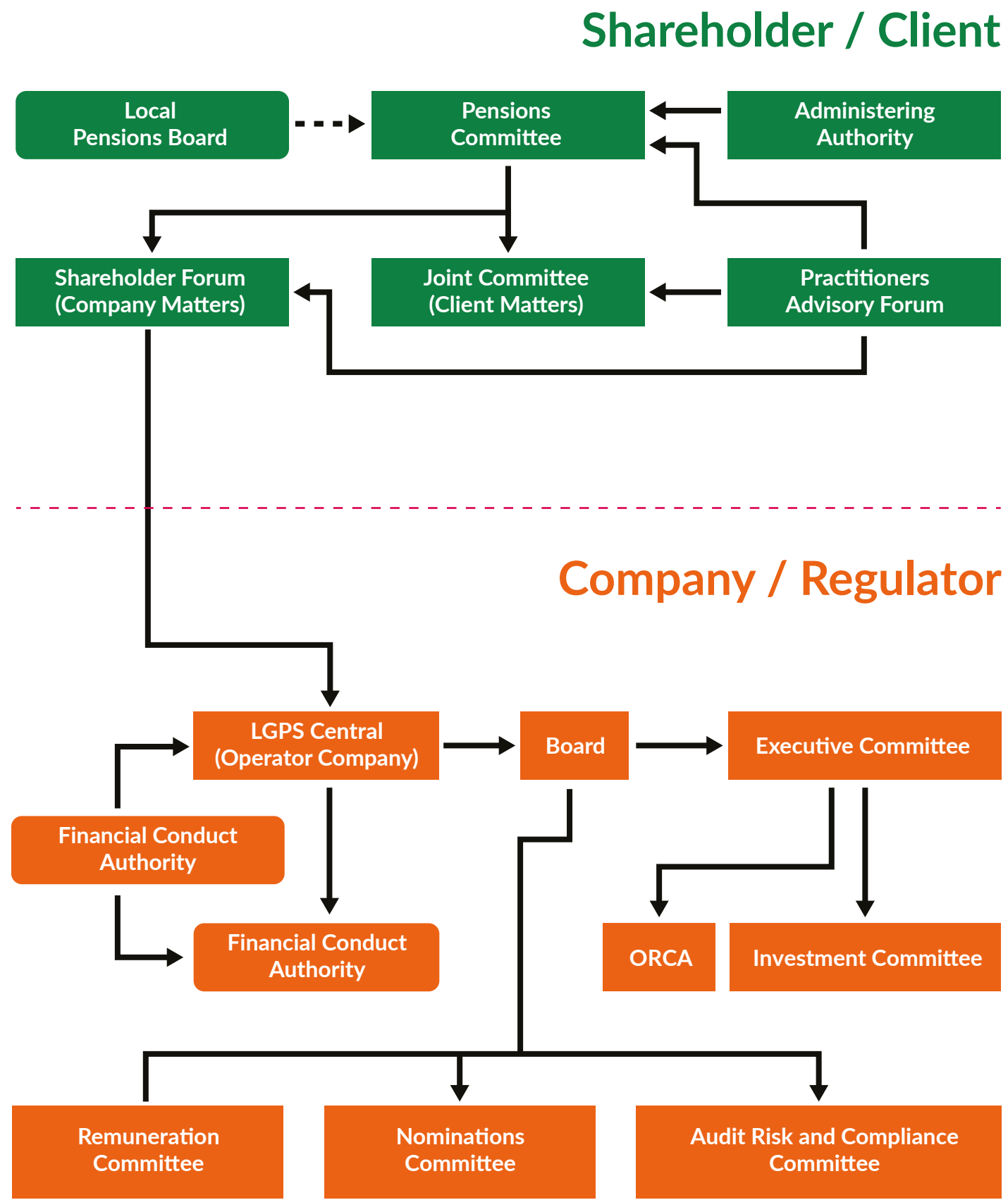
The formation of LGPS Central Limited on 1 April 2018 impacts on the roles of the Pensions Committee and the Pension Investment Sub-Committee.

However, the impact will be gradual as the transfer of the management activity to the new company progresses. Consequently, the existing governance arrangements and terms of reference run concurrently with new terms required to facilitate changes.

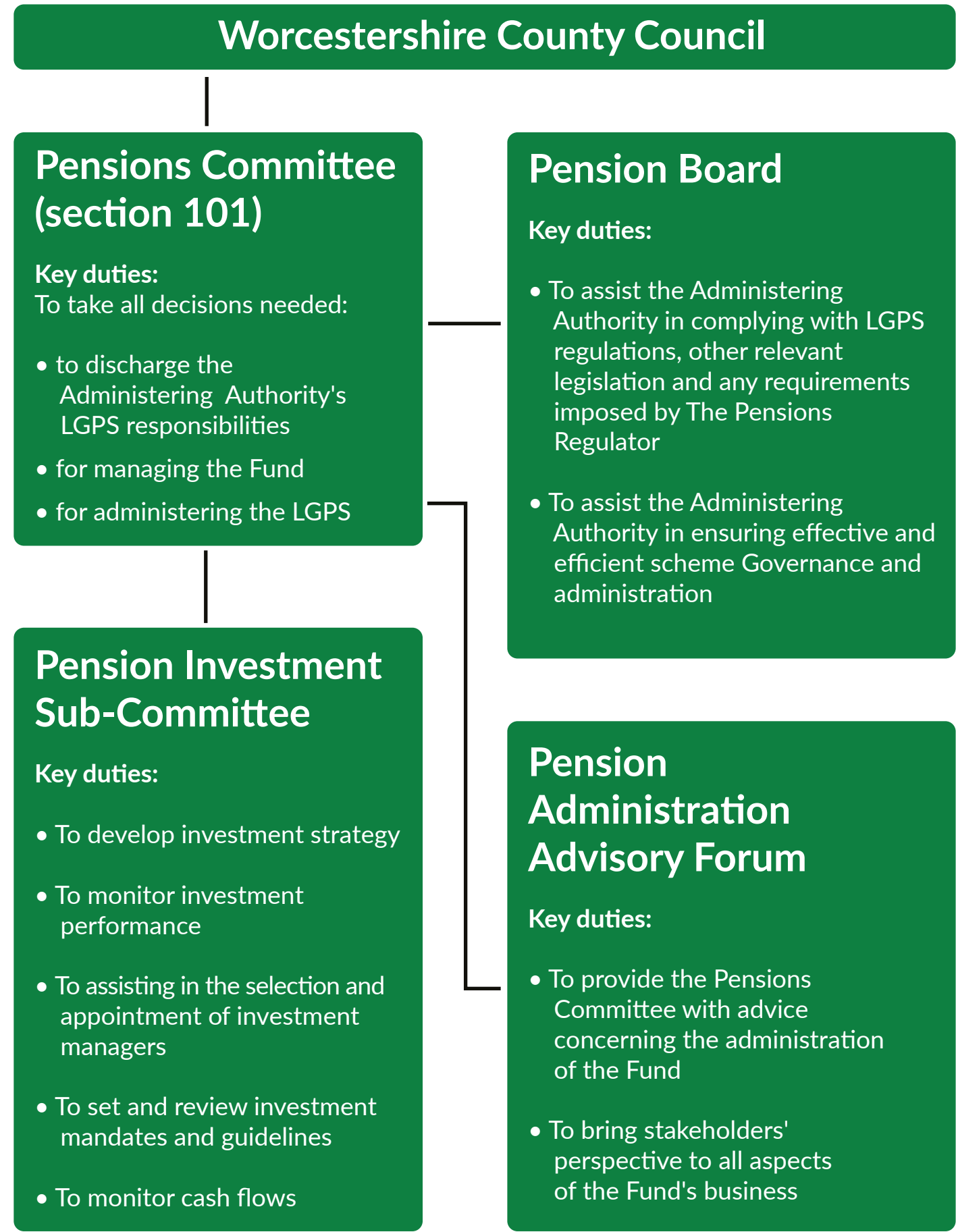


LGPS Central Limited

In collaboration with eight other Local Authorities (Cheshire, Leicestershire, Shropshire, Staffordshire, West Midlands, Derbyshire, Nottinghamshire, and West Midlands Integrated Transport Authority) we plan to pool actively managed assets using LGPS Central Limited using the following governance model.



Worcestershire Pension Fund Governance



8. Governance Compliance Statement



8. Governance Compliance Statement

| Ref | Principles | Compliance Status | Evidence of Compliance |
|-----|---|-------------------|---|
| A | Structure | | |
| a. | That the management of the administration of benefits and strategic management of Fund assets clearly rests with the main committee established by the appointing council. | Compliant | The responsibilities of the Pensions Committee (PC) and its Sub-Groups are set out in the Fund's Governance Policy Statement. The Governance Policy Statement was approved by Full Council. |
| b. | That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee. | Compliant | The Pensions Committee membership includes an employee and employer representative. Full membership details are set out in the Fund's Governance Policy Statement. |
| c. | That where a secondary committee or panel has been established, the structure ensures effective communication across both levels. | Compliant | The Pension Investment Sub-Committee provides strategic advice to the Pensions Committee regarding the management of the Fund's assets. The Chairman of the Pensions Committee also sits on the Pension Investment Sub-Committee to ensure effective communication. The Pensions Committee receives quarterly investment updates from the Pension Investment Sub-Committee. An Administration forum has been established. The employer and employee representatives from the Pensions Committee attend the Forum and there is a standing invitation to the Pension Board to attend the Forum. |

| Ref | Principles | Compliance Status | Evidence of Compliance |
|----------|---|-------------------|--|
| B | Representation | | |
| a. | <p>That all key stakeholders have the opportunity to be represented within the main or secondary committee structure. These include:</p> <ul style="list-style-type: none"> i) employing authorities (including non-scheme employers, e.g., admitted bodies) ii) scheme members (including deferred and pensioner scheme members) iii) where appropriate, independent professional observers, and iv) expert advisers (on an ad-hoc basis). | Compliant | <p>Membership of the Pensions Committee and Pension Investment Sub-Committee include employer and employee representatives and an independent investment adviser. Full membership details are set out in the Fund's Governance Policy Statement.</p> <p>Expert advisors attend the Pensions Committee as required for the nature of the main decisions. For example, the Actuary attends when the valuation is being considered, and the main Investment Consultant attends when the Strategic Asset Allocation decision is being made. The Investment Consultant regularly attends the Pensions Investment Sub-Committee meeting.</p> <p>All members are treated equally in terms of access to papers and to training that is given as part of the committee process.</p> |
| C | Selection and role of lay members | | |
| a. | That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee. | Compliant | The Pensions Committee has noted its terms of reference and the Fund's Governance Policy Statement. Minutes of the Pensions Committee meetings are published on the Council's website. A detailed Training programme is also provided to committee members and Pensions Investment Sub-Committee members. |
| b. | That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda. | Compliant | Declaration of interests is a standing agenda item at the start of all Pensions Committee meetings. The Pensions Committee and Pensions Investment Sub-Committee are serviced by Legal and Democratic Services who invite members to declare any financial or pecuniary interest related to specific matters on the agenda. Minutes of the Pensions Committee and Pensions Investment Sub-Committee meetings are published on the Council's website. |

| Ref | Principles | Compliance Status | Evidence of Compliance |
|----------|---|-------------------|---|
| D | Voting | | |
| a. | That the individual administering authorities on voting rights are clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees. | Compliant | Voting rights are clearly set out in the Fund's Governance Policy Statement. |
| E | Training/facility time / expenses | | |
| a. | That in relation to the way in which the administering authority takes statutory and related decisions, there is a clear policy on training, facility time and reimbursement of expenses for members involved in the decision-making process. | Compliant | A policy on expenses is set out in the Fund's Governance Policy Statement along with the number of Committee meetings required each year. The Fund has an approved Joint Training Policy for the Pensions Committee, Investment Sub-Committee and the Local Pension Board. |
| b. | That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum. | Compliant | These policies apply to all committee members and this is clearly set out in the Fund's Governance Policy Statement, Knowledge and Skills Policy Statement & the Joint Training Policy for the Pensions Committee, Pensions Investment Sub-Committee and the Local Pension Board. |
| c. | That the administering authority considers adopting annual training plans for committee members and maintains a log of all such training undertaken. | Compliant | The Fund's Knowledge and Skills Policy Statement sets out the requirement for annual training plans to be developed and maintained for committee members and for a log of all such training undertaken to be maintained. Regular feedback on training events is provided to Pensions Committee. |

| Ref | Principles | Compliance Status | Evidence of Compliance |
|----------|--|-------------------|---|
| F | Meetings (frequency/quorum) | | |
| a. | That an administering authority's main committee or committees meet at least quarterly. | Compliant | The Pensions Committee meets quarterly. This requirement is set out in the Fund's Governance Policy Statement. |
| b. | That an administering authority's secondary committee or panel meets at least twice a year and is synchronised with the dates when the main committee sits. | Compliant | The Pensions Investment Sub-Committee meets quarterly. These meetings are synchronised with the dates when the Pensions Committee sits. These requirements are set out in the Fund's Governance Policy Statement. The Pensions Administration Advisory Forum meets twice a year. |
| c. | That an administering authority that does not include lay members in its formal governance arrangements must provide a forum outside of those arrangements to represent the interests of key stakeholders. | Compliant | The Fund has established a Pensions Administration Advisory Forum which meets twice yearly. All Fund employers are invited to attend the Forum meetings. The Forum arrangement and terms of reference are set out in the Fund's Governance Policy Statement. |
| G | Access | | |
| a. | That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that are due to be considered at meetings of the main committee. | Compliant | All members of the Pensions Committee, Pension Investment Sub-Committee and the Pensions Administration Advisory Forum have equal access to committee papers, documents and advice that are due to be considered at meetings of the main committee. The Pensions Committee agendas and associated papers are published on the Council's website prior to the committee meeting. |

| Ref | Principles | Compliance Status | Evidence of Compliance |
|----------|---|-------------------|---|
| H | Scope | | |
| a. | That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements. | Compliant | The Pensions Administration Advisory Forum which meets twice yearly is also attended by the employer and employee representatives who sit on the Pensions Committee. This ensures flow of information between the wider scheme employers and the main committee. Scheme employers are invited to bring wider scheme issues to the attention of the Pensions Committee through the established communication routes. |
| I | Publicity | | |
| a. | That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in how the scheme is governed can say they want to be part of those arrangements. | Compliant | The Fund's Governance Policy Statement is published on the Council's website and all scheme employers are invited to attend the Pensions Administration Advisory Forum meetings. The Fund ran an open recruitment process for the employer and employee representative appointments to the now established Pension Board. Contact details are provided in the Communications Policy and in the Annual Report, as well as on the website, so other interested parties can find out more if they wish. |

9. Local Pension Board Annual Report



9. Local Pension Board Annual Report

The Public Services Pensions Act 2013 required the administering authority for each Local Government Pension Scheme (LGPS) Fund in England and Wales to establish a Pension Board.

The role of the Pension Board is to assist the administering authority to secure compliance with LGPS regulations and other legislation relating to the governance and administration of the Fund, together with any requirements imposed by the Pensions Regulator. In short, the Board's role is to ensure the effective and efficient governance and administration of the Fund.

The regulations require the membership of the Board to be made up of equal numbers of employer and scheme member representatives with a minimum of four members i.e. at least two employer representatives and two employee representatives. The employee representatives on the Board must be independent of the Fund – that is to say they must have no involvement with the day to day management of the Fund.

The membership of the Pension Board and how often the Board met during 2019/20 is detailed on page 7 of this report. A review of the existing Pension Board was undertaken and agreed at Pensions Committee in October 2019 when the existing Chair of the Pension Board stepped down. The constitution of the revised Board took longer than anticipated which resulted in no further Pension Boards being undertaken during 2019/20.

During the year the Board's work programme has covered the following areas:

Board meeting – 27 September 2019

The Board received and discussed information relating to:

- The Pension Board final accounts and annual report.
- Update on Fund transition arrangements with LGPS Central.
- Progress relating to the Guaranteed Members Pension (GMP) reconciliation.
- A review of the Pension Fund Risk register.
- A review of the business plan key performance targets and outputs.
- An update on the McCloud judgement by the Supreme Court.

Board meeting – 25 April 2019

The Board received and discussed information relating to:

- The Pension Board administration report identifying its key performance targets and outputs and key areas for consideration.
- Pension governance arrangements and policy review.
- Initial strategic asset allocation review.
- Training programme and evaluation of training events that had taken place.
- Update on Fund transition arrangements with LGPS Central.
- Pension Fund business strategy 2020 to 2023.
- A review of the Pension Fund Risk register.

10. Statement of Accounts 2019/20



10. Statement of Accounts 2019/20

Fund Account (money received and spent during 2019/20)

| 2018/19 | | 2019/20 | |
|--|---|-----------|----------------|
| £m | Total | Notes | £m |
| Dealings with members, employers and others directly involved with the Fund | | | |
| 81.8 | Contributions | 4 | 87.5 |
| 12.9 | Transfers in from other Pension Funds | 5 | 12.9 |
| 94.7 | | | 100.4 |
| (106.3) | Benefits | 6 | (111.9) |
| (8.7) | Payments to and on account of leavers | 7 | (11.2) |
| (115.0) | | | (123.1) |
| (20.3) | Net additions/(withdrawals) from dealings with members | | (22.7) |
| (1.1) | Administrative expenses | 8 | (1.5) |
| (12.0) | Management expenses | 9 | (14.5) |
| 33.4 | Net additions/(withdrawals) including Fund management and administrative expenses | | (38.7) |
| Returns on investments | | | |
| 51.7 | Investment income | 10 | 48.6 |
| (1.5) | Taxes on income | 11 | (0.7) |
| 77.5 | Profit and losses on disposal of investments and changes in the market value of investments | 12a & 15b | (159.1) |
| 127.7 | Net return on investments | | 111.2 |
| 94.3 | Net increase/(decrease) in the net assets available for benefits during the year | | (149.9) |
| 2,701.0 | Opening net assets | | 2,795.3 |
| 2,795.3 | Closing net assets | | 2,645.4 |

Management expenses have increased mainly due to disinvesting some existing passive equity funds into infrastructure and property funds which by their nature have larger management fees. The decrease in market valuations is mainly due to the impact of Covid-19.

Net Assets Statement for the year ended 31 March 2020 (showing the financial position at 31 March 2019 and 2020)

| 2018/19 | | | 2019/20 |
|---------|--|---------|---------|
| £m | Total | Notes | £m |
| 1.4 | Long-term Investment Assets | 12 | 1.4 |
| 2,753.1 | Investment Assets | 12 & 13 | 2,180.1 |
| | Investment Assets – LGPS Central Managed | | 428.8 |
| 32.9 | Cash Deposits | 12 | 25.5 |
| 2,787.4 | | | 2,635.8 |
| (29.0) | Investment Liabilities | 12 | (21.4) |
| 39.2 | Current Assets | 17 | 35.3 |
| 1.5 | Non-Current Assets | 18 | 2.0 |
| (3.8) | Current Liabilities | 19 | (6.3) |
| 2,795.3 | Net Assets | | 2,645.4 |

These financial statements do not take into account liabilities to pay pensions and other benefits after the period end. The actuarial present value of promised retirement benefits (determined in accordance with IAS 19) is disclosed in the actuarial statement (note 2 to the accounts). Note 14 to the accounts provide details on the fair value of assets.

Financial assets are included in the net assets statement above on a fair value basis as at the reporting date apart from those financial instruments that are held solely for the payments of principal and interest (SPPI) such as cash and debtors which are measured at amortised cost. 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 asset are recognised in the Fund account. The values of investments as shown in the net assets statement have been determined as follows:

- i) For market-quoted investments the value of an investment for which there is a readily available market price is determined by the bid market price ruling on the final day of the accounting period.
- ii) Fixed interest securities are recorded at net market value based on their current yields.
- iii) For unquoted investments the fair value of investments for which market quotations are not readily available is determined as follows:

- a. Valuations of delisted securities are based on the last sale price prior to delisting, or where subject to liquidation, the amount the Fund expects to receive on wind-up, less estimated realisation costs.
 - b. Securities subject to takeover offer – the value of the consideration offered under the offer, less estimated realisation costs.
 - c. Directly held investments include investments in limited partnerships, shares in unlisted companies, trusts and bonds/other unquoted securities typically including pooled investments in property, infrastructure, debt securities and private equity – the valuation of these pools or of directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The valuation standards followed in these valuations adhere to industry guidelines or to standards set by the constituent documents of the pool or the management agreement.
 - d. Investments in unquoted property and infrastructure pooled funds are valued at the net asset value or a single price advised by the Fund manager.
 - e. Investments in unquoted listed partnerships are valued based on the Fund’s share of the net assets in the limited partnership using the latest financial statements published by the respective Fund managers in accordance with the International Private Equity and Venture Capital Valuation Guidelines 2012.
- iv) Limited partnerships – fair value is based on the net asset value ascertained from periodic valuations provided by those controlling the partnership.
 - v) Pooled investment vehicles are valued at closing bid price if both bid and offer prices are published; or if single priced, at the closing single price. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income, which is reinvested in the Fund, net of applicable withholding tax.

Financial Liabilities

The Fund recognises financial liabilities at fair value as at the reporting date apart from those financial instruments that are held solely for the payments of principal and interest (SPPI) such as cash and debtors which are measured at amortised cost. 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 or amortised cost of the liability are recognised by the Fund.

Notes to the Accounts (providing additional information for the Fund Account and Net Assets Statement)

These now comprise of a summary of significant accounting policies (shown against the relevant note as opposed to a prescribed list of accounting policies in previous year’s accounts). Further information and detail of entries in the prime statements and other explanatory information and disclosures are as follows:

NOTE 1: DESCRIPTION OF FUND

a) General

The Fund is administered by Worcestershire County Council on behalf of their own employees, those of the Herefordshire Council and the region’s district councils/academies and admitted bodies. Teachers, police officers, and fire fighters have their own public service pension schemes.

In matters relating to the management of the Fund’s assets the Pensions Committee is advised in

relation to asset allocation decisions and the monitoring of external managers’ performance by the Pension Investment Sub-Committee, which includes an independent investment adviser and the scheme manager. The Pensions Committee consists of County Councillors and an employer and an employee representative. Formal monitoring takes place on a quarterly basis through meetings with investment managers to discuss their performance. Asset allocation is reviewed at least annually, and pension administration issues are discussed quarterly at the Pension Administration Advisory Forum with any resulting recommendations considered by the Pensions Committee. The day to day management of the Fund’s investments is divided between external investment managers who operate in accordance with mandates set out in the Investment Strategy Statement.

b) Membership

Membership of the LGPS is voluntary and employees are free to choose to join the scheme, remain in the scheme or make their own personal arrangement outside the scheme. Organisations participating in Worcestershire County Council Pensions Fund include the following:

- Scheduled bodies which are automatically entitled to be members of the Fund. These include county councils, district councils, foundation schools/colleges and academies.
- Admitted bodies, which participate in the Fund under the terms of an admission agreement between the Fund and the employer. Admitted bodies include voluntary, charitable and similar not for profit organisations, or private contractors undertaking a local authority function following outsourcing to the private sector.
- Designated bodies which are organisations that have passed resolutions with town or parish councils.

Membership details are set out below:

| | 31 March 2019 | 31 March 2020 |
|---|---------------|---------------|
| Number of employers | 196 | 202 |
| Employee Members of the Fund | | |
| County Council | 8,256 | 7,653 |
| Other Employers | 15,180 | 15,480 |
| Total | 23,436 | 23,133 |
| Pensioner Members of the Fund | | |
| County Council | 5,240 | 5,565 |
| Other Employers | 12,849 | 13,352 |
| Total | 18,089 | 18,917 |
| Deferred Members of the Fund | | |
| County Council | 8,379 | 8,602 |
| Other Employers | 12,350 | 12,983 |
| Total | 20,729 | 21,585 |
| Total Number of Membership Records | 62,254 | 63,635 |

c) Funding

Benefits are funded by contributions and investment earnings. Contributions are made by employee members of the Fund in accordance with the LGPS Regulations 2013 and range from 5.5% to 12.5% of pensionable pay for the financial year ending March 2020. Employer contributions are set based on actuarial valuations. The last valuation conducted was at 31 March 2019 which will take effect from the 1 April 2020 onwards. Currently, employer contribution rates range from 5.5% to 41.9% of pensionable pay based on the valuation undertaken as at the 31 March 2016. The common 2019/20 employer contribution rate for the Fund is 15.3%. To ensure employer contribution increases, required by the Fund’s Actuary following the 31 March 2013 actuarial valuation, remained affordable, the Administering Authority agreed with employers to phase in any increases in their Secondary rate over a period of up to 6 years.

d) Pension Benefits

Prior to 1 April 2014 pension benefits under the LGPS were based on final pensionable pay and length of pensionable service. 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 updated annually in line with the Consumer Prices Index.

A range of other benefits are also provided including early retirement, disability pensions and death benefits, as explained on the [LGPS website](#).

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 the International Accounting Standard (IAS) 19 and relevant actuarial standards.

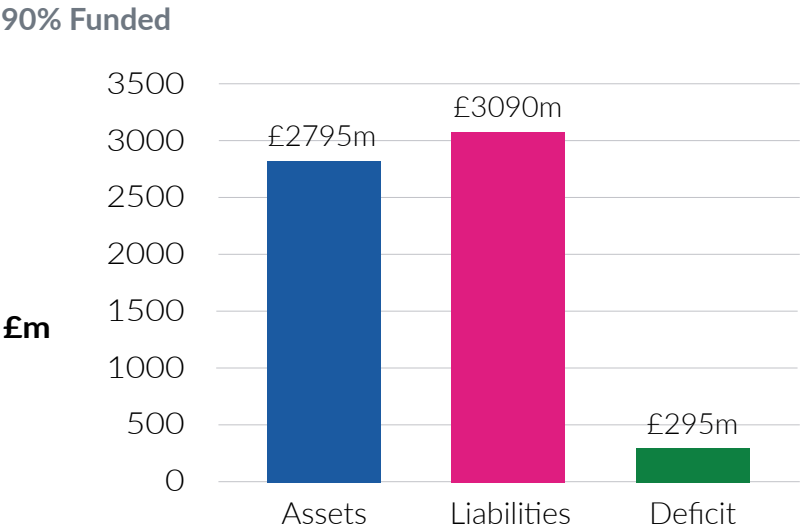
As permitted under the code, the Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statement (Note 2 below).

NOTE 2: FUNDING ARRANGEMENTS AND ACTUARIAL PRESENT VALUE OF PROMISED RETIREMENT BENEFITS

Funding Arrangements

This statement has been provided to meet the requirements under Regulation 57(1)(d) of The Local Government Pension Scheme Regulations 2013. An actuarial valuation of the Worcestershire Pension Fund was carried out as at 31 March 2019 to determine the contribution rates with effect from 1 April 2020 to 31 March 2023.

Based on the assumptions adopted, the Fund’s assets of £2,795 million represented 90% of the Fund’s past service liabilities of £3,090 million (the ‘Solvency Funding Target’) at the valuation date. The deficit at the valuation was therefore £295 million.



The valuation also showed that a Primary contribution rate of 17.5% of pensionable pay per annum was required from employers. The Primary rate is calculated as being sufficient, together with contributions paid by members, to meet all liabilities arising in respect of service after the valuation date.

The funding objective as set out in the FSS is to achieve and maintain a solvency funding level of 100% of liabilities (the solvency funding target). In line with the FSS, where a shortfall exists at the effective date of the valuation a deficit recovery plan will be put in place which requires additional contributions to correct the shortfall. Equally, where there is a surplus it is usually appropriate to offset this against contributions for future service, in which case contribution reductions will be put in place to allow for this.

The FSS which can be found on the Fund's website, sets out the process for determining the recovery plan in respect of each employer and takes on board all relevant assumptions such as: demography, commutation, short term pay increases, RPI/CPI). At this actuarial valuation the average recovery period adopted is 15 years, and the total initial recovery payment (the 'Secondary rate' for 2020-2023) is an addition of approximately £28m per annum in £ terms (which allows for the contribution plans which have been set for individual employers under the provisions of the FSS).

Further details regarding the results of the valuation are contained in the formal report on the actuarial valuation dated 31 March 2020.

In practice, each individual employer's position is assessed separately, and the contributions required are set out in the report. In addition to the certified contribution rates, payments to cover additional liabilities arising from early retirements (other than ill-health retirements) will be made to the Fund by the employers.

The funding plan adopted in assessing the contributions for each individual employer is in accordance with the Funding Strategy Statement (FSS). Any different approaches adopted, e.g. regarding the implementation of contribution increases and deficit recovery periods, are as determined through the FSS consultation process.

The valuation was carried out using the projected unit actuarial method and the main actuarial assumptions used for assessing the Solvency Funding Target and the Primary rate of contribution were as follows:

| | For past service liabilities (Solvency Funding Target) | For future service liabilities (Primary rate of contribution) |
|---|--|---|
| Rate of return on investments (discount rate) | 4.05% per annum | 4.65%** per annum |
| Rate of pay increases (long-term)* | 3.9% per annum | 3.9% per annum |
| Rate of increases in pensions in payment (in excess of GMP) | 2.4% per annum | 2.4% per annum |

* allowance was also made for short-term public sector pay restraint over a 4-year period.

**This is the discount rate for the 'growth pot' and applies to most of the employers. Certain employers have a more cautious investment strategy, and so a lower discount rate.

The assets were assessed at market value. The next triennial actuarial valuation of the Fund is due as at 31 March 2022. Based on the results of this valuation, the contribution rates payable by the individual employers will be revised with effect from 1 April 2023.

The McCloud Judgment

The 'McCloud judgment' refers to a legal challenge in relation to historic benefit changes for all public sector schemes being age discriminatory. The Government announced in 2019 that this needs to be remedied for all public sector schemes including the LGPS. This is likely to result in increased costs for some employers. This remedy is not yet agreed but guidance issued requires that each Fund sets out its policy on addressing the implications.

In line with guidance issued by the LGPS Scheme Advisory Board, the above funding level and Primary contribution rate do not include an allowance for the estimated cost of the McCloud judgment. However, at the overall Fund level we estimate that the cost of the judgment could be an increase in past service liabilities of broadly £29 million and an increase in the Primary Contribution rate of 0.6% of Pensionable Pay per annum.

Where the employer has elected to include a provision for the cost of the judgment, this is included within the secondary rate for that employer (and also within the whole Fund secondary rate of £28 million per annum shown above).

Impact of Covid-19

The valuation results and employer contributions above were assessed as at 31 March 2019. In 2020 we have so far seen significant volatility and uncertainty in markets around the world in relation to the Covid-19 pandemic. This potentially has far-reaching consequences in terms of funding and risk, which will need to be kept under review. We believe that it is important to take stock of the situation as opposed to make immediate decisions in what is an unprecedented set of events. Our view is that employer contributions should not be revisited but the position should be kept under review by the Administering Authority who will monitor the development of the situation and keep all stakeholders informed of any potential implications so that the outcome can be managed effectively.

Actuarial Present Value of Promised Retirement Benefits for the Purposes of IAS 26

IAS 26 requires the present value of the Fund's promised retirement benefits to be disclosed, and for this purpose the actuarial assumptions and methodology used should be based on IAS 19 rather than the

assumptions and methodology used for funding purposes. To assess the value of the benefits on this basis, we have used the following financial assumptions as at 31 March 2020 (the 31 March 2019 assumptions are included for comparison):

| | 31 March 2019 | 31 March 2020 |
|--|----------------|----------------|
| Rate of return on investments (discount rate) | 2.4% per annum | 2.4% per annum |
| Rate of CPI Inflation/CARE benefits revaluation | 2.2% per annum | 2.1% per annum |
| Rate of pay increases* | 3.7% per annum | 3.6% per annum |
| Rate of increases in pensions in payment (in excess of GMP)/Deferred revaluation | 2.3% per annum | 2.2% per annum |

* This is the long-term assumption. An allowance corresponding to that made at the latest formal actuarial valuation for short-term public sector pay restraint was also included.

The demographic assumptions are the same as those used for funding purposes, with the 31 March 2020 assumptions being updated to reflect the assumptions adopted for the 2019 actuarial valuation. Full details of these assumptions are set out in the formal report on the actuarial valuation dated March 2020.

Corporate bond yields were similar at the start and end of year resulting in the same discount rate of 2.4% p.a. being used for IAS 26 purposes at the year-end as for last year. The expected long-term rate of CPI inflation decreased during the year, from 2.2% p.a. to 2.1%, which served to decrease the liabilities slightly over the year.

The value of the Fund’s promised retirement benefits for the purposes of IAS 26 as at 31 March 2019 was estimated as £4,202 million including the potential impact of the McCloud judgment.

Interest over the year increased the liabilities by c£101 million and allowing for net benefits accrued/ paid over the period also increased the liabilities by c£63 million (this includes any increase in liabilities arising as a result of early retirements/augmentations and the potential impact of GMP Indexation – see comments below). There was also a decrease in liabilities of £159 million due to ‘actuarial gains’ (i.e. the effects of the changes in the actuarial assumptions used, referred to above, and the incorporation of the 31 March 2019 actuarial valuation results into the IAS 26 figures).

The net effect of all the above is that the estimated total value of the Fund’s promised retirement benefits as at 31 March 2020 is therefore £4,207 million. Therefore, based on the IAS 26 assumptions adopted, the IAS 26 balance sheet position at the 31 March 2019 and the 31 March 2020 is as follows:

| | 31 March 2019 | 31 March 2020 |
|---|---------------|---------------|
| | £m | £m |
| Present value of promised retirement benefits | 4,202 | 4,207 |
| Fair value of Fund assets | 2,795 | 2,635 |
| Net Liability | 1,407 | 1,572 |

GMP Indexation

At present, the public service schemes are required to provide full CPI pension increases on GMP benefits for members who reach State Pension Age between 6 April 2016 and 5 April 2021. The UK Government may well extend this at some point in the future to include members reaching State Pension Age from 6 April 2021 onwards, which would give rise to a further cost to the LGPS and its employers. If the Fund were required to index-link GMP benefits in respect of those members who reach their State Pension Age after April 2021, then this would increase the Fund liabilities and we have included an approximate allowance for this within the final IAS 26 liability figure above.

Paul Middleman
Fellow of the Institute and Faculty of Actuaries
Mercer Limited
May 2020

Laura Evans
Fellow of the Institute and Faculty of Actuaries
Mercer Limited
May 2020

NOTE 3: EVENTS AFTER THE REPORTING 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. Events taking place after this date are not reflected in the financial statements or notes. Management have reviewed and can confirm that there are no significant events after the reporting period.

The Covid-19 global pandemic has caused significant uncertainty with regard to national economic conditions and this is likely to impact on the level of funding that local government bodies may receive in future years which will need to be taken into account for employer’s contributions to the Fund.

It is anticipated that the future value of investments may be exposed to increased market volatility as a result of Covid-19 and this may impact on the value of the Fund in the short to medium term; however it is not possible to reliably estimate the financial impact of this on the position and performance of the Fund in future periods.

The Pension Fund Accounts include more specific detail regarding the impact of Covid-19 in the accompanying disclosure notes concerning Funding Arrangements and Accounting Assumptions and the Chief Financial Officer’s foreword.

NOTE 4: CONTRIBUTIONS RECEIVABLE

Normal contributions, both from the members and from employers, are accounted for on an accruals basis at the percentage rate recommended by the Fund’s 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 of 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. The contributions received are detailed below:

| | 2018/19 | 2019/20 |
|--------------------------------|-------------|-------------|
| By Category | £m | £m |
| Employers | | |
| Normal contributions | 36.5 | 39.6 |
| Deficit recovery contributions | 18.8 | 19.0 |
| Augmentation contributions | 3.2 | 4.4 |
| Additional contributions | 0.0 | 0.0 |
| Employees | | |
| Normal contributions | 23.0 | 24.0 |
| Additional contributions | 0.3 | 0.5 |
| | 81.8 | 87.5 |

| | 2018/19 | 2019/20 |
|-------------------------------|-------------|-------------|
| By authority: | £m | £m |
| Worcestershire County Council | 9.4 | 10.0 |
| Scheduled bodies | 58.2 | 63.2 |
| Community admission bodies | 5.4 | 5.9 |
| Transferee admission bodies | 7.8 | 7.5 |
| Designated bodies | 1.0 | 0.9 |
| | 81.8 | 87.5 |

NOTE 5: TRANSFERS IN AND FROM OTHER PENSION FUNDS

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 LGPS regulations. Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged. Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement. The transfers in and from other Pension Funds are as follows:

| | 2018/19 | 2019/20 |
|----------------------|-------------|-------------|
| | £m | £m |
| Individual transfers | 12.9 | 12.9 |
| | 12.9 | 12.9 |

NOTE 6: 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. The benefits paid are as follows:

| | 2018/19 | 2019/20 |
|---|--------------|--------------|
| By category: | £m | £m |
| Pensions | 84.3 | 89.1 |
| Commutations and lump sum retirement benefits | 19.9 | 20.7 |
| Lump sum death benefits | 2.1 | 2.1 |
| | 106.3 | 111.9 |

| | 2018/19 | 2019/20 |
|-------------------------------|--------------|--------------|
| By authority: | £m | £m |
| Worcestershire County Council | 39.1 | 41.7 |
| Scheduled bodies | 55.7 | 57.7 |
| Admitted bodies | 1.7 | 1.6 |
| Community admission bodies | 6.4 | 7.2 |
| Transferee admission bodies | 2.8 | 3.0 |
| Designated bodies | 0.6 | 0.7 |
| | 106.3 | 111.9 |

NOTE 7: PAYMENTS TO AND ON ACCOUNT OF LEAVERS

| | 2018/19 | 2019/20 |
|----------------------|------------|-------------|
| | £m | £m |
| Individual transfers | 8.7 | 11.2 |
| Group transfers | 0.0 | 0.0 |
| | 8.7 | 11.2 |

At year-end there were no potential liabilities in respect of individuals transferring out of the Fund upon whom the Fund is awaiting final decisions.

NOTE 8: ADMINISTRATIVE EXPENSES

All administrative expenses are accounted for on an accruals basis. All staff costs of the Fund's administration team are charged direct to the Fund. Associated management, accommodation and other overheads are apportioned to this activity and charged as expenses to the Fund.

| | 2018/19 | 2019/20 |
|--------------------|------------|------------|
| | £m | £m |
| Employee expenses | 0.6 | 0.6 |
| Support services | 0.1 | 0.1 |
| Actuarial services | 0.4 | 0.8 |
| Other expenses | 0.0 | 0.0 |
| | 1.1 | 1.5 |

The audit fee (included in support services above) for work completed by the Fund's external auditors for the year ended 31 March 2020 was £23,742 1.6% of total admin costs (£19,222 for the year ended 31 March 2019 1.9% of total admin costs). In addition, a non audit service fee of £8,500 included in support services above was incurred relating to IAS19 requirements.

NOTE 9: MANAGEMENT EXPENSES

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 permit costs incurred in connection with the investment and administration of the Fund to be charged against the Fund.

The Code of Practice does not require any breakdown of the Fund's administrative expenses. However in the interests of greater transparency, the Fund discloses its management expenses in accordance with CIPFA guidance *Accounting for Local Government Pension Scheme Management 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.

| | 2018/19 | 2019/20 |
|--|-------------|-------------|
| | £m | £m |
| Oversight and Governance | 0.1 | 0.1 |
| Investment Management Expenses | | |
| Administration, management and custody fees* | 11.9 | 14.4 |
| Other expenses | 0.0 | 0.0 |
| | 12.0 | 14.5 |

NOTE 9A: INVESTMENT MANAGEMENT EXPENSES

Fixed income and equity investment managers' expenses are charged on a percentage basis of the market value of assets under management and therefore increase or reduce as the value of these investments change. Global Custodian fees are agreed in the respective mandate governing their appointment.

The cost of obtaining investment advice from the Fund's Independent Investment Adviser is included in investment management charges. All investment management expenses are accounted for on an accruals basis. The management costs are as follows:

| | 2018/19 | 2019/20 |
|------------------------|-------------|-------------|
| | £m | £m |
| Management fees | 10.7 | 13.4 |
| Custody fees | 0.4 | 0.3 |
| Transaction costs | 0.8 | 0.7 |
| | 11.9 | 14.4 |

The £14.4m investment management expenses incurred in 2019/20 represent 0.55% or 55 basis points (bps) of the market value of the Fund's assets as at 31 March 2020 (0.42% or 42bps 31 March 2019).

The cash for the pooled property investments, pooled infrastructure investment and Equity Protection solution drawdowns were transitioned from the overweight position held in UK passive equities, which have a very low management fee in comparison.

The reason for the investment in pooled property investments and pooled infrastructure investments was to further diversify the Fund's assets whilst maintaining long-term target investment returns. These investments have a J-Curve return profile, so are expected to provide increased returns as the pooled funds mature.

* The Fund has applied CIPFA's guidance 'Accounting for Local Government Pension Scheme Management Costs', which requires external investment management fees and transaction costs to be deducted from asset values (rather than invoiced and paid directly). These are shown gross: the application of the guidance increases management expenses from £12.8 million to £14.5 million for 2019/20 (£9.7 million to £12.0 million for 2018/19). It is important to note that the application of the guidance does not represent an actual increase in costs, or a decrease in the Fund's resources to pay pension benefits.

NOTE 10: INVESTMENT INCOME

Income from equities (dividend income) is accounted for on the date stocks 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.

Income from fixed interest, cash and short-term deposits is accounted for on an accruals basis, using the effective interest rate of the financial institution 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. Income from other investments is accounted for on an accruals basis.

The changes in market value of investments during the year are recognised as income and comprise all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments and unrealised changes in market value.

| | 2018/19 | 2019/20 |
|-----------------------------|---------|---------|
| | £m | £m |
| Fixed interest securities | 14.4 | 2.0 |
| Equity dividends | 23.8 | 25.2 |
| Pooled property investments | 7.3 | 10.4 |

| | 2018/19 | 2019/20 |
|-----------------------------------|-------------|-------------|
| | £m | £m |
| Pooled infrastructure investments | 5.5 | 9.0 |
| Interest on cash deposits | 0.6 | 2.0 |
| Securities lending | 0.1 | 0.0 |
| | 51.7 | 48.6 |

NOTE 11: TAXES ON INCOME

The Fund is a registered public service scheme under section (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 withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a Fund expense as it arises.

| | 2018/19 | 2019/20 |
|----------------------------|--------------|--------------|
| | £m | £m |
| Withholding tax – equities | (1.5) | (0.7) |
| | (1.5) | (0.7) |

NOTE 12: INVESTMENTS

| | Market value 31 March 2019 | Market Value 31 March 2020 |
|---|-------------------------------|-------------------------------|
| | £m | £m |
| Long-term investment assets | | |
| LGPS central shares | 1.4 | 1.4 |
| | | |
| Investment assets – LGPS central managed | | |
| Equities | 0.0 | 285.2 |
| Fixed interest securities | 0.0 | 143.6 |
| | | |
| Investment assets – WPF managed | | |
| Fixed interest securities | 361.5 | 211.2 |
| Equities | 715.7 | 307.9 |
| Pooled investment vehicles | 1,291.0 | 1,126.0 |
| Pooled property investments | 171.8 | 149.8 |

| | Market value 31 March 2019 | Market Value 31 March 2020 |
|-------------------------------------|-------------------------------|-------------------------------|
| | £m | £m |
| Pooled infrastructure investments | 159.4 | 299.1 |
| Pooled debt assets | 12.4 | 38.0 |
| Derivatives – futures | 32.1 | 42.8 |
| Derivatives – forward FX | 0.1 | 0.0 |
| Cash deposits | 32.9 | 25.5 |
| Investment income due | 7.3 | 5.3 |
| Amounts receivable for sales | 1.8 | 0.0 |
| Total investment assets | 2,787.4 | 2,635.8 |
| | | |
| Investment liabilities | | |
| Derivatives – futures | (20.8) | (21.4) |
| Derivatives – forward FX | (2.8) | (0.0) |
| Amounts payable for purchases | (5.4) | (0.0) |
| Total investment liabilities | (29.0) | (21.4) |
| | | |
| Net investment assets | 2,758.4 | 2,614.4 |

NOTE 12A: RECONCILIATION OF MOVEMENTS IN INVESTMENTS AND DERIVATIVES

| | Market value 31 March 2019 | Purchases during the year and derivative payments | Sales during the year and derivative receipts | Change in market value during the year | Market value 31 March 2020 |
|---|-------------------------------------|---|---|--|-------------------------------------|
| | £m | £m | £m | £m | £m |
| Long-term investment assets | | | | | |
| LGPS central shares | 1.4 | 0.0 | 0.0 | 0.0 | 1.4 |
| | 1.4 | 0.0 | 0.0 | 0.0 | 1.4 |
| Investment assets – LGPS central managed | | | | | |

| | Market value 31 March 2019 | Purchases during the year and derivative payments | Sales during the year and derivative receipts | Change in market value during the year | Market value 31 March 2020 |
|--|----------------------------------|---|---|--|-------------------------------------|
| | £m | £m | £m | £m | £m |
| Fixed interest securities | 0.0 | 345.9 | 0.0 | (60.7) | 285.2 |
| Equities | 0.0 | 158.6 | 0.0 | (15.0) | 143.6 |
| | 1.4 | 504.5 | 0.0 | (75.7) | 430.2 |
| | | | | | |
| Investment assets – WPF managed | | | | | |
| Fixed interest securities | 361.5 | 313.4 | (466.1) | 2.4 | 211.2 |
| Equities | 715.7 | 149.8 | (541.6) | (16.0) | 307.9 |
| Pooled investment vehicles | 1,291.0 | 3.8 | (65.4) | (103.4) | 1,126.0 |
| Pooled property investments | 171.8 | 12.6 | (26.2) | (8.4) | 149.8 |
| Pooled infrastructure investments | 159.4 | 203.0 | (78.0) | 14.7 | 299.1 |
| Pooled debt investments | 12.4 | 25.8 | (1.6) | 1.4 | 38.0 |
| | 2,713.2 | 1,212.9 | (1,178.9) | (185.0) | 2,562.2 |
| | | | | | |
| Derivative contracts | | | | | |
| Futures | 11.3 | 74.7 | (83.9) | 19.3 | 21.4 |
| Forward currency contracts | (2.7) | 15.0 | (14.7) | 2.4 | 0.0 |
| | 2,721.8 | 1,302.6 | (1,277.5) | (163.3) | 2,583.6 |
| | | | | | |
| Other investment balances | | | | | |
| Cash deposits | 32.9 | | | 4.2 | 25.5 |
| Investment income due | 7.3 | | | | 5.3 |
| Amounts receivable for sales of investments | 1.8 | | | | 0.0 |
| Amounts payable for purchases of investments | (5.4) | | | | 0.0 |
| Net investment assets | 2,758.4 | | | (159.1) | 2,614.4 |

Prior year comparators:

| | Market value 31 March 2018 | Purchases during the year and derivative payments | Sales during the year and derivative receipts | Change in market value during the year | Market value 31 March 2019 |
|--|----------------------------------|---|---|--|-------------------------------------|
| | £m | £m | £m | £m | £m |
| Long-term Investment Assets | | | | | |
| LGPS Central – AFIM | 0.5 | 0.0 | (0.5) | 0.0 | 0.0 |
| LGPS Central – Shares | 1.4 | 0.0 | 0.0 | 0.0 | 1.4 |
| | 1.9 | 0.0 | (0.5) | 0.0 | 1.4 |
| | | | | | |
| Investment Assets | | | | | |
| Fixed interest securities | 359.8 | 90.9 | (88.3) | (0.9) | 361.5 |
| Equities | 752.5 | 301.8 | (304.5) | (34.1) | 715.7 |
| Pooled investment vehicles | 1,292.0 | 1.7 | (131.3) | 128.6 | 1,291.0 |
| Pooled Property investments | 128.5 | 64.2 | (22.8) | 1.9 | 171.8 |
| Pooled Infrastructure Investments | 96.1 | 77.9 | (16.0) | 1.4 | 159.4 |
| Pooled Debt investments | 0.0 | 15.0 | (2.9) | 0.3 | 12.4 |
| | 2,630.8 | 551.5 | (566.3) | 97.2 | 2,713.2 |
| | | | | | |
| Derivative contracts: | | | | | |
| Futures | 24.5 | 1.4 | (1.3) | (13.3) | 11.3 |
| Forward currency contracts | 1.6 | 13.7 | (7.3) | (10.7) | (2.7) |
| | 2,656.9 | 566.6 | (574.9) | 73.2 | 2,721.8 |
| | | | | | |
| Other investment balances: | | | | | |
| Cash deposits | 27.1 | | | 4.3 | 32.9 |
| Investment income due | 6.5 | | | | 7.3 |
| Amount receivable for sales of investments | 0.7 | | | | 1.8 |
| Amounts payable for purchases of investments | (1.8) | | | | (5.4) |
| Net investment assets | 2,689.4 | | | 77.5 | 2,758.4 |

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year. The changes in purchases and sales in derivatives relate to transactions made within the equity protection strategy maintained by River & Mercantile Transaction costs are not included in the cost of purchases and sale proceeds, as they have been included in Investment Management Expenses as per CIPFA guidance. Transaction costs include costs charged directly to the scheme such as fees, commissions, and other fees. Transaction costs incurred during the 2019/2020 year amounted to £0.7 million, (2018/2019 £0.8 million). These transaction costs represent 0.03% or 3bps of the Market Value of the Fund's assets as at 31 March 2020 (3bps at 31 March 2019).

Indirect costs are incurred through the bid-offer spread on investments within pooled investments vehicles. The amount of indirect costs is not provided separately to the Fund.

NOTE 12B: ANALYSIS OF INVESTMENTS (EXCL. DERIVATIVE CONTRACTS, CASH AND OTHER BALANCES)

| | 31 March 2019 | 31 March 2020 |
|--------------------------------------|---------------|---------------|
| | £m | £m |
| Long-term Investment Assets | | |
| LGPS Central – shares | 1.4 | 1.4 |
| | 1.4 | 1.4 |
| | | |
| Fixed interest securities | | |
| UK Gilts | 220.1 | 211.2 |
| UK corporate quoted | 7.3 | 0.0 |
| Overseas public sector quoted | 0.0 | 0.0 |
| Overseas corporate quoted | 134.1 | 0.0 |
| | 361.5 | 211.2 |
| | | |
| Equities: | | |
| UK quoted | 13.2 | 8.8 |
| Overseas quoted | 702.5 | 293.1 |
| | 715.7 | 301.9 |
| | | |
| Pooled Investment Vehicles | | |
| Other UK managed Funds – UK equities | 375.0 | 285.9 |
| – Overseas equities | 483.5 | 449.4 |
| – Global equities | 417.8 | 389.0 |
| – Emerging market equities | 0.0 | 287.9 |
| – Global bonds | 0.0 | 143.6 |

| | 31 March 2019 | 31 March 2020 |
|--|----------------|----------------|
| | £m | £m |
| Other overseas managed Funds – Overseas equities | 14.7 | 5.0 |
| | 1,291.0 | 1,560.8 |
| Pooled Funds – Additional Analysis | | |
| Pooled property investments – UK | 86.8 | 75.2 |
| Pooled property investments – overseas | 85.0 | 74.6 |
| | 171.8 | 149.8 |
| Pooled Infrastructure investments | 159.4 | 299.1 |
| | 159.4 | 299.1 |
| Pooled Debt investments | 12.4 | 38.0 |
| | 12.4 | 38.0 |
| Derivatives – futures | 32.1 | 42.8 |
| Derivatives – forward FX | 0.1 | 0.0 |
| Cash deposits | 32.9 | 25.5 |
| Investment income due | 7.3 | 5.3 |
| Amounts receivable for sales | 1.8 | 0.0 |
| Total investment assets | 2,787.4 | 2,635.8 |
| | | |
| Investment liabilities | | |
| Derivatives – futures | (20.8) | (21.4) |
| Derivatives – forward FX | (2.8) | (0.0) |
| Amounts payable for purchases | (5.4) | (0.0) |
| Total investment liabilities | (29.0) | (21.4) |
| Net investment assets | 2,758.4 | 2,614.4 |

NOTE 12C: PENSION FUND INVESTMENTS ANALYSED BY FUND MANAGER

The proportion of the market value of investment assets held by external Fund managers at the year-end was:

| External Fund Manager | 2018/19 | | 2019/20 | |
|---|---------|----|---------|----|
| | £m | % | £m | % |
| LGPS Central (Bonds) | 0.0 | 0 | 143.6 | 6 |
| LGPS Central (Emerging Markets) | 0.0 | 0 | 285.2 | 11 |
| JP Morgan Asset Management (Bonds) | 144.6 | 5 | 0.2 | 0 |
| JP Morgan Asset Management (Emerging Markets) | 165.4 | 6 | 1.5 | 0 |
| Nomura Asset Management UK Ltd | 382.8 | 14 | 321.1 | 12 |

| External Fund Manager | 2018/19 | | 2019/20 | |
|---------------------------------------|----------------|------------|----------------|------------|
| | £m | % | £m | % |
| Schroder Investment Management | 189.9 | 7 | 1.4 | 0 |
| Legal and General Asset Management | 1,276.2 | 46 | 1,118.3 | 43 |
| Green Investment Bank | 48.3 | 2 | 46.7 | 2 |
| Hermes (Fund I and II) | 48.6 | 2 | 97.9 | 4 |
| Invesco (Euro and a UK Property Fund) | 108.2 | 4 | 100.5 | 4 |
| VENN | 26.7 | 1 | 21.1 | 1 |
| Walton Street | 17.0 | 1 | 7.6 | 0 |
| Walton Street II | 0.0 | 0 | 3.2 | 0 |
| AEW | 19.9 | 1 | 17.4 | 1 |
| Stonepeak | 10.6 | 0 | 60.6 | 2 |
| First State | 51.9 | 2 | 93.9 | 4 |
| EQT | 12.4 | 0 | 38.0 | 1 |
| River and Mercantile | 241.8 | 9 | 245.4 | 9 |
| WCC Managed Account | 5.4 | 0 | 4.1 | 0 |
| | 2,749.7 | 100 | 2,607.7 | 100 |

The above excludes £1.4m (2018/19 £1.4m) Invested in LGPS Central and £5.3m (2018/19 £7.3m) of Investment Income due. The following investments represent more than 5% of the net assets of the scheme:

| | Market value 31 March 2019 | % of total Fund | Market value 31 March 2020 | % of total Fund |
|---|----------------------------|-----------------|----------------------------|-----------------|
| Security | £m | % | £m | % |
| LGIM – North America Index Pooled Fund | 307.5 | 11.2 | 287.7 | 11.1 |
| LGIM – UK Equity Index Pooled Fund | 375.0 | 13.7 | 285.9 | 11.0 |
| LGPS Central Emerging Market Equity Pool | 0.0 | 0.0 | 285.2 | 11.0 |
| River and Mercantile UK Gilts | 220.1 | 8.0 | 211.2 | 8.1 |
| LGIM – Europe (ex-UK) Index Pooled Fund | 176.0 | 6.4 | 155.8 | 6.0 |
| LGPS Central Corporate Bond Pool | 0.0 | 0.0 | 143.6 | 5.5 |
| LGIM – Client Specific United Fund – STAJ | 133.8 | 4.9 | 137.4 | 5.3 |
| LGIM – FTSE Developed Equity Pooled Fund | 159.6 | 5.8 | 134.0 | 5.1 |

NOTE 12 D: STOCK LENDING

The Fund operates the practice of lending stock to a third party for a financial consideration. Securities released to a third party under the stock lending agreement with the Fund's custodian, BNY Mellon, are included in the net assets statement to reflect the Fund's continuing economic interest of a proprietary nature in those securities.

The total amount of stock lent at the year-end was £4.6 million (2019 £25.9 million). Counterparty risk is managed through holding collateral at the Fund's custodian bank. The total collateral, which consisted of acceptable corporate and sovereign debt as well as equities was £5.0 million (2019 £28.1 million) representing 108.8% of stock lent.

Income received from stock lending activities was £0.0 million for the year ending 31 March 2020 (2019 £0.1million). This is included within the 'Investment Income' figure detailed on the Fund Account.

Stock lending commissions are remitted to the Fund via the custodian. During the period the stock is on loan, the voting rights of the loaned stocks are passed to the borrower. There are no liabilities associated with the loaned assets.

NOTE 13A: ANALYSIS OF DERIVATIVES

The Fund uses derivative financial instruments to manage its exposure to specific risks arising from its investment activities. The Fund does not hold derivatives for speculative purposes.

The value of futures contracts is determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin. The future value of forward currency contracts is based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.

Objectives and Policies for Holding Derivatives

Most of the holding in derivatives is to hedge exposures to reduce risk in the Fund. Derivatives may be used to gain exposure to an asset more efficiently than holding the underlying asset. The use of derivatives is managed in line with the investment management agreement between the Fund and its investment managers.

In 2019/20 the Fund entered into a contract with River and Mercantile, to hedge the recent gains in Equities. This involved entering into exchange-traded options on 3 major indices and purchasing a collateral pool of Gilts.

a) Futures

The Fund's investment managers hold cash balances in order to ensure efficient and timely trading when opportunities arise. The Fund's management did not want this cash to be 'out of the market' and so enabled a number of investment managers to buy and sell futures contracts which had an underlying economic value broadly equivalent to the cash held. The economic exposure represents the notional value of the stock purchased under futures contracts and is therefore subject to market movements. The portfolio cannot be geared to and must have the liquidity needed to cover open positions. Derivative receipts and payments represent the realised gains and losses on futures contracts.

b) Forward Foreign Currency

In order to maintain appropriate diversification and to take advantage of overseas investment returns, the Fund's bond mandate targets outperformance against a global benchmark index. To reduce volatility associated with the fluctuating currency rates, the Fund has enabled the bond mandate investment manager to purchase and sell forward foreign currencies as a hedge.

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.

Futures

Outstanding exchange traded futures contracts are as follows:

| ASSETS | | Economic Exposure | Market Value 31 March 2019 | Economic Exposure | Market Value 31 March 2020 |
|----------------------------------|----------------|-------------------|----------------------------|-------------------|----------------------------|
| Type of future | Expiration | £m | £m | £m | £m |
| UK GILTS exchange traded | Under one year | 1.9 | 0.0 | 0.0 | 0.0 |
| UK FTSE exchange traded option | Under one year | 0.0 | 23.5 | 0.0 | 15.9 |
| EUROSTOXX exchange traded option | Under one year | 0.0 | 4.5 | 0.0 | 15.2 |
| US S&P exchange traded option | Under one year | 0.0 | 3.8 | 0.0 | 11.7 |
| Overseas exchanged traded | under one year | 27.6 | 0.3 | 0.0 | 0.0 |
| Total assets | | | 32.1 | | 42.8 |

| LIABILITIES | | Economic Exposure | Market Value 31 March 2019 | Economic Exposure | Market Value 31 March 2020 |
|-----------------------------------|----------------|-------------------|----------------------------|-------------------|----------------------------|
| Type of future | Expiration | £m | £m | £m | £m |
| UK GILTS exchange traded | Under one year | 0.0 | 0.0 | 0.0 | 0.0 |
| UK FTSE exchange traded option | Under one year | 0.0 | (12.8) | 0.0 | (9.5) |
| EUROSTOXX exchange traded option | Under one year | 0.0 | (2.7) | 0.0 | (6.1) |
| US S&P 500 exchange traded option | Under one year | 0.0 | (5.1) | 0.0 | (5.8) |
| Overseas exchanged traded | Under one year | (21.4) | (0.2) | (21.4) | 0.0 |
| Total liabilities | | | (20.8) | | (21.4) |
| Net futures | | | 11.3 | | 11.3 |

OPEN FORWARD CURRENCY CONTRACTS AS AT 31 MARCH 2020

| Settlement | Currency Bought | Local Currency Value | Currency Sold | Local Currency Value | Asset Value | Liability Value |
|--|-----------------|----------------------|---------------|----------------------|-------------|-----------------|
| Type of future | | £m | | £m | £m | £m |
| There were no open contracts as at the 31 March 2020 | | | | | | |
| | | | | | 0.0 | (0.0) |
| Net forward currency contracts at 31 March 2020 | | | | | | (0.0) |

| Settlement | Currency Bought | Local Currency Value | Currency Sold | Local Currency Value | Asset Value | Liability Value |
|--|-----------------|----------------------|---------------|----------------------|-------------|-----------------|
| Type of future | | £m | | £m | £m | £m |
| Prior year comparative: | | | | | | |
| Open forward currency contracts at 31 March 2019 | | | | | 0.1 | (2.8) |
| Net forward currency contracts at 31 March 2019 | | | | | | (2.7) |

ANALYSIS OF CASH

Cash comprises demand deposits and cash equivalents; these include 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.

| ASSETS | 2018/19 | 2019/20 |
|------------------|-------------|-------------|
| Cash | £m | £m |
| Cash deposits | 18.2 | 18.6 |
| Cash instruments | 14.7 | 6.9 |
| | 32.9 | 25.5 |

NOTE 14: FAIR VALUE

NOTE 14 A: 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 price available at the reporting date.

| Description of asset | Valuation hierarchy | Basis of valuation | Observable and unobservable inputs | Key sensitivities affecting the valuations provided |
|---------------------------|---------------------|---|------------------------------------|---|
| Market-Quoted Investments | Level 1 | Published bid market price ruling on the final day of the accounting period | Not required | Not required |

| Description of asset | Valuation hierarchy | Basis of valuation | Observable and unobservable inputs | Key sensitivities affecting the valuations provided |
|---|---------------------|--|---|--|
| Fixed Interest Securities | Level 1 | Fixed interest securities are valued at net market value based on current yields | Not required | Not required |
| Pooled Equity Funds | Level 2 | Closing bid price where bid and offer prices are published; or the single price, as applicable | Net Asset Value (NAV)-based pricing set on a forward pricing basis and in the case of accumulation Funds, reinvested income net of applicable withholding tax | Not required |
| Forward foreign exchange derivatives | Level 2 | Market forward exchange rates at the year-end | Exchange rate risk | Not required |
| Derivatives – Futures | Level 2 | Option pricing model | Annualised volatility of counterparty credit risk | Not required |
| Property, Infrastructure and Debt Funds | Level 3 | Unit or security price as advised by Investment Manager or responsible entity | Funds share of net assets in limited partnership, using Financial Statements published by the manager as at the final day of the accounting period | Valuations could be affected by material events occurring between the date of the financial statements provided and the Fund's own reporting date, by changes to expected cashflows, and by any differences between audited and unaudited accounts |

Please see paragraphs under the Net assets Statement for more detail of our basis for measurement for the above Financial Instruments.

NOTE 14 B: FAIR VALUE HIERARCHY

Level 1: Financial instruments 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 interest securities and quoted index linked securities. Listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2: Financial instruments 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 and where these techniques use inputs that are based significantly on observable market data.

Level 3: Financial instruments at level 3 are those where at least one input could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, pooled property investments and pooled infrastructure investments which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions. The following table provides an analysis of the financial assets and liabilities of the pension Fund into levels 1 to 3, based on the level at which the fair value is observable:

| Values at 31 March 2020 | Quoted market price Level 1 £m | Using observable inputs Level 2 £m | With significant unobservable inputs Level 3 £m | Total £m |
|---|-----------------------------------|---------------------------------------|--|----------------|
| Fair value financial assets | | | | |
| Financial assets at fair value through profit and loss | 953.2 | 1,168.8 | 486.9 | 2,608.9 |
| Total fair value financial assets | 953.2 | 1,168.8 | 486.9 | 2,608.9 |
| Fair value financial liabilities | | | | |
| Financial liabilities at fair value through profit and loss | | (21.4) | | (21.4) |
| Total fair value financial liabilities | 0.0 | (21.4) | 0.0 | (21.4) |
| Net fair value financial assets | 953.2 | 1147.4 | 486.9 | 2,587.5 |

| Values at 31 March 2019 | Quoted market price Level 1 £m | Using observable inputs Level 2 £m | With significant unobservable inputs Level 3 £m | Total £m |
|--|-----------------------------------|---------------------------------------|--|----------------|
| Fair value financial assets | | | | |
| Financial assets at fair value through profit and loss | 1086.3 | 1,323.2 | 343.6 | 2,753.1 |
| Total fair value financial assets | 1086.3 | 1,323.2 | 343.6 | 2,753.1 |

| Values at 31 March 2019 | Quoted market price Level 1 | Using observable inputs Level 2 | With significant unobservable inputs Level 3 | Total |
|---|-----------------------------------|--|---|----------------|
| | £m | £m | £m | £m |
| Fair value financial liabilities | | | | |
| Financial liabilities at fair value through profit and loss | | (29.0) | | (29.0) |
| Total fair value financial liabilities | 0.0 | (29.0) | 0.0 | (29.0) |
| Net fair value financial assets | 1,086.3 | 1,294.2 | 343.6 | 2,724.1 |

NOTE 14 C: SENSITIVITY OF ASSETS VALUED AT LEVEL 3

Having analysed historical data and current market trends, and consulted with independent investment advisors, the Fund has determined that the valuation methods described in Note 14a are likely to be accurate to within the following ranges, and has set out below the consequent potential impact on the closing value of investments held at 31 March 2020.

| Sensitivity Analysis | Valuation range | Value as at 31st March 2020 | Valuation Increase | Valuation Decrease |
|---|--------------------|-----------------------------------|-----------------------|-----------------------|
| | +/- % | £m | £m | £m |
| Pooled Investments – Property Funds | 15.0% | 149.8 | 172.3 | 127.3 |
| Pooled Investments – Infrastructure Funds | 6.5% | 299.1 | 320.0 | 278.2 |
| Pooled Investments – Debt Funds | 6.5% | 38.0 | 40.5 | 35.3 |
| Total | | 486.9 | 532.8 | 440.8 |

Reconciliation of Fair Value Measurements within Level 3

| Investment Movement | Pooled Investments – Property Funds | Pooled Investments – Infrastructure Funds | Pooled Investments – Debt Funds | Total |
|---------------------------|--|--|--|-------|
| | +/- % | £m | £m | £m |
| Market Value 1 April 2019 | 171.8 | 159.4 | 12.4 | 343.6 |
| Transfers into Level 3 | 0.0 | 0.0 | 0.0 | 0.0 |

| Investment Movement | Pooled Investments – Property Funds | Pooled Investments – Infrastructure Funds | Pooled Investments – Debt Funds | Total |
|-----------------------------------|--|--|--|--------------|
| | +/- % | £m | £m | £m |
| Transfers out of Level 3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Purchases and derivative Pymts | 12.6 | 203.0 | 25.8 | 241.4 |
| Sales and derivative receipts | (26.2) | (78.0) | (1.6) | (105.8) |
| Unrealised gains/(losses) | (8.9) | 15.2 | 0.9 | 7.2 |
| Realised gains/(losses) | 0.5 | (0.5) | 0.5 | 0.5 |
| Market value 31 March 2020 | 148.9 | 299.1 | 38.0 | 486.9 |

NOTE 15: FINANCIAL INSTRUMENTS

NOTE 15 A: CLASSIFICATION OF FINANCIAL INSTRUMENTS

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of financial assets and liabilities by category and net assets statement heading.

| Fair value through profit and loss 2018/19 | Financial Instruments at Amortised Cost 2018/19 | | Fair value through profit and loss 2019/20 | Financial Instruments at Amortised Cost 2019/20 |
|---|--|-----------------------------------|---|--|
| £m | £m | | £m | £m |
| Financial assets | | | | |
| | 1.4 | Other share capital | | 1.4 |
| 0.0 | | LGPS Central Managed | 428.8 | |
| 361.5 | | Fixed interest securities | 211.1 | |
| 715.7 | | Equities | 307.9 | |
| 1,291.0 | | Pooled investment vehicles | 1,126.0 | |
| 171.8 | | Pooled property investments | 149.8 | |
| 159.4 | | Pooled Infrastructure investments | 299.1 | |
| 12.4 | | Pooled Debt investments | 38.0 | |
| 32.1 | | Derivatives – Futures | 42.8 | |
| 0.1 | | Derivatives – Forward FX | 0.0 | |
| | 58.7 | Cash | | 29.6 |
| 9.1 | | Other investment Balances | 5.3 | |

| Fair value through profit and loss 2018/19 | Financial Instruments at Amortised Cost 2018/19 | | Fair value through profit and loss 2019/20 | Financial Instruments at Amortised Cost 2019/20 |
|--|---|---------------------------|--|---|
| £m | £m | | £m | £m |
| | 13.4 | Current assets | | 31.2 |
| | 1.5 | Non-current assets | | 2.0 |
| 2,753.1 | 75.0 | | 2,608.9 | 64.2 |
| Financial liabilities | | | | |
| (20.8) | | Derivatives – Futures | (21.4) | |
| (2.8) | | Derivatives – Forward FX | (0.0) | |
| (5.4) | | Other investment balances | (0.0) | |
| | (3.8) | Current liabilities | | (6.3) |
| (29.0) | (3.8) | | (21.4) | (6.3) |
| 2,724.1 | 71.2 | | 2,587.5 | 57.9 |

NOTE 15 B: NET GAINS AND LOSSES ON FINANCIAL INSTRUMENTS

| 31 March 2019 | | 31 March 2020 |
|------------------------------|------------------------------------|----------------|
| £m | | £m |
| Financial assets | | |
| 97.2 | Fair value through profit and loss | (185.0) |
| 4.3 | Financial Assets at Amortised Cost | 4.2 |
| Financial liabilities | | |
| (24.0) | Fair value through profit and loss | 21.7 |
| 77.5 | Total | (159.1) |

Fair value through profit and loss is the combination of realised and unrealised profit and loss.

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

NOTE 16: NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

In the course of every day operating, the Fund is subject to a number of risk factors arising from the holding of financial instruments. The main risks arising from the holding of the Fund's financial instruments are market risk, credit risk and liquidity risk.

As detailed in the Investment Strategy Statement, the Fund holds equity and bond instruments in order to meet its investment objectives. The Fund's investment objectives and risk management policies are as follows:

- 1) The investment objective for the Fund is to:
 - a. Ensure that sufficient assets are available to meet liabilities as they fall due;
 - b. Maximise the return at an acceptable level of risk.
- 2) Risk management is mostly concerned with:
 - a. Avoiding the possibility of loss, or
 - b. Limiting a deficiency in the underlying Fund, or
 - c. Avoiding a contribution rate increase in the future.

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 its 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, whilst optimising the return on risk. There are three main types of market risk that the Fund is exposed to as at 31 March 2020:

- Equity Risk.
- Interest Rate Risk.
- Foreign Exchange Risk.

Equity risk refers to the risk arising from the volatility in stock prices; this can be systematic risk, the risk due to general market factors and affects the entire industry, or unsystematic risk, which refers to the risk specific to a company that arises due to the company specific characteristics. Interest rate risk is the risk that the value of a security will fall as a result of increase in interest rates. Foreign exchange risk arises because of fluctuations in the currency exchange rates.

The Fund reduces its unsystematic equity risk by diversifying investments across global markets, investing in over 1,000 companies worldwide through active segregated mandates and passive pooled funds. Investment restrictions are built into contracts held with each investment manager to ensure risk concentration is minimal and gearing of the Fund's equity and fixed income assets cannot take place. An Equity Protection Strategy has also been implemented to protect against significant market falls in its passive equity portfolio.

Interest rate risk has been reduced through the holding of fewer bonds as a percentage of the Fund's total assets.

Foreign Exchange risk exists in relation to the Fund's overseas equity investments. The Fund runs un-hedged equity portfolios and therefore is subject to currency fluctuations. It is the Administering Authority's view that in the long-run currency volatility trends to an average of nil against Sterling and therefore any hedging of currency would just be an additional cost to the Fund.

The Fund Contracts Portfolio Evaluation Ltd to measure the Fund's investment returns, absolute and relative risk for each portfolio and for the Fund independently. The Fund receives quarterly reports from Portfolio Evaluation Ltd listing returns and risk. The Fund's Independent Investment Adviser also provides a yearly report to the Pension Investment Advisory Panel, providing details of the Fund's risk and comparisons to other LGPS Funds.

Equity Risk Analysis

Following analysis of historical data and expected investment return movement during the financial year, in consultation with the Fund's Independent Investment Adviser and Portfolio Evaluation Ltd, the Fund has determined that the following movements in market price risk are reasonably possible for the 2019/20 reporting period:

| Asset Type | Potential Market Movements (+/-) |
|------------------------------------|----------------------------------|
| Fixed interest securities | 5.7% |
| Global bonds | 5.7% |
| UK equities | 14.1% |
| Overseas equities | 11.9% |
| UK pooled investment vehicle | 14.1% |
| Overseas pooled investment vehicle | 12.5% |
| Global pooled investment vehicle | 12.5% |
| Emerging markets pooled equities | 12.5% |
| Pooled property investments | 15.0% |
| Pooled infrastructure investments | 6.5% |
| Pooled debt investments | 6.5% |

The potential price changes disclosed above are broadly consistent with a one standard deviation movement in the value of the assets. The analysis assumes that all other variables, in particular foreign exchange rates and interest rates, remain the same.

If the market price of the Fund's investments increases/decreases in line with the potential market movements above, the change in the net assets available to pay benefits will be as follows (the actual prior year movement in all asset classes is shown in note 12):

| Asset Type | Value as at 31 March 2020 | Percentage change | Value on increase | Value on decrease |
|-------------------------------------|---------------------------|-------------------|-------------------|-------------------|
| | £m | % | £m | £m |
| Cash and cash equivalents | 25.5 | 0.0% | 25.5 | 25.5 |
| Investment portfolio assets: | | | | |
| UK fixed interest securities | 211.2 | 5.7% | 223.2 | 199.2 |
| Overseas fixed interest securities | 0.0 | 5.7% | 0.0 | 0.0 |
| Global Bonds | 143.6 | 5.7% | 151.8 | 135.4 |
| UK equities | 8.8 | 14.1% | 10.0 | 7.6 |
| Overseas equities | 293.1 | 11.9% | 328.0 | 258.2 |
| UK pooled investment vehicle | 285.9 | 14.1% | 326.2 | 245.6 |
| Overseas pooled investment vehicle | 454.4 | 12.5% | 511.2 | 397.6 |
| Global pooled investment vehicle | 389.0 | 12.5% | 437.6 | 340.4 |
| Emerging Market Pooled Equities | 287.9 | 12.5% | 323.9 | 251.9 |
| Pooled property investments | 149.8 | 15.0% | 172.2 | 127.4 |
| Pooled Infrastructure investments | 299.1 | 6.5% | 318.6 | 279.6 |
| Pooled Debt Investments | 38.0 | 6.5% | 40.5 | 35.5 |
| Net derivative assets | 11.0 | 0.0% | 11.0 | 11.0 |
| Investment income due | 5.3 | 0.0% | 5.3 | 5.3 |
| Amounts receivable for sales | 0.0 | 0.0% | 0.0 | 0.0 |
| Amount payable for purchases | 0.0 | 0.0% | 0.0 | 0.0 |
| Total | 2,602.6 | | 2,885.1 | 2,320.1 |

Prior-year comparators

| Asset Type | Value as at 31 March 2019 | Percentage change | Value on increase | Value on decrease |
|-------------------------------------|---------------------------|-------------------|-------------------|-------------------|
| | £m | % | £m | £m |
| Cash and cash equivalents | 32.9 | 0.0% | 32.9 | 32.9 |
| Investment portfolio assets: | | | | |
| UK fixed interest securities | 227.4 | 3.3% | 234.9 | 219.9 |
| Overseas fixed interest securities | 134.1 | 3.3% | 138.5 | 129.7 |
| UK equities | 13.2 | 9.2% | 14.4 | 12.0 |
| Overseas equities | 702.5 | 12.1% | 787.5 | 617.5 |
| UK pooled investment vehicle | 375.0 | 9.2% | 409.5 | 340.5 |
| Overseas pooled investment vehicle | 498.2 | 10.5% | 550.5 | 445.9 |
| Global pooled investment vehicle | 417.8 | 10.5% | 461.7 | 373.9 |
| Pooled property investments | 171.8 | 6.1% | 182.3 | 161.3 |
| Pooled Infrastructure investments | 159.4 | 6.1% | 169.1 | 149.7 |
| Pooled Debt investments | 12.4 | 6.1% | 13.2 | 11.6 |
| Net derivative assets | 8.6 | 0.0% | 8.6 | 8.6 |
| Investment income due | 7.3 | 0.0% | 7.3 | 7.3 |
| Amounts receivable for sales | 1.8 | 0.0% | 1.8 | 1.8 |
| Amount payable for purchases | (5.4) | 0.0% | -5.4 | -5.4 |
| Total | 2,757.0 | | 3,006.8 | 2,507.2 |

Interest Rate Risk Analysis

The Fund's direct exposure to interest rate movements is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

| Asset Type | Value as at 31 March 2019 | Value as at 31 March 2020 |
|---------------------------|---------------------------|---------------------------|
| | £m | £m |
| Cash and cash equivalents | 32.9 | 25.5 |
| Cash balances | 25.8 | 4.1 |
| Fixed interest securities | 361.5 | 211.2 |
| Total | 420.2 | 240.8 |

Interest Rate Risk Sensitivity Analysis

The Fund recognises that interest rates can vary and can affect both income to the Fund and the value of the net assets available to pay benefits. The Fund's performance reporting advisor, Portfolio Evaluation Limited, has advised that medium to long-term average rates are expected to move less than 100 basis points from one year to the next and experience suggests that such movements are likely.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits as at 31 March 2020 of a +/- 100 Basis Points (BPS) change in interest rates:

| Asset Type | Carrying amount as at 31 March 2020 | Change in year in the net assets available to pay benefits | |
|---|-------------------------------------|--|--------------|
| | | +100 BPS | -100 BPS |
| | £m | £m | £m |
| Cash and cash equivalents | 25.5 | 25.8 | 25.2 |
| Cash balances | 4.1 | 4.1 | 4.1 |
| Fixed interest securities | 211.2 | 213.3 | 209.1 |
| Total change in assets available | 240.8 | 243.2 | 238.4 |

| Asset Type | Carrying amount as at 31 March 2019 | Change in year in the net assets available to pay benefits | |
|---|-------------------------------------|--|--------------|
| | | +100 BPS | -100 BPS |
| | £m | £m | £m |
| Cash and cash equivalents | 32.9 | 33.2 | 32.6 |
| Cash balances | 25.8 | 26.1 | 25.5 |
| Fixed interest securities | 361.5 | 365.1 | 357.9 |
| Total change in assets available | 420.2 | 424.4 | 416.0 |

A 1% increase in interest rates will not affect the interest received on fixed income but will reduce their fair value and vice versa. Changes in interest rates do not impact the value of cash deposits / cash and cash equivalent balances but they will have a small effect on the interest income received on those balances. Charges to both the fair value of assets and the income received from investments impact on the net assets available to pay benefits.

Currency Risk

The following table summarises the Fund's currency exposure:

| Currency exposure – asset type | Asset value as at 31 March 2019 | Asset value as at 31 March 2020 |
|--------------------------------------|------------------------------------|------------------------------------|
| | £m | £m |
| Overseas quoted securities | 702.5 | 293.1 |
| Overseas pooled investment vehicle | 483.0 | 454.4 |
| Global pooled investment vehicle | 433.0 | 389.0 |
| Global Bonds and Pooled EM Equities | 0.0 | 431.5 |
| Overseas pooled property investments | 85.0 | 74.6 |
| Total overseas assets | 1,703.5 | 1,642.6 |

Overseas bonds are 100% hedged to GBP at 31 March 2020.

Currency Risk – Sensitivity Analysis

Following analysis of historical data in consultation with the Fund's performance measurement provider, the Fund considers the likely volatility associated with foreign exchange rate movements to be 10.2% (as measured by one standard deviation).

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

An 10.2% strengthening/weakening of the pound against various currencies in which the Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

| Currency exposure – asset type | Asset value as at 31 March 2020 | Change to net assets available to pay benefits | |
|--------------------------------------|------------------------------------|---|---------|
| | £m | +10.2% | -10.2% |
| | £m | £m | £m |
| Overseas quoted securities | 293.1 | 323.0 | 263.2 |
| Overseas pooled investment vehicle | 454.4 | 500.7 | 408.1 |
| Global pooled investment vehicle | 389.0 | 428.7 | 349.3 |
| Global Bonds and Pooled EM Equities | 431.5 | 475.5 | 387.5 |
| Overseas pooled property investments | 74.6 | 82.2 | 67.0 |
| Total change in assets available | 1,642.6 | 1,810.1 | 1,475.1 |

| Currency exposure – asset type | Asset value as at 31 March 2019 | Change to net assets available to pay benefits | |
|--------------------------------------|------------------------------------|---|---------|
| | £m | +11.0% | -11.0% |
| | £m | £m | £m |
| Overseas quoted securities | 702.5 | 779.9 | 625.1 |
| Overseas pooled investment vehicles | 498.2 | 553.1 | 443.3 |
| Global pooled investment vehicles | 417.8 | 463.8 | 371.8 |
| Overseas pooled property investments | 85.0 | 94.4 | 75.6 |
| Total change in assets available | 1,703.5 | 1,891.2 | 1,515.8 |

Credit Risk

Credit risk is an investor's risk of loss arising from a borrower who does not make payments as promised. In essence the Fund's entire investment portfolio is exposed to some form of credit risk, with the exception of the derivatives position, where the risk equates to the net market value of a positive derivative position. However the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner. Investment restrictions are listed in the contract held with the manager, which limit the amount of credit risk the manager is allowed to take and also states an average credit rating with regards to bonds held that should be maintained.

The bond manager provides a quarterly investment report to the Fund, which details the credit risk held in the portfolio. The Fund's Independent Investment Adviser also provides a yearly report to the Pension Investment Advisory Panel, providing details of the Fund's bond portfolio absolute and relative risk.

Deposits are not made with banks and financial institutions unless they are rated independently and have a strong credit rating. In addition, the Funds invests an agreed percentage of its Funds in the money markets to provide diversification. Money market Funds chosen all have an 'AAA' rating from a leading rating agency.

The Fund's cash holding at 31 March 2020 was £29.6 million (31 March 2019: £58.4 million). This was held with the following institutions:

| Summary | Rating | Balances as at 31 March 2019 | Balances as at 31 March 2020 |
|-------------------------------------|--------|---------------------------------|---------------------------------|
| | | £m | £m |
| Money market Funds | | | |
| BNY Mellon US Dollar Liquidity Fund | AAA | 6.4 | 6.9 |
| JPM GBP Liquidity LVNAV | AAA | 6.7 | 0.0 |
| JPM liq-USD Liquidity-XDI | AAA | 1.7 | 0.0 |

| Summary | Rating | Balances as at 31 March 2019 | Balances as at 31 March 2020 |
|------------------------------|--------|------------------------------|------------------------------|
| | | £m | £m |
| Bank deposit accounts | | | |
| The Bank of New York Mellon | A-1+ | 17.8 | 18.6 |
| Bank current accounts | | | |
| Barclays Bank PLC | A-1 | 25.8 | 4.1 |
| Total | | 58.4 | 29.6 |

The above Assets are held at Amortised Cost and are either liquid or very short dated securities in high-quality counterparties. Therefore the expected loss is assessed as a trivial sum and no allowance has been set aside for this.

Liquidity Risk

Market liquidity risk is the risk that a given security or asset cannot be traded quickly enough in the market to prevent a loss (or make the required profit) or to meet the financial obligations of the Fund as they fall due. The Fund's investment managers purchase quoted and tradable securities. Equities held are listed on major world stock markets and managers employed are highly experienced in equity trading. The liquidity risk relating to the bond holdings is monitored and managed by the bond manager on an on-going basis. The Council also takes steps to ensure that the Pension Fund has adequate cash resources to meet commitments.

NOTE 17: CURRENT ASSETS

| | 2018/19 | 2019/20 |
|--|-------------|-------------|
| | £m | £m |
| Contributions due from employer in respect of: | | |
| Employer | 8.8 | 6.9 |
| Members | 1.7 | 1.8 |
| Magistrates Courts Bulk Transfer Payment Due | 0.6 | 0.0 |
| Augmentation | 0.1 | 0.0 |
| Cash balances | 25.8 | 4.1 |
| Other Debtors | 2.2 | 22.5 |
| | 39.2 | 35.3 |

The above Assets are carried at Amortised cost, other than cash balances and other debtors (see below), the funds are due from Government institutions and therefore no allowance for expected losses has been set aside. The other debtors increase in 2019/20 mainly relate to the withdrawal of part of our Equity portfolio with River & Mercantile.

NOTE 18: NON CURRENT ASSETS

| | 2019/19 | 2019/20 |
|---|------------|------------|
| | £m | £m |
| Magistrates Courts Bulk Transfer Payment Due | 0.0 | 0.0 |
| *LGPS Central Capital Advance treated as loan | 0.7 | 0.7 |
| **Reimbursement of lifetime tax allowances | 0.2 | 0.2 |
| Contributions from Employers | 0.0 | 0.1 |
| Augmentation | 0.6 | 1.0 |
| | 1.5 | 2.0 |

*This was part of the regulatory capital required to set up the company LGPS Central Limited.

**This includes debtor in relation to the lifetime tax allowance limit as the Fund pays all the tax upfront on behalf of the pensioner and is reimbursed from additional pension deductions over time.

NOTE 19: CURRENT LIABILITIES

| | 2018/19 | 2019/20 |
|--------------------------------|--------------|--------------|
| | £m | £m |
| Investment management expenses | (3.6) | (0.8) |
| Payroll and external vendors | (0.2) | (1.0) |
| Other expenses | (0.0) | (4.5) |
| | (3.8) | (6.3) |

NOTE 20: RELATED PARTY TRANSACTIONS

Worcestershire County Council

The Fund is administered by Worcestershire County Council. Consequently, there is a strong relationship between the Council and the Fund.

The Council incurred costs of £1.5 million in 2019/2020 (2018/2019: £1.0 million) 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 Fund and contributed £10.0 million to the Fund in 2019/2020 (2018/2019: £9.4 million).

LGPS Central Limited has been established to manage investment assets on behalf of eight LGPS funds across the Midlands. It is jointly owned in equal shares by the eight Administering Authorities participating.

The annual running costs of £0.6 million was charged to the Fund in 2019/20 by LGPS Central (£0.5 million in 2018/19).

Key Management Personnel

The posts of Chief Financial Officer, Senior Finance Manager and HR Service Centre Manager are deemed to be key management personnel with regards to the Fund. The financial value of their relationship with the Fund (in accordance with IAS24) is set out below:

| | 2018/19 | 2019/20 |
|---------------------------------------|---------|---------|
| | £000 | £000 |
| Short term benefits* | 50 | 49 |
| Long-term/ post-retirement benefits** | 389 | 429 |
| | 439 | 478 |

*This is the pension's element of short term remuneration for key management personnel, i.e. annual salary, benefits in kind and employer contributions.

**This is the accrued pension benefits, expressed as cash equivalent transfer value.

Governance

The Pensions Committee Employer Representative, Employee Representative and Chief Financial Officer are active members of the Fund.

NOTE 21: CONTINGENT LIABILITIES

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 of future events.

Outstanding capital commitments (investments) at 31 March 2020 totalled £147.5 million (31 March 2019: £294.5 million).

These commitments relate to outstanding call payments due on unquoted limited partnership Funds held in the Pooled Property Investments, Pooled Infrastructure investments and Pooled Debt Investments part of the portfolio. The amounts 'called' by these Funds are irregular in both size and timing over a period of between one and three years from the date of the original commitment.

NOTE 22: CONTINGENT ASSETS

A contingent asset arises where an event has taken place that gives the Fund a possible asset whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Fund.

Contingent assets are not recognised in the financial statements but are disclosed as a note to the accounts.

The Councils below have provided guarantees to a number of organisations that have been admitted to the Fund to fund any potential pension liability. The organisations with a pension liability more than £195,000 (which the Fund considers to be material for these purposes) are:

- HALO Leisure (£1.273million), **Herefordshire Council**.
- Wychavon Leisure Community Association (£0.509million), **Wychavon District Council**.
- Bromsgrove District Housing Trust (£0.679 million), **Bromsgrove District Council**.
- Community Housing Group (£5.835 million), **Wyre Forest District Council**.

There are a further 15 organisations with a pension liability less than £195,000. The Fund has considered various factors in determining the potential risk of having to fund any future liability, including risk of failure of the business and membership profile, and is satisfied that they do not represent a significant potential liability. There are also 10 organisations with a guarantee via pass through arrangements. As new contractors, these employers will all commence fully funded with no initial funding deficit. In line with the 'Initial pension guarantee' employers above, we are assuming that the active members would remain active on termination of the contract and be transferred back to the relevant school/ academy or to the new service provider. On this basis, the amount for all these employers is reflected as nil for this year's accounts.

Eleven admitted body employers in the Fund hold insurance bonds to guard against the possibility of being unable to meet their pension obligations. These bonds are drawn in favour of the Fund and payment will only be triggered in the event of employer default. No bonds were called upon in this financial year.

Note that the existing bonds and guarantees from the previous financial year have all been discussed with the Actuary 'Mercers' and updated where necessary.

NOTE 23: ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVCS)

The Fund provides an in-house AVC scheme for its members. In 2019/2020 some members of the Fund paid voluntary contributions and transfers to Scottish Widows and Utmost Life (Was Equitable Life until the 1 January 2020) to buy extra pension benefits when they retire. Retirement benefits were also purchased during the year. The contributions are paid directly from scheme employers to the AVC provider. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

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

The amounts administered under AVC arrangements are as follows:

| | 2018/19 | 2019/20 |
|---|---------|---------|
| | £m | £m |
| Contributions received | 0.2 | 0.2 |
| Investments purchased | 0.2 | 0.2 |
| Change in market value | 0.2 | (0.2) |
| Retirement benefits paid or transferred | 0.3 | 0.2 |

The combined value of the AVC funds at 31 March 2020 was £2.6 million, (31 March 2019 £2.8 million).

NOTE 24: AGENCY SERVICES

The Fund pays discretionary awards to the former employees of Herefordshire County Council. The amounts paid are not included within the Fund’s Accounts but are provided as a service and fully reclaimed from the employer. The sums are disclosed below.

| | 2018/19 | 2019/20 |
|--|---------|---------|
| | £m | £m |
| Payments on behalf of Herefordshire County Council | 0.1 | 0.1 |
| | 0.1 | 0.1 |

NOTE 25: CRITICAL JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Fund’s liabilities are calculated every three years by the appointed Actuary. The methodology used is in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the Actuary and are summarised in note 2. This estimate is subject to significant variances based on changes to the underlying assumptions.

There were no significant changes to the CIPFA code of practice on local authority accounting (the code). IFRS 9 requires the investment assets to be accounted for at fair value within the accounts. The adoption of IFRS 9 in 2018 had no impact on the accounts for Pension Funds as the investment assets were already held at fair value through profit and loss as directed by the code.

The adoption of IFRS 15 revenue from customers with contracts was also introduced from 1 April 2018. This had no impact on the pension fund accounts as the Funds revenue is primarily Investment Interest and Contributions, both of which are outside the scope of the standard.

NOTE 26: ASSUMPTIONS MADE ABOUT THE FUTURE AND ANY 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 at the year-end date and the amounts reported for the revenues and expenses during the year. Estimates and assumptions are made considering historical experience, current trends and other relevant factors. However, the nature of estimation means that the actual outcomes could differ from the assumptions and estimates.

The item in the notes to the accounts at 31 March 2020 for which there is a significant risk of material adjustment in the forthcoming financial year is as follows.

| Item | Uncertainties | Effect is actual results differ from assumptions |
|---|---|---|
| Actuarial present value of promised retirement benefits (Note 2) | 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 assets. A firm of consulting actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied. | The effects on the net pension liability of changes in individual assumptions can be measured. For instance: <ul style="list-style-type: none">A 0.5% increase in the discount rate assumption would result in an 8% decrease in the pension liability, which is equivalent to £229m.A 0.25% increase in assumed earnings inflation would result in a 0.8% increase in the value of liabilities, which is equivalent to £23m.A one-year increase in assumed life expectancy would result in a 2% increase in the value of liabilities, which is equivalent to £69m. |
| Property and infrastructure valuations. (Level 3 investments) | The Funds directly held investment properties are valued at fair value by independent valuers in accordance with RICS valuation professional standards, whilst infrastructure investments are valued at fair value by independent experts. For 2019/20 there is additional uncertainty regarding the property valuations due to the time that it will take to fully realise the impact of Covid-19 upon illiquid assets such as property. The valuations have been updated based on the information available as at 31 March 2020 and may be subject to variations as further market information becomes available. | The total value of indirect property investments in the financial statements is £149.8m (£171.8m in 2018/19). There is a risk that this investment may be under or overstated in the accounts. The total value of direct infrastructure investments in the financial statements is £299.1m (£159.4m in 2018/19). There is a risk that this investment may be under or overstated in the accounts. |

VALUATION OF INVESTMENTS LEVEL 3

Financial instruments at level 3 are those where at least one input could have a significant effect on the instrument’s valuation is not based on observable market data. Such instruments would include unquoted equity investments, pooled property investments and pooled infrastructure investments which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions. As well as the details in the table above, further detail is provided in Notes 14a to c above.

Independent auditor’s report to the members of Worcestershire County Council on the consistency of the pension fund financial statements of Worcestershire Pension Fund included in the Pension Fund Annual Report

Opinion

The pension fund financial statements of Worcestershire Pension Fund (the ‘pension fund’) administered by Worcestershire County Council (the "Authority") for the year ended 31 March 2020 which comprise the Fund Account, the Net Assets Statement and the notes to the pension fund financial statements, including a summary of significant accounting policies are derived from the audited pension fund financial statements for the year ended 31 March 2020 included in the Authority's Statement of Accounts (the “Statement of Accounts”).

In our opinion, the accompanying pension fund financial statements are consistent, in all material respects, with the audited financial statements in accordance with proper practices as defined in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2019/20 and applicable law.

Pension Fund annual report – Pension Fund financial statements

The Pension Fund Annual Report and the pension fund financial statements do not reflect the effects of events that occurred subsequent to the date of our report on the Statement of Accounts. Reading the pension fund financial statements and the auditor’s report thereon is not a substitute for reading the audited Statement of Accounts and the auditor’s report thereon.

The audited financial statements and our Report thereon

We expressed an unmodified audit opinion on the pension fund financial statements in the Statement of Accounts in our report dated 27 October 2020.

Chief Financial Officer’s responsibilities for the pension fund financial statements in the Pension Fund Annual Report

Under the Local Government Pension Scheme Regulations 2013 the Chief Financial Officer of the Authority is responsible for the preparation of the pension fund financial statements, which must include the Fund Account, the Net Asset Statement and supporting notes and disclosures prepared in accordance with proper practices. Proper practices for the pension fund financial statements in both the Statement of Accounts and the Pension Fund Annual Report are set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2019/20.

Auditor’s responsibility

Our responsibility is to express an opinion on whether the pension fund financial statements in the Pension Fund Annual Report are consistent, in all material respects, with the audited pension fund financial statements in the Statement of Accounts based on our procedures, which were conducted in accordance with International Standard on Auditing 810 (Revised), Engagements to Report on Summary Financial Statements.

Use of our report

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 paragraph 20(5) of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority’s members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

Peter Barber

Peter, Key Audit Partner
for and on behalf of Grant Thornton UK LLP, Local Auditor

Birmingham

23 November 2020



Appendix A

Funding Strategy Statement March 2020

This Funding Strategy Statement has been prepared to set out the Funding Strategy for the Worcestershire Pension Fund (the 'Fund'), in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).



Contents

Executive Summary

97

Introduction

100

Purpose of the FSS in Policy Terms

102

Aims and Purpose of the Fund

103

Responsibilities of the Key Parties

104

Solvency Funding Target

106

Link to Investment Policy and the Investment Strategy Statement (ISS)

110

Identification of Risks and Counter-Measures

112

Monitoring and Review

115

Appendices

Appendix A: Acturial Method and Assumptions

117

Appendix B: Employer Deficit Recovery Payments

122

Appendix C: Admission Policy

124

Appendix D: Termination Policy

127

Appendix E: Covenant Assessment and Monitoring Policy

131

Appendix F: Investment Pot Risk Management Policy

133

Appendix G: Glossary

135

Executive Summary

Ensuring that the Worcestershire Pension Fund (the ‘Fund’) has sufficient assets to meet its pension liabilities in the long-term is the fiduciary responsibility of the Administering Authority (Worcestershire County Council).

The purpose of this Funding Strategy Statement (‘FSS’) is to set out a clear and transparent funding strategy that will identify how each Fund employer’s pension liabilities are to be met going forward.

The details contained in this FSS will have a financial and operational impact on all participating employers in the Worcestershire Pension Fund. It is imperative therefore that each existing or potential employer is aware of the details contained in it.

Given this, and in accordance with governing legislation, all interested parties connected with the Fund have been consulted and given opportunity to comment prior to this FSS being finalised and adopted. This FSS takes into consideration all comments and feedback received.

The results of the 2019 valuation show the liabilities to be 90% covered by the current assets using the prudent assumptions set out in **Appendix A**. The Fund’s long-term objective is to achieve a 100% solvency level with the funding deficit of 10% being covered by deficit contributions. Deficit recovery periods vary by employer category, with a maximum deficit recovery period of 15 years.

The key financial assumption used to determine the funding liabilities and the future service (‘Primary’) contribution rate for each investment pot at the valuation date are:

| | Growth pot | Medium pot | Cautious pot |
|-----------------------------------|------------|------------|--------------|
| Funding liabilities discount rate | 4.05% p.a. | 3.8% p.a. | 2.65% p.a. |
| Future service discount rate | 4.65% p.a. | 4.4% p.a. | 2.65% p.a. |
| CPI price inflation | 2.4% p.a. | 2.4% p.a. | 2.4% p.a. |

In assessing the value of the Fund’s liabilities, allowance has been made for asset out-performance (above CPI inflation) by taking into account the investment strategy adopted by the Fund. If, at the valuation date, the Fund had been invested in a ‘minimum risk’ portfolio, the assessed value of the Fund’s liabilities at the valuation would have been significantly higher, resulting in a funding level of 54%.

To help maintain stability of contributions in the future, the Fund has implemented a number of strategies to help manage risk:

- Investment pots to offer to employers which exhibit lower investment risk than the current whole fund strategy with effect from 1 April 2020. Further detail regarding the asset strategy for each pot is available in the Fund’s ISS.
- Equity Protection strategy to protect against potential falls in the equity markets via the use of derivatives.
- Covenant assessment and monitoring for participating employers, as detailed in **Appendix E**.
- Consulting with employers on the use of ill-health liability insurance to ensure that the eligible employers are not exposed to large deficits on the ill-health retirement of one or more of their members.

The Fund has a number of key aims and objectives. The key funding objectives are referred to throughout the FSS and are summarised below:

- Achieve and maintain assets equal to 100% of liabilities within a target 15-year average timeframe, whilst remaining within reasonable risk parameters.
- Determine employer contribution requirements to maintain long-term cost efficiency, whilst recognising the constraints on affordability and strength of employer covenant, with the aim being to maintain as predictable an employer contribution requirement as possible.
- Strike the appropriate balance between long-term investment performance and the Fund's funding objectives.
- Ensure net cash outgoings can be met as/when required.
- Minimise unrecoverable debt on employer termination.
- Ensure that the future strategy, investment management actions, governance and reporting procedures take full account of longer-term risks and sustainability.
- To provide more certainty in employer contribution outcomes (within reasonable parameters) by implementing a number of risk management techniques to manage various aspects of the Fund's financial risks, specifically an Equity Protection strategy and Employer Investment Pots.

The FSS has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the 'solvency' of the Fund and the 'long-term cost efficiency' of the Local Government Pension Scheme (the 'LGPS') so far as this relates to the Fund.

Key elements of the Funding Strategy are as follows:

- To include appropriate margins to allow for the possibility of adverse events (e.g. material reduction in investment returns, economic downturn and higher inflation outlook) leading to a worsening of the funding position which would normally lead to volatility of contribution rates at future valuations if these margins were not included. This prudence is required by the regulations and guidance issued by professional bodies and Government agencies to assist the Fund in meeting its primary solvency objective.
- Deficit recovery periods are determined by the Fund with the aim of recovering deficits as quickly as participating employers can reasonably afford given other competing cost pressures, taking into account the Fund's view of the employer's covenant and the risk to the Fund.
- The recovery periods will be set by the Administering Authority with a maximum deficit recovery period of 15 years, although employers will be free to select any shorter deficit recovery period if they wish.
- Employers who are expected to have a shorter participation period e.g. closed to new entrants will generally have a shorted recovery period.
- Deficit recovery contributions will be expressed in £s.
- Similar principles are applied to employers who have a surplus of assets over liabilities where the surplus is being run off over the period as an offset to future service contributions.

- It is possible for employers to prepay their contributions for the full 3 years or annually at each April in return for a cash saving.
- The key financial assumption – the discount rate – is derived for each investment pot by considering the prudent long-term expected return on the underlying assets over and above assumed future Consumer Price Index (CPI) inflation.
- The demographic assumptions for the whole Fund have been determined by carrying out a bespoke analysis of the Fund's membership along with a review of other LGPS funds.
- As part of the Fund's risk management framework, employer type, maturity, funding position, status and ongoing covenant strength will be considered by the Fund when allocating an employer to a specific investment pot.

It is strongly recommended that employers also consider and understand the detailed Fund policies in the main body as these impact on your participation in the Fund over the short and long-term.

1. Introduction

The Local Government Pension Scheme Regulations 2013 ('the 2013 Regulations') and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 ('the 2014 Transitional Regulations') and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (all as amended) (collectively; 'the Regulations') provide the statutory framework from which an Administering Authority is required to prepare a FSS. The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Fund, the Fund will prepare and publish their funding strategy;
- In preparing the FSS, the Fund must have regard to:
 - the guidance issued by CIPFA for this purpose; and
 - the Investment Strategy Statement (ISS) for the Fund published under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy set out in the FSS or the ISS.

Benefits

The benefits provided by the LGPS are specified in the governing legislation contained in the Regulations referred to above. The FSS addresses the issue of managing the need to fund those benefits over the long-term, whilst at the same time facilitating scrutiny and accountability through improved transparency and disclosure.

The LGPS is a defined benefit arrangement with final pensionable pay related benefits and Career Averaged Revalued Earnings ('CARE') benefits earned thereafter. There is also a '50:50 Scheme Option', where members can elect to accrue 50% of the member's retirement benefits and pay 50% of the normal member contribution.

Contributions

The required levels of employee contributions are specified in the Regulations.

Employer contributions and deficit recovery payments are determined by an actuarial valuation.

Primary Rate

The 'Primary rate' for an employer is the contribution rate is that required to meet the cost of the future accrual of benefits, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the Funding Strategy adopted for that employer, the actuarial method used and the employer's covenant. This includes provision for ancillary death in service and ill-health benefits (subject to any external insurance arrangement) and administration costs.

The Primary rate for the whole fund is the weighted average (by payroll) of the individual employers' Primary rates.

Secondary Rate

The 'Secondary rate' is an adjustment to the Primary rate to address any past service deficit or surplus. In addition, as part of the 2019 actuarial valuation, the Secondary rate will also include any provision made

by an employer in respect of the estimated cost of McCloud. The Secondary rate may be expressed as a percentage adjustment to the Primary rate, and/or a cash adjustment in each of the three years beginning 1 April in the year following that in which the valuation date falls.

In addition to paying the Primary rate for future accrual of benefits, employers are required to make any required deficit recovery payments via the Secondary rate.

Secondary rates for the whole fund in each of the three years shall also be disclosed. These will be the calculated weighted average based on the whole Fund payroll in respect of percentage rates and the total amount across all employers in respect of cash adjustments.

2. Purpose of the FSS in Policy Terms

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding should be assessed, implementation of the Funding Strategy is the responsibility of the Fund, acting on the professional advice provided by the actuary.

The Fund’s long-term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due.

The purpose of this FSS is therefore:

- To establish a clear and transparent Fund-specific strategy which will identify how employers’ pension liabilities are best met going forward by taking a prudent longer-term view of funding those liabilities.
- To establish contributions at a level to ‘secure the solvency’ of the Fund and the ‘long-term cost efficiency’.
- To have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

The intention is for this FSS to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected, including the disparate investment pots, it must remain a single strategy for the Fund to implement and maintain.

3. Aims and Purpose of the Fund

The aims of the Fund are to:

- ‘Manage employers’ liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due.
- Enable employer contribution rates to be kept at a reasonable and affordable cost to the taxpayers, scheduled, resolution and admitted bodies, while achieving and maintaining the Fund solvency and long-term cost efficiency, which should be assessed in light of the profile of the Fund now and in the future due to sector changes.
- Maximise the returns from investments within reasonable risk parameters taking into account the above aims.

The purpose of the Fund is to:

- Receive monies in respect of contributions, transfer values and investment income, and
- Pay out monies in respect of benefits, transfer values, exit credits, costs, charges and expenses as defined in the Regulations.

4. Responsibilities of the Key Parties

The efficient and effective management of the Fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently. The key parties are the Administering Authority, the Pensions Committee, the individual employers and the Fund's Actuary and details of their roles are set out below. Other parties required to play their part are bankers, custodians, investment managers, auditors, legal/investment/governance advisors and the Local Pension Board.

Key Parties to the FSS

The **Fund**, in particular the Pensions Committee, should:

- Operate the Fund.
- Collect employer and employee contributions, investment income and other amounts due to the Fund as stipulated in the Regulations.
- Pay from the Fund the relevant entitlements as stipulated in the Regulations.
- Invest surplus monies in accordance with the Regulations.
- Ensure that cash is available to meet liabilities as and when they fall due.
- Take measures as set out in the Regulations to safeguard the Fund against the consequences of employer default.
- Manage the valuation process in consultation with the Fund's actuary.
- Prepare and maintain a FSS and an ISS, both after proper consultation with interested parties.
- Monitor all aspects of the Fund's performance and funding, amending the FSS/ISS as necessary.
- Effectively manage any potential conflicts of interest arising from it also being a Fund employer, and
- Enable the Local Pension Board to review the valuation process as set out in their terms of reference.

In practice the Pensions Committee may delegate responsibility for the implementation of some of the above responsibilities to Fund officers.

The **Individual Employer** should:

- 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 and ensure that any payroll estimates notified to the Fund (for example as part of any pre-payment calculations) are as accurate as possible.
- Develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework.
- Make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain.
- Have regard to The Pensions Regulator's focus on data quality and comply with any requirement set by the Fund in this context.

- Notify the Fund promptly of any changes to membership which may affect future funding.
- Understand the pensions impacts of any changes to their organisational structure and service delivery model, and
- Understand that the quality of the data provided to the Fund will directly impact on the assessment of the liabilities and contributions. In particular, any deficiencies in the data would normally result in the employer paying higher contributions than otherwise would be the case if the data was of high quality.

The **Fund Actuary** should:

- Prepare valuations including the setting of employers' contribution rates at a level to ensure the Fund's solvency after agreeing assumptions with the Fund and having regard to their FSS and the Regulations.
- Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill-health retirement costs, etc.
- Provide advice and valuations on the termination of admission agreements including in relation to exit credit payments.
- Provide advice to the Fund on bonds and other forms of security against the financial effect on the Fund of employer default.
- Assist the Fund in assessing whether employer contributions need to be revised between valuations as required by the Regulations.
- Advise on funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the ISS, and
- Ensure the Fund is aware of any professional guidance or other professional requirements which may be of relevance to the Fund Actuary's role in advising the Fund.

5. Solvency Funding Target

Securing the 'solvency' and 'long-term cost efficiency' is a regulatory requirement. To meet these requirements, the long-term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the 'funding target') assessed on an ongoing past service basis including allowance for projected final pay where appropriate. In the long-term, an employer's total contribution rate would ultimately revert to its Primary rate of contribution.

Solvency and Long-Term Efficiency

Each employer's contribution rates and deficit recovery payments are set at such a level to achieve full solvency in a reasonable timeframe. Solvency is defined as a level where the Fund's liabilities i.e. benefit payments can be reasonably met as they arise.

Employer contributions are also set in order to achieve long-term cost efficiency. Long-term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time.

The FSS has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the 'solvency' of the Fund and 'long-term cost efficiency' of the LGPS so far as relating to the Fund.

Determination of the Solvency Funding Target and Deficit Recovery Payments

The principal method and assumptions to be used in the calculation of the funding target are set out in **Appendix A**. The assumptions for deficit recovery payments are set out in **Appendix B**.

Underlying these assumptions are:

- That the Fund is expected to continue for the foreseeable future; and
- Favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

This allows the Fund to take a longer term view when assessing the contribution requirements for certain employers.

In considering this the Fund, based on the advice of the Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful potentially taking into account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2020 at the latest.

As part of each valuation separate employer contribution rates are assessed by the Fund Actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the distinct employers and employer groups in the Fund.

The Fund, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2019 actuarial valuation:

Individual employer contributions will be expressed and certified as Primary rate and Secondary rate.

Deficit Recovery Payments

It is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Fund's view of the employer's covenant and risk to the Fund.

Recovery periods will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. This will determine the minimum contribution requirement and employers will be free to select any shorter deficit recovery period and higher contributions if they wish, including the option of prepaying the deficit contributions in one lump sum either on an annual basis or a one-off payment. This will be reflected in the monetary amount requested via a reduction in overall deficit contributions payable. The Fund does retain ultimate discretion in applying these principles for individual employers on grounds of affordability and covenant strength.

The key principles when considering deficit recovery are as follows:

- The Fund will consider whether it is appropriate for deficit contribution reductions to apply compared to the existing funding plan (allowing for indexation where applicable) where deficits remain. This will be based on assessment of the employer covenant (including affordability of the existing funding plan) and any other relevant factors.
- Subject to consideration of affordability, as a general rule the deficit recovery period will reduce by at least 3 years for employers at this valuation when compared to the preceding valuation. This is to target full solvency over a similar (or shorter) time horizon. This is to maintain (as far as possible) equity between different generations of taxpayers and to protect the Fund against the potential for an unrecoverable deficit. The deficit recovery period will be set to at least cover the expected interest costs (actual interest costs will vary in line with investment performance) on the deficit.
- Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. Subject to affordability considerations and other factors, a bespoke period may be applied in respect of particular employers where the Fund considers this to be warranted (see Deficit Recovery assumptions in **Appendix B**). The average recovery period adopted by all employers will be set out within the Actuary's report. Employers will be notified of their individual deficit recovery payment amounts as part of the provision of their individual valuation results. Where increases (or decreases) in employer contributions are required from 1 April 2020, following completion of the 2019 actuarial valuation, at the sole discretion of the Fund the increase (or decrease) from the rates of contribution payable in the year 2020/21 may be implemented in steps, over a maximum of 3 years, depending on affordability of contributions as determined by the administering authority. This will be notified to employers as part of the valuation process. However, where a surplus exists or where there has been a reduction in contributions paid in respect of an employer's deficit at the valuation, the Fund would not consider it appropriate for any increase in contributions paid in respect of future accrual of benefits to be implemented in steps.
- As part of the process of agreeing funding plans with individual employers, the Fund will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities.
- It is acknowledged by the Fund that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Fund therefore would be willing to use its discretion to accept an evidence-based affordable level of contributions for the organisation

for the three years 2020/2023. Any application of this option is at the ultimate discretion of the Fund officers and Section 151 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.

- For those bodies identified as having a weaker covenant, the Fund will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans.
- Notwithstanding the above principles, the Fund, in consultation with the actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.
- On the cessation of an employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment. In such circumstances:

Funding for Non Ill-Health Early Retirement Costs

Employers are required to meet all costs of early retirement strain (i.e. the increase in liability caused by paying a member's benefits early) by immediate capital payments into the Fund.

Funding for Ill-Health Retirement Costs

Should a member retire on ill-health grounds, this will normally result in a funding strain for that employer (i.e. increased liability). The size of any funding strain will depend on how the cost of that ill-health retirement compares with the expected cost built in the actuarial assumptions for that employer. The actual cost will also depend on the level of any benefit enhancements awarded (which depend on the circumstances of the ill-health retirement) and also how early the benefits are brought into payment.

The contributions payable over 2020/23 include an allowance for ill-health retirement costs (alongside those for voluntary early retirements). Where an ill-health retirement occurs no additional contributions will be due immediately from the employer although any funding strain or profit will emerge following the subsequent actuarial valuation through increased/reduced deficit, depending on the difference in the funding cost of the ill-health retirement (on the actuarial valuation assumptions) and the expected cost built into the contributions payable.

Employers Leaving the Fund

The policy for employers who have a guarantor participating in the Fund:

Where an employer with a guarantor leaves the Fund, the valuation of the termination payment will be calculated using the funding assumptions for that employer's investment pot. Further details are set out in the Termination Policy in **Appendix D**.

The residual assets and liabilities and hence any surplus or deficit will normally transfer back to the guarantor but in circumstances where an exiting employer is expected to still be responsible for the termination deficit or surplus, an exit payment/exit credit may be payable from/to the exiting employer.

Where a surplus is potentially payable as an exit credit and a risk sharing arrangement is in place this is subject to representation (as required under the Regulations from 20 March 2020) from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor, in particular any 'risk-sharing' agreements that may exist. If representation is not made to the satisfaction of the Fund then the surplus will not be paid directly to the exiting employer following cessation (despite any other agreements that may be in place). A similar approach will be taken where a deficit is payable, where the default would be to collect the deficit in the absence of the representation from the interested parties.

The information that will be required by the Fund from employers to make a determination on whether an exit credit should be paid where a risk sharing arrangement is in place, and a representation has been made, will be supplied to the interested parties at the appropriate time.

The policy for employers who do not have a guarantor participating in the Fund:

Where an employer with no guarantor leaves the Fund and leaves liabilities with the Fund which the Fund must meet without recourse to that employer, the valuation of the termination payment (or Exit credit) will be calculated using a discount rate based on a minimum risk investment strategy and a more prudent life expectancy assumption. Further details are set out in the Termination Policy in **Appendix D**.

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 6 months of completion of the cessation assessment by the Actuary). For the avoidance of doubt this will include an appropriate provision for potential costs of the McCloud case remedy as per the approach set out in this FSS.
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Fund at their sole discretion) following completion of the termination process.

The Fund can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary and, for example, may adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers.

The termination policy is set out in **Appendix D**.

6. Link to Investment Policy and the Investment Strategy Statement (ISS)

The results of the 2019 valuation show the liabilities to be 90% covered by the current assets, with the funding deficit of 10% being covered by future deficit contributions.

In assessing the value of the Fund’s liabilities in the valuation, allowance has been made for growth asset out-performance as described below, taking into account the investment strategy adopted by the Fund, as set out in the ISS.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which represents the ‘minimum risk’ investment position which would deliver a very high certainty of real returns above assumed CPI inflation. Such a portfolio would consist of a mixture of long-term index-linked, fixed interest gilts and possible swaps.

Investment of the Fund’s assets in line with this portfolio would minimise fluctuations in the Fund’s funding position between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out this valuation it would not be appropriate to make any allowance for growth assets out-performance or any adjustment to market implied inflation assumption due to supply/demand distortions in the bond markets. This would result in a real return versus CPI inflation of negative 0.9% per annum at the valuation date. On this basis of assessment, the assessed value of the Fund’s liabilities at the valuation would have been significantly higher, resulting in a funding level of 54%. This is a measure of the level of reliance on future investment returns i.e. level of investment risk being taken.

Departure from a minimum risk investment strategy, in particular to include growth assets such as equities, gives a better prospect that the assets will, over time, deliver returns in excess of CPI inflation and reduce the contribution requirements. The target solvency position of having sufficient assets to meet the Fund’s pension obligations might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The overall strategic asset allocation is set out in the Investment Strategy Statement (ISS).

Based on the investment strategy in the ISS and the Actuary’s assessment of the return expectations for each asset class, this leads to an overall best estimate average expected return of 3.0% per annum in excess of CPI inflation as at the valuation date. For the purposes of setting funding strategy however, the Fund believes that it is appropriate to take a margin for prudence on these return expectations (i.e. to use an assumption that has a greater than 50% chance of being achieved) and this is expected under the Regulations and guidance. This margin however, has been adjusted to take account of the risk management strategies implemented to reduce the volatility of returns within the investment strategy. In isolation, this allows a lower margin for prudence to be used than would otherwise be the case if these risk management strategies were not in place.

Risk Management

In the context of managing various aspects of the Fund’s financial risks, the Fund has implemented a number of risk management techniques. The principal aim of these risk management techniques is to effectively look to provide more certainty of contribution outcomes within reasonable parameters.

In particular:

- **Equity Protection** – the Fund has implemented protection against potential falls in the equity markets via the use of derivatives. The aim of the protection is to provide further stability (or even a reduction) in employer deficit contributions (all other things equal) in the event of a significant equity market fall (although it is recognised that it will not protect the Fund in totality). Further information in relation to the equity protection arrangement is available within the Fund’s Investment Strategy Statement and Committee papers.
- **Investment ‘pots’** – the Fund will implement alternative investment strategies with differential levels of investment risk with effect from 1 April 2020. The aim is to provide greater control over employers’ exposure to investment risk (see **Appendix F** for further information). The pot an employer sits in will be reflected in the relevant employer’s asset share, funding basis and contribution requirements.

7. Identification of Risks and Counter-Measures

The funding of defined benefits is by its nature uncertain. Funding of the Fund is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Fund has been advised by the Fund Actuary that the greatest risk to the funding level is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that assumed in the long-term. The Actuary's formal valuation report includes quantification of some of the major risk factors. The risk mitigations are set out in the Fund's separate risk register which is included in the Committee papers.

Financial

The financial risks are as follows:

- Investment markets fail to perform in line with expectations.
- Protection and risk management fail to perform in line with expectations.
- Market outlook moves at variance with assumptions.
- Investment fund managers fail to achieve performance targets over the longer term.
- Asset re-allocations in volatile markets may lock in past losses.
- Pay and price inflation turning out to be significantly more or less than anticipated.
- Future underperformance arising as a result of participating in the larger asset pooling vehicle, and
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.

Any increase in employer contribution rates or deficit recovery payments (as a result of these risks) may in turn impact on the service delivery of that employer and their financial position.

In practice the extent to which these risks can be reduced is limited. However, the Fund's asset allocation (including in each separate investment pot) is kept under constant review and the performance of the investment managers is regularly monitored. In addition, the implementation of a risk management framework to manage the key financial risks will help reduce risk over time.

Demographic

The demographic risks are as follows:

- Future unanticipated changes in life expectancy (longevity).
- Potential strains from ill-health retirements, over and above what is allowed for in the valuation assumptions (or level of ill-health insurance protection, where relevant).
- Unanticipated acceleration of the maturing of the Fund resulting in materially negative cashflows and shortening of liability durations

Increasing longevity is something which government policies, both national and local, are designed to promote. It does, however, result in a greater liability for Pension Funds.

Ill-health retirements can be costly for employers, particularly small employers where one or two costly ill-health retirements can take them well above the 'average' implied by the valuation assumptions. Increasingly we are seeing employers mitigate the number of ill-health retirements by employing HR / occupational health preventative measures. These in conjunction with ensuring the regulatory procedures in place to ensure that ill-health retirements are properly controlled, can help control exposure to this demographic risk. An external ill-health insurance arrangement can also help to ensure that the eligible employers are not exposed to large deficits due to the ill-health retirement of one or more of their members.

Whilst regulatory procedures are in place to ensure that ill-health retirements are properly controlled, employing bodies also need to recognise that unforeseen costs for them will arise in the event that the number of ill-health retirements were to exceed the assumptions made. Early retirements for reasons of redundancy and efficiency do not affect the solvency of the Fund because they are the subject of a direct charge.

Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, employers should be doing everything in their power to minimise the number of ill-health retirements.

With regards to increasing maturity (e.g. due to further cuts in workforce and/or restrictions on new employees accessing the Fund), the Fund regularly monitors the it's cashflow requirements and considers the impact on the investment strategy.

Regulatory

The key regulatory risks are as follows:

- Changes to Regulations, e.g. changes to the benefits package, retirement age, potential new entrants to Fund.
- Changes to national pension requirements and/or HMRC Rules.
- Political risk that the guarantee from the Department for Education for academies is removed or modified along with the operational risks as a consequence of the potential for a large increase in the number of academies in the Fund due to Government policy.

Membership of the LGPS is open to all local government staff and should be encouraged as a valuable part of the contract of employment. However, increasing membership does result in higher employer costs.

Governance

The Fund has done as much as it believes it reasonably can to enable employing bodies and Fund members (via their representatives on the Pensions Committee and Pension Board) to make their views known to the Fund and to participate in the decision-making process. Previous versions of this FSS were consulted on prior to the 13 December 2019 Pensions Committee meeting. This version was finalised following the Pensions Committee meeting on 17 March 2020.

Governance risks are as follows:

- The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated.
- Fund unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements) with the result that contribution rates are set at too low a level.

- Fund not advised of an employer closing to new entrants, something which would normally require an increase in contribution rates.
- An employer ceasing to exist with insufficient funding or adequacy of a bond.
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements, and
- Changes in the Committee membership.

For these risks to be minimised much depends on information being supplied to the Fund by the employing bodies. Arrangements are strictly controlled and monitored, but in most cases the employer, rather than the Fund as a whole, bears the risk.

8. Monitoring and Review

The Fund has taken advice from the Actuary in preparing this FSS, and has consulted with the employers participating in the Fund.

The Fund will monitor the progress of the Funding Strategy and, if considered appropriate, the Funding Strategy will be reviewed (other than as part of the triennial valuation process), for example, if there:

- Has been a significant change in market conditions, and/or deviation in the progress of the Funding Strategy.
- Have been significant changes to the Fund membership, or LGPS benefits e.g. resolution of the McCloud remedy.
- Have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the Funding Strategy.
- Have been any significant special contributions paid into the Fund.
- Has been a change in Regulations or Guidance which materially impacts on the policies within the Funding Strategy.

When monitoring the Funding Strategy, if the Fund considers that any action is required, the relevant employers will be contacted. In the case of admitted bodies, there is statutory provision for rates to be amended between valuations and this will be considered in conjunction with the employer affected and any associated guarantor of the employer's liabilities (if relevant).

The structure and make-up of the investment pots will also be periodically reviewed between valuations based on the size and maturity of the liabilities within each pot. This will also allow for any movements of employers between the pots due to changes in funding position, covenant and also at the request of an employer.

A full review of this FSS will occur no less frequently than every 3 years, to coincide with completion of a full actuarial valuation.

The McCloud Judgment

The cost management process was set up by HMT, with an additional strand set up by the Scheme Advisory Board (for the LGPS). The aim of this was to control costs for employers and taxpayers via adjustments to benefits and/or employee contributions.

As part of this, it was agreed that employers should bear the costs/risks of external factors such as the discount rate, investment returns and inflation changes, whereas employees should bear the costs/risks of other factors such as wage growth, life expectancy changes, ill-health retirement experience and commutation of pension.

The outcomes of the cost management process were expected to be implemented from 1 April 2019, based on data from the 2016 valuations for the LGPS. This has now been put on hold due to age discrimination cases brought in respect of the firefighters and judges schemes, relating to protections provided when the public sector schemes were changed (which was on 1 April 2014 for the LGPS and 1 April 2015 for other Schemes).

The Government have confirmed that this judgment will result in a remedy being required for the LGPS. The Scheme Advisory Board issued guidance here which sets out how the McCloud case should be allowed for within the 2019 valuation.

The Fund has considered its policy in relation to costs that could emerge from the McCloud judgment in line with the guidance from the Scheme Advisory Board in conjunction with the Actuary. Whilst the remedy is not known and may not be known for some time, for the purpose of this valuation, when considering the appropriate contribution provision, it has been assumed that the judgment would have the effect of removing the current age criteria applied to the underpin implemented in 2014 for the LGPS. This underpin therefore would apply to all active members as at 1 April 2012. The relevant estimated costs have been quantified and notified to employers on this basis but also highlighting that the final costs maybe significantly different. Employers were able to choose to include these estimated costs over 2020/23 in their certified contributions. Alternatively, they were able to make allowance within their budgets and advised that backdated contributions could be payable if the remedy is known before the next valuation.

The mechanism to achieve this has been set out in the Actuary’s certificate.

Appendix A: Acturial Method and Assumptions

Method

The actuarial method to be used in the calculation of the solvency 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 Fund 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, alternative methods are adopted, which make advance allowance for the anticipated future ageing and decline of the current closed membership group potentially over the period of the rates and adjustments certificate.

Financial Assumptions – Solvency Funding Target

Investment return (discount rate)

The discount rates for the investment pots have been derived based on the expected return on the Fund assets based on the long-term strategy set out in the Investment Strategy Statement (ISS). The discount rates include appropriate margins for prudence. When assessing the appropriate discount rate consideration has been given to the returns in excess of CPI inflation (as derived below).

These real returns will be reviewed from time to time based on the investment pot strategy, market outlook and the Fund’s overall risk metrics. The discount rates will be reviewed as a matter of course at the time of a formal valuation or a formal employer rate review.

Growth investment pot

For employers in the Growth investment pot the discount rate at the valuation has been derived based on an assumed return of 1.65% per annum above CPI inflation i.e. a real return of 1.65% per annum and a total discount rate of 4.05% per annum.

Medium investment pot

For employers in the Medium investment pot the discount rate at the valuation has been derived based on an assumed return of 1.4% per annum above CPI inflation i.e. a real return of 1.4% per annum and a total discount rate of 3.8% per annum.

Cautious investment pot

For employers in the Cautious investment pot the discount rate at the valuation has been derived based on an assumed return of 0.25% per annum above CPI inflation i.e. a real return of 0.25% per annum and a total discount rate of 2.65% per annum.

Inflation

The inflation assumption will be taken to be the investment market’s expectation for Retail Price Index (RPI) inflation 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 Fund’s accrued liabilities, but subject to the following two adjustments:

- An allowance for supply/demand distortions in the bond market is incorporated, and
- An adjustment due to retirement pensions being increased annually by the change in the Consumer Prices Index rather than the Retail Prices Index

The overall reduction to RPI inflation at the valuation date is 1.0% per annum. This adjustment to the RPI inflation assumption will be reviewed from the valuation date to take in to account any reform in the RPI index, as announced by the Chancellor of the Exchequer. The change will then be implemented for the policies set out in this statement.

Salary increases

In relation to benefits earned prior to 1 April 2014, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long-term salary increase assumption allowance has been made for expected short term pay restraint for some employers as budgeted in their financial plan. The assumption used for an employer will be notified to them separately as part of the discussions but typically will be a minimum of 2% per annum until 31 March 2023.

Application of bespoke salary increase assumptions as put forward by individual employers will be at the ultimate discretion of the Fund but as a minimum must be reasonable and practical. To the extent that experience differs to the assumption adopted, the effects will emerge at the next actuarial valuation.

Pension increases/Indexation of CARE benefits

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 the CPI (e.g. some Guaranteed Minimum Pensions where the LGPS is not currently required to provide full indexation). For members in pensionable employment, their CARE benefits are also indexed by CPI although this can be less than zero i.e. a reduction in benefits, whereas for pension increases this cannot be negative, as pensions cannot be reduced.

Demographic Assumptions

Mortality/Life Expectancy

The mortality in retirement assumptions are based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the Fund. The mortality tables used are set out below, with a loading reflecting LGPS experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. A specific mortality assumption has also been adopted for current members who retire on the grounds of ill-health. For all members, it is assumed that the trend in longevity seen over recent time periods (as evidenced in the 2018 CMI analysis) will continue in the longer term and as such, the assumptions build in a level of longevity ‘improvement’ year on year in the future in line with the CMI 2018 projections and a long-term improvement trend of 1.75% per annum.

As an indication of impact, assumed life expectancies at age 65 are:

| Membership Category | Male Life Expectancy at 65 | Female Life Expectancy at 65 |
|-----------------------|----------------------------|------------------------------|
| Pensioners | 22.5 | 24.9 |
| Actives aged 45 now | 24.1 | 26.9 |
| Deferreds aged 45 now | 22.6 | 25.8 |

For example, a male pensioner, currently aged 65, would be expected to live to age 88.1. Whereas a male active member aged 45 would be expected to live until age 89.6. This is a reflection of the expected improvement in life expectancy over the next 20 years in the assumptions above.

The mortality before retirement has also been adjusted based on LGPS wide experience.

Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take a 3/80^{ths} cash sum (available as standard under the pre 1 April 2008 benefit structure). The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up regardless of age.

Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the incidence of ill-health retirements, withdrawal rates and the proportions married/civil partnership assumption remain in line with the assumptions adopted for the last valuation. In addition, no allowance will be made for the future take-up of the 50:50 option. Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate. Other assumptions are as per the last valuation.

Expenses

Expenses are met out of the Fund, in accordance with the Regulations. This is allowed for by adding 0.4% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

The costs of any discretion exercised by an employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation.

Method and Assumptions used in calculating the cost of future accrual (or primary rate)

The future service liabilities are calculated using the same assumptions as the funding target except that a different financial assumption for the discount rate is used. A critical aspect here is that the Regulations state the desirability of keeping the ‘Primary Rate’ (the future accrual cost) as stable as possible so this needs to be taken into account when setting the assumptions.

As future accrual contributions are paid in respect of benefits built up in the future, the Primary Rate should take account of the market conditions applying at future dates, not just the date of the valuation and a slightly higher expected return from the investment strategy has been assumed. This reflects the future liabilities for which these contributions will be paid have a longer average duration than the past service liabilities as they relate to active members only, and therefore, these contributions will be invested for a longer period.

Financial Assumptions – Future Accrual

The financial assumptions in relation to future accrual of benefits are not specifically linked to investment conditions as at the valuation date itself, and the following overall assumed real discount rates apply for each investment pot:

Growth investment pot

For employers in the Growth investment pot, the financial assumptions in relation to future service (i.e. the primary rate) are based on an overall assumed real discount rate of 2.25% per annum above the long-term average assumption for consumer price inflation of 2.4% per annum. This leads to a discount rate of 4.65% per annum.

Medium investment pot

For employers in the Medium investment pot, the financial assumptions in relation to future service (i.e. the primary rate) are based on an overall assumed real discount rate of 2% per annum above the long-term average assumption for consumer price inflation of 2.4% per annum. This leads to a discount rate of 4.4% per annum.

Cautious investment pot

For employers in the Cautious investment pot the discount rate at the valuation has been derived based on an assumed return of 0.25% per annum above CPI inflation i.e. a real return of 0.25% per annum and a total discount rate of 2.65% per annum.

Employer Asset Shares

The Fund is a multi-employer pension Fund that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is necessary to make some approximations in the timing of cashflows and allocation of investment returns when deriving the employer asset share.

In attributing the overall investment performance obtained on the assets of the investment pot for each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the pot for the employer unless agreed otherwise between the employer and the Fund at the sole discretion of the Fund.

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation. The investment return credited will depend on which investment pot the employers’ assets are in.

Other adjustments are also made on account of the funding positions of orphan bodies which fall to be met by all other active employers in the Fund.

Summary of key whole Fund assumptions used for calculating funding target and cost of future accrual (the ‘primary rate’) for the 2019 actuarial valuation

| | % |
|--|------------|
| Long-term yields | |
| Market implied RPI inflation | 3.4% p.a. |
| Solvency Funding Target financial assumptions | |
| Investment return/Discount Rate (Growth pot) | 4.05% p.a. |
| Investment return/Discount Rate (Medium pot) | 3.8% p.a. |
| Investment return/Discount Rate (Cautious pot) | 2.65% p.a. |
| CPI price inflation | 2.4% p.a. |
| Long-Term Salary increases* | 3.9% p.a. |
| Pension increases/indexation of CARE benefits | 2.4% p.a. |

| | % |
|--|------------|
| Future service accrual financial assumptions | |
| Investment return/Discount Rate (Growth pot) | 4.65% p.a. |
| Investment return/Discount Rate (Medium pot) | 4.4% p.a. |
| Investment return/Discount Rate (Cautious pot) | 2.65% p.a. |
| CPI price inflation | 2.4% p.a. |
| Long-Term Salary increases | 3.9% p.a. |
| Pension increases/indexation of CARE benefits | 2.4% p.a. |

*Short term salary increases may also apply and each employer will be notified of this separately.

| Current Status | Retirement Type | Mortality Table |
|------------------|------------------|--|
| Pensioner | Normal Health | 99% S3PMA_CMI_2018 [1.75%] 91% S3PFA_M_CMI_2018 [1.75%] |
| | Dependant | 131% S3PMA_CMI_2018 [1.75%] 91% S3DFA_CMI_2018 [1.75%] |
| | Ill-Health | 118% S3IMA_CMI_2018 [1.75%] 130% S3IFA_CMI_2018 [1.75%] |
| | Future Dependant | 126% S3PMA_CMI_2018 [1.75%] 108% S3DFA_CMI_2018 [1.75%] |
| Active | Normal Health | 104% S3PMA_CMI_2018 [1.75%] 92% S3PFA_M_CMI_2018 [1.75%] |
| | Ill-Health | 120% S3IMA_CMI_2018 [1.75%] 142% S3IFA_CMI_2018 [1.75%] |
| Deferred | All | 128% S3PMA_CMI_2018 [1.75%] 107% S3PFA_M_CMI_2018 [1.75%] |
| Future Dependant | Dependant | 133% S3PMA_CMI_2018 [1.75%] 115% S3DFA_CMI_2018 [1.75%] |

Other demographic assumptions are set out in the Actuary’s formal report.

Appendix B: Employer Deficit Recovery Payments

The Fund's long-term objective is for the Fund to achieve a 100% solvency level over a reasonable time period. As the assets of the Fund are less than the liabilities at the effective date, a deficit recovery plan needs to be adopted such that additional contributions are paid into the Fund to meet the shortfall.

Deficit payments will be expressed as £s amounts (with the exception of the Town and Parish Council's group where deficit contributions will be paid as a % of pensionable pay), and it is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Fund's view of the employer's covenant and risk to the Fund.

Recovery periods will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. This will determine the minimum contribution requirement and employers will be free to select any shorter deficit recovery period and higher contributions if they wish, including the option of prepaying the deficit contributions in one lump sum either on annual basis or a one-off payment. This will be reflected in the monetary amount requested via a reduction in overall £ deficit contributions payable.

The determination of the recovery periods is summarised in the table below:

| Category | Default Deficit Recovery | Derivation |
|--|---|--|
| Fund Employers | 18 years | Determined by reducing the period from the preceding valuation by at least 3 years (where appropriate) |
| Open Admitted Bodies | 18 years | Determined by reducing the period from the preceding valuation by at least 3 years |
| Closed Employers | Lower of 15 years and the future working lifetime of the membership | Determined by reducing the period from the preceding valuation and the membership of the employer |
| Employers with a limited participation in the Fund | Determined on a case by case basis | Length of expected period of participation in the Fund |

In determining the actual recovery period to apply for any particular employer or employer grouping, the Fund 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 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.

The objective is to recover any deficit over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the deficit contributions at the

expected monetary levels from the preceding valuation (allowing for any indexation in these monetary payments over the recovery period).

For any employers assessed to be in surplus, their individual contribution requirements will be adjusted to such an extent that any surplus is unwound over a 15 year period for open employers, or the lower of 15 years and the future working lifetime of the membership for closed employers, unless agreed otherwise with the Fund (if surpluses are sufficiently large, contribution requirements will be set to a minimum nil total amount). The current level of contributions payable by the employer may also be phased down to the reduced level as appropriate.

Other Factors Affecting the Employer Deficit Recovery Payments

As part of the process of agreeing funding plans with individual employers, the Fund will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities. All other things equal this could result in a longer recovery period being acceptable to the Fund, although employers will still be expected to at least cover expected interest costs on the deficit.

It is acknowledged by the Fund that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Fund therefore may in some cases be willing to use its discretion to accept an evidence based affordable level of contributions for such organisations for the three years 2020/2023. Any application of this option is at the ultimate discretion of the Fund officers and Section 151 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.

For those bodies identified as having a weaker covenant, the Fund will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans. As a minimum, the annual deficit payment must meet the on-going interest costs to ensure, everything else being equal, that the deficit does not increase in monetary terms.

Notwithstanding the above, the Fund, in consultation with the actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

Appendix C: Admission Policy

Introduction

This document details the Fund’s policy on the methodology for assessment of ongoing contribution requirements and admissions into the. It supplements the general policy of the Fund as set out in the FSS.

- Admission bodies are required to have an ‘admission agreement’ with the Fund. In conjunction with the Regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.
- Scheme Employers have a statutory right to participate in the LGPS and their staff therefore can become members of the LGPS at any time, although some organisations (Part 2 Scheme Employers) do need to designate eligibility for its staff.

A list of all current employing bodies participating in the Fund is kept as a live document and will be updated by the Fund as bodies are admitted to, or leave the Fund.

Entry to the Fund

Unless agreed otherwise by the Fund, prior to admission to the Fund, an Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Fund. If the risk assessment and/or bond amount is not to the satisfaction of the Fund (as required under the LGPS Regulations) it will consider and determine whether the admission body must pre-fund for termination with contribution requirements assessed using the minimum risk methodology and assumptions.

Some aspects that the Fund may consider when deciding whether to apply a minimum risk methodology are:

- Uncertainty over the security of the organisation’s funding sources e.g. the body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves.
- If the admitted body has an expected limited lifespan of participation in the Fund.
- The average age of employees to be admitted and whether the admission is closed to new joiners.

In order to protect other Fund employers, where it has been considered undesirable to provide a bond, a guarantee must be sought in line with the LGPS Regulations.

At the discretion of the Fund, where an admission is in respect of 10 or less LGPS posts the Admitted Body will be admitted to the Fund on a ‘Pass Through’ basis where the Admitted Body’s ongoing contribution requirements are agreed between the Letting Employer and the Admitted Body, without an individual contribution assessment being carried out.

Second generation outsourcings for staff not employed by the scheme employer contracting the services to an admitted body

A 2nd generation outsourcing is one where a service is being outsourced for the second time, usually after the previous contract has come to an end. For Best Value Authorities, principally the main Councils, they are bound by The Best Value Authorities Staff Transfers (Pensions) Direction 2007 so far as 2nd generation outsourcings are concerned. In the case of most other employing bodies, they should have regard to Fair Deal Guidance issued by the Government.

It is usually the case that where services have previously been outsourced, the transferees are employees of the contractor as opposed to the original scheme employer and as such will transfer from one contractor to another without being re-employed by the original scheme employer. There are even instances where staff can be transferred from one contractor to another without ever being employed by the outsourcing scheme employer that is party to the Admission Agreement. This can occur when one employing body takes over the responsibilities of another, such as a maintained school (run by the local education authority) becoming an academy. In this instance the contracting body is termed a ‘Related Employer’ for the purposes of the Local Government Pension Scheme Regulations and is obliged to guarantee the pension liabilities incurred by the contractor.

‘Related employer’ is defined as ‘any Scheme employer or other such contracting body which is a party to the admission agreement (other than an administering authority in its role as an administering authority)’.

LGPS Regulations 2013: Schedule 2 Part 3, Para 8

Where, for any reason, it is not desirable for an admission body to enter into an indemnity or bond, the admission agreement must provide that the admission body secures a guarantee in a form satisfactory to the administering authority from –

- (a) A person who funds the admission body in whole or in part.
- (b) In the case of an admission body falling within the description in paragraph 1(d), the Scheme employer referred to in that paragraph.
- (d) A body that is providing or will provide a service or assets in connection with the exercise of a function of a Scheme employer as a result of –
 - (i) The transfer of the service or assets by means of a contract or other arrangement.
 - (ii) A direction made under section 15 of the Local Government Act 1999 (115) (Secretary of State’s powers).
 - (iii) Directions made under section 497A of the Education Act 1996 (116).
- (c) A person who –
 - (i) Owns, or
 - (ii) Controls the exercise of the functions of, the admission body; or

In accordance with the above Regulations, the Fund requires a guarantee from the related employer. The related employer may seek a bond from the admitted body taking into account the risk assessment carried out by the Fund Actuary.

Admitted Bodies Providing a Service

Generally Admitted Bodies providing a service (including those admitted on a Pass Through basis) will have a guarantor within the Fund that will stand behind the liabilities. Accordingly, in general, the minimum risk approach to funding and termination will not apply for these bodies.

As above, the Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Fund. This assessment would normally be based on advice in the form of a ‘risk assessment report’ provided by the actuary to the Fund. As the Scheme Employer is effectively the ultimate guarantor for these admissions to the Fund it must also be satisfied (along with the Fund) over the level (if any) of any bond requirement. Where bond agreements are to the satisfaction of the Fund, the level of the bond amount will be subject to review on a regular basis. In the

case of an Admission Body admitted on a Pass Through basis, the requirement to carry out an assessment of the level of risk on premature termination of the contract may be waived at the agreement of the Fund and the Letting Employer who act as guarantor to the Admission Body.

In the absence of any other specific agreement between the parties, deficit recovery periods for Admitted Bodies will be set in line with the Fund’s general policy as set out in the FSS.

Any risk sharing arrangements agreed between the Scheme Employer and the Admitted Body will be documented in the commercial agreement between the two parties and not the admission agreement.

In the event of termination of the Admitted Body, any orphan liabilities in the Fund will be subsumed by the relevant Scheme Employer. Please see the Fund’s Termination Policy for further details.

An exception to the above policy applies if the guarantor is not a participating employer within the Fund, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the Fund, the Fund may in this case treat the admission body as pre-funding for termination, with contribution requirements assessed using the minimum risk methodology and assumptions.

Pre-funding for Termination

An employing body may choose to pre-fund for termination i.e. to amend their funding approach to a minimum risk methodology and assumptions as detailed in the Fund’s Termination Policy. This will substantially reduce the risk of an uncertain and potentially large debt being due to the Fund at termination. However, it is also likely to give rise to a substantial increase in contribution requirements, when assessed on the minimum risk basis.

For any employing bodies funding on such a minimum risk strategy a notional investment strategy will be assumed as a match to the liabilities. In particular, the employing body’s notional asset share of the Fund will be credited with an investment return in line with the minimum risk funding assumptions adopted rather than the notional investment returns generated by the investment strategy for the employer’s investment pot. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Fund, or depending on any case specific circumstances.

Appendix D: Termination Policy

Introduction

This document details the Fund’s policy on the methodology for assessment of termination payments in the event of the cessation of an employer’s participation in the Fund. It supplements the general policy of the Fund as set out in the FSS.

Termination of an Employer’s Participation

An employer ceases to participate within the Fund when the last active member leaves the Fund. This includes where the employer ceases to be eligible for membership e.g. a contract with a local authority comes to an end or the employer chooses to voluntarily cease participation.

When an employing body terminates for any reason, employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case the employees will retain pension rights within the Fund i.e. either deferred benefits or immediate retirement benefits.

In addition to any liabilities for current employees the Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members except where there is a complete transfer of responsibility to another Fund with a different Fund.

The employer becomes an exiting employer under the Regulations and the Fund is then required to obtain an actuarial valuation of that employer’s liabilities in respect of benefits of the exiting employer’s current and former employees along with a termination contribution certificate.

When an employer exits the Fund the Regulations give power to the Fund to set a repayment plan to recover the outstanding debt over a period at its sole discretion and this will depend on the affordability of the repayments and financial strength of the exiting employer. Once this repayment plan is set the payments would not be reviewed for changes in the funding position due to market or demographic factors.

The Fund’s policy for termination payment plans is as follows:

- 1. The default position is for exit payments and exit credits to be paid immediately in full following completion of the termination process (within 6 months of completion of the cessation assessment by the Actuary).
- 2. At the discretion of the Fund, exit payment instalment plans over a defined period will only be agreed when there are issues of affordability that risk the financial viability of the organisation and the ability of the Fund to recover the debt.
- 3. Any costs associated with the exit valuation will be paid by the employer by either increasing the exit payment or reducing the exit credit by the appropriate amount. In the case of an employer where the exit debt/credit is the responsibility of the original employer through a risk sharing agreement the costs will be charged directly to the employer unless the original employer directs otherwise.

In the event that unfunded liabilities arise that cannot be recovered from the exiting body, these will normally fall to be met by the Fund as a whole (i.e. all employers) unless there is a guarantor or successor body within the Fund.

With the exception of grouped employers (see below), the Fund’s policy is that a termination assessment will be made based on a minimum risk funding basis, unless the employing body has a guarantor within the Fund or a successor body exists to take over the employing body’s liabilities (including those for former employees).

Termination Assessments

The policy for employers who have a guarantor participating in the Fund:

If the employing body (including those admitted on a Pass Through basis) has a guarantor within the Fund or a successor body exists to take over the employing body’s liabilities, the Fund’s policy is that the valuation funding basis will be used for the termination assessment unless the guarantor informs the Fund otherwise.

The residual assets and liabilities, and hence any surplus or deficit will normally transfer back to the guarantor of the employing body within the Fund. (For Admission Bodies, this process is sometimes known as the ‘novation’ of the admission agreement.) This may, if agreed by the successor body, constitute a complete amalgamation of assets and liabilities to the successor body.

In circumstances where an exiting employer is expected to still be responsible for all or part of the termination position, an exit payment/exit credit may be payable from/to the exiting employer. This is subject to representation by all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor, in particular any ‘risk-sharing’ agreements that may exist. In line with the amending Regulations (The Local Government Pension Scheme (Amendment) Regulations 2020) the parties will need to make representation to the Fund if they believe an Exit Credit should be paid outside the policy set out above, or if they dispute the determination of the Fund.

The information required by the Fund from employers to make a determination on whether an exit credit should be paid where a risk sharing arrangement is in place, and a representation has been made, will be supplied to the interested parties at the appropriate time.

The policy for employers who do not have a guarantor participating in the Fund:

A termination assessment will be made based on a minimum risk funding basis. This is to protect the other employers in the Fund as, at termination, the employing body’s liabilities will become orphan liabilities within the Fund, and there will be no recourse to it if a shortfall emerges in the future (after participation has terminated).

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 6 months of completion of the cessation assessment by the Actuary).
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Fund at their sole discretion) following completion of the termination process.

The Fund can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the actuary.

The Fund currently groups Town and Parish Councils for contribution rate setting purposes. The Fund’s policy is that, on termination of participation within the group, the termination assessment will be based on a simplified share of deficit/surplus approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit/surplus share as at the last actuarial valuation of the Fund, in proportion to the respective payrolls for the body and the group as a whole, and then adjusting to the date of exit. The share of deficit/surplus will be assessed based on the ongoing valuation funding basis for the group as a whole at the last actuarial valuation. The adjustment to the date of exit will normally be made in line with the funding assumptions adopted for the group as at the last actuarial valuation unless the actuary and Fund consider that the circumstances warrant a different treatment, for example, to allow for actual investment returns over the period from the last actuarial valuation to exit.

In addition, for some Multi-Academy Trusts (MAT), a grouped approach has been taken with individual academies within a Trust no longer being separately identifiable on the Fund’s administration system or for funding or contribution purposes. On termination of participation of one of the academies within such a MAT, the termination assessment will be based on a simplified share of deficit/surplus approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit/surplus share as at the last actuarial valuation of the Fund, in proportion to the respective payrolls for the employees of the exiting academy and the MAT a whole, and then adjusting to the date of exit. The share of deficit/surplus will be assessed based on the ongoing valuation funding basis for the MAT as a whole at the last actuarial valuation. The adjustment to the date of exit will normally be made in line with the funding assumptions adopted for the MAT as at the last actuarial valuation unless the actuary and Fund consider that the circumstances warrant a different treatment, for example, to allow for actual investment returns over the period from the last actuarial valuation to exit.

Unless agreed otherwise by the Fund, any unfunded liability that cannot be reclaimed from the outgoing grouped body will be underwritten by the group/MAT and not all employers in the Fund. Following termination, the residual liabilities and assets in respect of that body will be subsumed by any guarantor body for the group, or in the absence of a guarantor, subsumed by the group/MAT.

It is possible under certain circumstances that an employer can apply to transfer all assets and current and former members’ benefits to another LGPS Fund in England and Wales. In these cases no termination assessment is required as there will no longer be any orphan liabilities in the Fund. Therefore, a separate assessment of the assets to be transferred will be required.

Future Terminations

In many cases, termination of an employer’s participation is an event that can be foreseen, for example, because the organisation’s operations may be planned to be discontinued and/or the admission agreement is due to cease. Under the Regulations, in the event of the Fund becoming aware of such circumstances, it can amend an employer’s minimum contributions such that the value of the assets of the employing body is neither materially more nor materially less than its anticipated liabilities at the date it appears to the Fund that it will cease to be a participating employer. In this case, employing bodies are encouraged to open a dialogue with the Fund to commence planning for the termination as early as possible. Where termination is disclosed in advance the Fund will operate procedures to reduce the sizeable volatility risks to the debt amount in the run up to actual termination of participation. For example, on agreement with the employer, by moving the employer to a lower risk funding basis or a notional minimum risk funding basis. The Fund will modify the employing body’s approach in any case, where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

Minimum Risk Termination Basis

The minimum risk financial assumptions that applied at the actuarial valuation date (31 March 2019) are set out below in relation to any liability remaining in the Fund. These will be updated on a case-by-case basis, with reference to prevailing market conditions at the relevant employing body’s cessation date.

| Minimum risk assumptions | 31 March 2019 |
|---|---------------|
| Discount Rate | 1.5% p.a. |
| CPI inflation | 2.4% p.a. |
| Pension increases/indexation of CARE benefits | 2.4% p.a. |

These financial assumptions will be reviewed on an ongoing basis to allow for changes in market conditions along with any structural or legislative changes.

In particular, since the valuation date it has been announced that RPI inflation is likely to be reformed, with the reform potentially meaning the index is closer to the CPIH inflation measure. This would need to be reflected when deriving an updated market estimate of the CPI inflation. For example, when assessing a termination position (at February 2020) we will adjust the market RPI inflation to arrive at the CPI inflation assumption by deducting 0.7% per annum as opposed to the 1.0% per annum at the valuation date when assessing an employer’s termination position. This adjustment will be kept under review as more details emerge on the reform of RPI.

All demographic assumptions will be the same as those adopted for the 2019 actuarial valuation, except in relation to the life expectancy assumption. Given the minimum risk financial assumptions do not protect against future adverse demographic experience a higher level of prudence will be adopted in the life expectancy assumption. This will be reviewed from time to time to allow for any material changes in life expectancy trends and will be formally reassessed at the next valuation.

The termination basis for an outgoing employer will include an adjustment to the assumption for longevity improvements over time by increasing the rate of improvement in mortality rates to 2.25% p.a. from 1.75% used in the 2019 valuation for ongoing funding and contribution purposes.

Appendix E: Covenant Assessment and Monitoring Policy

An employer’s covenant underpins its legal obligation and ability to meet its financial responsibilities now and in the future. The strength of covenant depends upon the robustness of the legal agreements in place and the likelihood that the employer can meet them. The covenant effectively underwrites the risks to which the Fund is exposed, including underfunding, longevity, investment and market forces.

An assessment of employer covenant focuses on determining the following:

- Type of body and its origins.
- Nature and enforceability of legal agreements.
- Whether there is a bond in place and the level of the bond.
- Whether a more accelerated recovery plan should be enforced.
- Whether there is an option to call in contingent assets.
- Is there a need for monitoring of ongoing and termination funding ahead of the next actuarial valuation?

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital.

Risk Criteria

The assessment criteria upon which an employer should be reviewed could include:

- Nature and prospects of the employer’s industry.
- Employer’s competitive position and relative size.
- Management ability and track record.
- Financial policy of the employer.
- Profitability, cashflow and financial flexibility.
- Employer’s credit rating.
- Position of the economy as a whole.

Not all of the above would be applicable to assessing employer risk within the Fund; rather a proportionate approach to consideration of the above criteria would be made, with further consideration given to the following:

- The scale of obligations to the Fund relative to the size of the employer’s operating cashflow.
- The relative priority placed on the Fund compared to corporate finances.
- An estimate of the amount which might be available to the scheme on insolvency of the employer as well as the likelihood of that eventuality.

Assessing Employer Covenant

The employer covenant will be assessed objectively and its ability to meet their obligations will be viewed in the context of the Fund’s exposure to risk and volatility based on publically available information and/

or information provided by the employer. The monitoring of covenant strength along with the funding position (including on the termination basis) enables the Fund to anticipate and pre-empt employer funding issues and thus adopt a proactive approach. In order to objectively monitor the strength of an employer’s covenant, adjacent to the risk posed to the Fund, a number of fundamental financial metrics will be reviewed to develop an overview of the employer’s stability and a rating score will be applied using a Red/Amber/Green (RAG) rating structure.

In order to accurately monitor employer covenant, it will be necessary for research to be carried out into employers’ backgrounds and, in addition, for those employers to be contacted to gather as much information as possible. Focus will be placed on the regular monitoring of employers with a proactive rather than reactive view to mitigating risk.

The covenant assessment will be combined with the funding position to derive an overall risk score. Action will be taken if these metrics meet certain triggers based on funding level, covenant rating and the overall risk score.

Frequency of Monitoring

The funding position and contribution rate for each employer participating in the Fund will be reviewed as a matter of course with each triennial actuarial valuation. However, it is important that the relative financial strength of employers is reviewed regularly to allow for a thorough assessment of the financial metrics. The funding position will be monitored (including on the termination basis) using an online system provided to officers by the Fund Actuary.

Employers subject to a more detailed review, where a risk criterion is triggered, will be reviewed at least every six months, but more realistically with a quarterly focus.

Covenant Risk Management

The focus of the Fund’s risk management is the identification and treatment of the risks and it will be a continuous and evolving process which runs throughout the Fund’s strategy. Mechanisms that will be explored with certain employers, as necessary, will include but are not limited to the following:

- 1. Parental Guarantee and/or Indemnifying Bond.
- 2. Transfer to a more prudent actuarial basis (e.g. the termination basis).
- 3. Shortened recovery periods and increased cash contributions

Appendix F: Investment Pot Risk Management Policy

In the context of managing aspects of the Fund’s financial risks, the Fund has implemented a choice of ‘investment’ pots to offer to employers (with effect from 1 April 2020) which exhibit differential levels of investment risk based on alternative underlying investment strategies. The three available investment pots are called:

- The Growth pot;
- The Medium pot; and
- The Cautious pot

This strategy will be reviewed periodically as part of the governance of the Fund’s overall risk management framework. This policy should be considered alongside the Fund’s Covenant Assessment and Monitoring Policy.

Investment Strategies

The current Fund investment strategy will apply to the ‘Growth pot’. The ‘Medium pot’ and ‘Cautious pot’ will give employers the option to reduce the level of investment risk that they wish to take, particularly for those employers that are considering leaving the Fund.

The strategic allocation for the Fund as a whole and for each of the investment pots is set out in the Investment Strategy Statement.

The investment strategy underlying each investment pot will be reviewed formally at each actuarial valuation along with the overall Fund investment strategy. This will also allow for any movements of employers between the investment pots due to changes in funding position, covenant and also at the request of an employer.

In addition, a high level health check will be performed annually allowing for market changes and outlook as well as underlying changes in the maturity and profile of the liabilities of the employers within each pot. However, a formal review may be undertaken mid-valuation if there is a material shift of employers between pots and/or material shift in the funding position in order to more efficiently manage the overall risk.

The investment pots will be managed within the overall Fund investment strategy as far as possible. If any investment options are unavailable, and are deemed to be desirable, then the Fund will consider obtaining access to these options through the LGPS Central Limited pool or potentially directly.

Employer Allocations

The allocations to each investment pot will be reviewed in detail alongside the actuarial valuation every 3 years. The Fund will take into account the following employer factors when considering overall risk and allocating an employer to a specific pot:

- Employer type e.g. tax raising body, academy, admitted body.
- Employer ongoing covenant strength including any guarantee or security.
- Employer size, maturity and funding position.
- Employer status e.g. open/closed to new members and objectives.

If, based on a covenant assessment carried out by the Fund, an employer is deemed to have a weaker covenant than other employers in the Fund, or is expected to exit the Fund in the near future, the Fund reserves the right to move an employer (typically following discussions with that employer) into either the Medium or Cautious pot to provide some protection against deterioration in funding position for the employer and the Fund as a whole. Any orphaned liabilities, once an employer exits the Fund, will generally be automatically moved into the Cautious pot as these liabilities have no sponsoring employer and are ultimately underwritten by all employers within the Fund.

As part of a triennial valuation, any employer can elect to move to a lower risk investment strategy to reduce their level of investment risk exposure and the potential volatility in their future funding position.

The choice of investment pot will be reflected in each employer's asset share, funding basis and contribution requirements.

The above employer factors will be monitored regularly between actuarial valuations and the allocation to a specific investment pot may be reviewed between actuarial valuations in the following circumstances:

- Material change in certain types of employers' funding position.
- Material change in an employer's status or covenant.
- Request from an employer to move investment pots, subject to the agreement of the Fund.

Appendix G: Glossary

50/50 Scheme

In the LGPS, active members are given the option of accruing a lower personal benefit in the 50/50 Scheme, in return for paying a lower level of contribution.

Actuarial Valuation

An investigation by an actuary into the ability of the Fund to meet its liabilities. For the LGPS the Fund Actuary will assess the funding level of each participating employer and agree contribution rates with the Fund to fund the cost of new benefits and make good any existing deficits as set out in the separate FSS. The asset value is based on market values at the valuation date.

Administering Authority

The Council with a statutory responsibility for running the Fund and that is responsible for all aspects of its management and operation.

Admission Bodies

A specific type of employer under the 'LGPS' who do not automatically qualify for participation in the Fund but are allowed to join if they satisfy the relevant criteria set out in the Regulations.

Benchmark

A measure against which fund performance is to be judged.

Best Estimate Assumption

An assumption where the outcome has a 50/50 chance of being achieved.

Bonds

Loans made to an issuer (often a government or a company) which undertakes to repay the loan at an agreed later date. The term refers generically to corporate bonds or government bonds (gilts).

Career Average Revalued Earnings Scheme (CARE)

With effect from 1 April 2014, benefits accrued by members in the LGPS take the form of CARE benefits. Every year members will accrue a pension benefit equivalent to $\frac{1}{49}$ th of their pensionable pay in that year. Each annual pension accrued receives inflationary increases (in line with the annual change in the Consumer Prices Index) over the period to retirement.

Cautious Investment Strategy

An investment strategy linked to income generating assets which target a minimum yield above CPI inflation allowing for default, reinvestment risk and any other reasonable margins of prudence deemed appropriate.

Contingent Assets

Assets held by employers in the Fund that can be called upon by the Fund in the event of the employer not being able to cover the debt due upon termination. The terms will be set out in a separate agreement between the Fund and employer.

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 or affordability constraints in the short term.

CPI

Acronym standing for ‘Consumer Prices Index’. CPI is a measure of inflation with a basket of goods that is assessed on an annual basis. The reference goods and services differ from those of RPI. These goods are expected to provide lower, less volatile inflation increases. Pension increases in the LGPS have been linked to the annual change in CPI since April 2011.

CPIH

An alternative measure of CPI which includes owner occupiers’ housing costs and Council Tax (which are excluded from CPI).

Deficit

The extent to which the value of the Fund’s past service liabilities exceeds the value of the Fund’s assets. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions).

Deficit Recovery Period

The target length of time over which the current deficit is intended to be paid off. A shorter period will give rise to a higher annual contribution, and vice versa.

Discount Rate

The rate of interest used to convert a cash amount e.g. future benefit payments occurring in the future to a present value.

Employer’s Future Accrual Rate

The contribution rate payable by an employer, expressed as a % of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses.

Employing Bodies

Any organisation that participates in the LGPS, including admission bodies and Fund employers.

Equities

Shares in a company which are bought and sold on a stock exchange.

Equity Protection

An insurance contract which provides protection against falls in equity markets. Depending on the pricing structure, this may be financed by giving up some of the upside potential in equity market gains.

Exit Credit

The amount payable from the Fund to an exiting employer in the case where the exiting employer is determined to be in surplus at the point of cessation based on a termination assessment by the Fund Actuary.

Fund/Scheme Employers

Employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Fund Employers.

Funding or Solvency Level

The ratio of the value of the Fund’s assets and the value of the Fund’s liabilities expressed as a percentage.

Funding Strategy Statement (FSS)

This is a key governance document that outlines how the administering authority will manage employer’s contributions and risks to the Fund.

Government Actuary’s Department (GAD)

The GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

Growth Investment Strategy

A predominantly growth asset biased investment strategy targeting long-term additional outperformance above CPI inflation. Further information is available in the Investment Strategy Statement.

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.

Investment Pot

This describes a bespoke notional investment strategy which applies to one or more employers and is dependent on the liability and risk profile. Dictates the financial assumptions used to determine the employer’s contribution requirements. The relevant discount rate used for valuing the present value of liabilities is determined based on the notional investment strategy for the relevant investment pot’s investment strategy. This is expressed as an expected return over CPI.

Investment Strategy

The long-term distribution of assets among various asset classes that takes into account the Funds objectives and attitude to risk.

Letting Eemployer

An employer that outsources part of its services/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.

Liabilities

The actuarially calculated present value of all benefit entitlements i.e. Fund cashflows of all members of the Fund, built up to date or in the future. The liabilities in relation to the benefit entitlements earned up to the valuation date are compared with the present market value of Fund assets to derive the deficit and funding/solvency level. Liabilities can be assessed on different set of actuarial assumptions depending on the purpose of the valuation.

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.

Lower Risk Funding Basis

An approach where the discount rate used to assess the liabilities is determined based on the expected long-term return achieved on the Fund’s lower risk investment strategy. This is usually adopted for employers who are deemed to have a weaker covenant than others in the Fund, who are planning to exit the Fund or who would like to target a lower risk strategy. This basis is adopted for ongoing contribution rate purposes as the employers’ asset share is invested in the lower risk investment strategy.

Mandatory Scheme Employers

Employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Scheme Employers. For example, these include councils, colleges, universities and academies.

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.

Medium Investment Strategy

An alternate investment strategy available to employers who wish to reduce investment risk to some extent compared to the Growth investment strategy but still target long-term additional outperformance above CPI inflation. Further information is available in the Investment Strategy Statement.

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).

Minimum Risk Basis

An approach where the discount rate used to assess the liabilities is determined based on the market yields of Government bond investments based on the appropriate duration of the liabilities being assessed. This is usually adopted when an employer is exiting the Fund.

Orphan Liabilities

Liabilities in the Fund for which there is no sponsoring employer within the Fund. Ultimately orphan liabilities must be underwritten by all other employers in the Fund.

Pass Through

Arrangement whereby the risks of participating in the LGPS are retained by the Letting Employer with the Admission Body's contributions being a reflection of the rate of the Letting Employer (subject to any specific adjustment required under the separate contractual arrangement).

Percentiles

Relative ranking (in hundredths) of a particular range. For example, in terms of expected returns a percentile ranking of 75 indicates that in 25% of cases, the return achieved would be greater than the figure, and in 75% cases the return would be lower.

Phasing/Stepping of Contributions

When there is an increase/decrease in an employer's long-term contribution requirements, the increase in contributions can be gradually stepped or phased in over an agreed period. The phasing/stepping can be in equal steps or on a bespoke basis for each employer.

Pooling

Employers may be grouped together for the purpose of calculating contribution rates, (i.e. a single contribution rate applicable to all employers in the pool). A pool may still require each individual employer to ultimately pay for its own share of deficit, or (if formally agreed) it may allow deficits to be passed from one employer to another.

Pre-payment

The payment by employers of contributions to the Fund earlier than that certified by the Actuary. The

amount paid will be reduced in monetary terms compared to the certified amount to reflect the early payment.

Present Value

The value of projected benefit payments, discounted back to the valuation date.

Primary Rate

The contribution rate required to meet the cost of future accrual of benefits, ignoring any past service surplus or deficit but allowing for any employer-specific circumstances, such as its membership profile, the Funding Strategy adopted for that employer, the actuarial method used and/or the employer's covenant.

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.

Prudent Assumption

An assumption where the outcome has a greater than 50/50 chance of being achieved i.e. the outcome is more likely to be overstated than understated. Legislation and Guidance requires the assumptions adopted for an actuarial valuation to be prudent.

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.

Real Return or Real Discount Rate

A rate of return or discount rate net of (CPI) inflation.

Recovery Plan

A strategy by which an employer will make up a funding deficit over a specified period of time ('the recovery period'), as set out in the FSS.

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, 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 Rate

The adjustment to the Primary rate to arrive at the total contribution each employer is required to pay. It is essentially the additional contribution (or reduction in contributions) resulting from any deficit (or surplus) attributable to the employer within the Fund.

Section 13 Valuation

In accordance with Section 13 of the Public Service Pensions Act 2014, the Government Actuary's Department (GAD) have been commissioned to advise the Department for Communities and Local Government (DCLG) in connection with reviewing the 2016 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

Solvency Funding Target

An assessment of the present value of benefits to be paid in the future. The desired funding target is to achieve a solvency level of a 100% i.e. assets equal to the accrued liabilities at the valuation date assessed on the ongoing concern basis.

Valuation Funding Basis

The financial and demographic assumptions used to determine the employer’s contribution requirements. The relevant discount rate used for valuing the present value of liabilities is consistent with an expected rate of return of the Fund’s investments. This includes an expected out-performance over gilts in the long-term from other asset classes, held by the Fund.



Appendix B

Policy Statement on Communications



1. Introduction

We aim to produce clear communications in a plain English style that provide everyone with any interest in the Fund with ready access to all the information they need to make informed decisions.

We may make our communications available in languages other than English or in Braille or in other formats upon request to suit those with special needs.

We can be contacted in person, by letter, by phone or by email.

We aim to respond to all requests in a timely manner and by meeting the enquirer's information objectives.

We will collaborate with other Funds throughout the year to produce communications that benefit from shared expertise and cost saving.

We aim to continually develop our communications / the resource we devote to engagement.

Our flagship communications offering is our website at:

www.worcestershirepensionfund.org.uk

We aim to maintain a compliant website that provides stakeholders with a first port of call for all of their pensions information needs, so that they can make informed decisions. NB: we are not able to provide financial advice.

We aim to invest in digitisation to maximise self-service for our members and employers.

2. Communicating with Employers

We will engage with our prospective and actual employers to:

- Explain our requirements of them.
- Define their information needs and expectations of us.
- Identify and deliver their training needs.

We will maintain an up to date Pension Administration Strategy.

We will maintain an Employers area on our website to provide regularly updated guidance / forms including monthly employer newsletters.

We will deliver a bi-annual employer forum to discuss, manage and communicate major strategic issues, legislation changes and funding matters.

Of the 5 members of our Pension Board there are 2 employer representatives who scrutinise all Pensions Committee decisions and can take items for discussion to our Pensions Committee on behalf of employer.

The Pensions Committee of 8 has 1 employer representative.

3. Communicating with Members

We will make available a range of publications/forms for prospective and actual scheme members including a Guide to the LGPS.

We will provide an annual benefit statement to our employee members and our deferred members by 31 August.

We will provide an annual newsletter to our employee members and our deferred members.

We will provide an annual newsletter, an annual payslip and a P60 to our pensioner members. We will also provide them with a pension payslip when there is a change of more than £1 per month in their pension.

Of the 5 members of our Pension Board there are 2 member/trade union representatives who scrutinise all Pensions Committee decisions and can take items for discussion to our Pensions Committee on behalf of members.

The Pensions Committee of 8 has 1 member/trade union representative.

4. Communications with Other Stakeholders

Our Annual Report and Financial Statements are available from our website.

Our website will also provide up to date information about our governance, funding, investments, finances and operations.

We will deliver appropriate communications to comply with and apply all relevant legislation/guidance (for example from The Pensions Regulator, The Local Government Association, Her Majesty’s Revenue & Customs, The Local Government Pension Scheme Advisory Board, etc.).

We will deliver a training programme for members of our Pensions Committee and Pension Board.



Appendix C

Worcestershire Pension Fund
Investment Strategy Statement 2020



1. Introduction

This is the Investment Strategy Statement (the ‘Statement’) of the Worcestershire Pension Fund (the ‘Fund’) as required by regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the ‘Regulations’). In preparing this Statement, the Pensions Committee has consulted with such persons as it considered appropriate.

Worcestershire County Council is the administering authority for the Fund under the regulations. Worcestershire County Council delegates responsibility for the administration and management of the Fund to the Pensions Committee. The Pensions Committee has oversight of the implementation of the management arrangements for the Fund’s assets and comprises of Elected Members and one Employee Representative and one Employer Representative. In addition, the Fund has the statutory Local Pensions Board whose role is to assist in the good governance of the scheme by ensuring compliance with statutory and regulatory duty. Finally, the Pensions Investment Sub-Committee advises the Pensions Committee on investment issues relating to the Fund. The Local Pensions Board has no decision-making powers whereas the Pensions Investment Sub-Committee does.

This statement which is reflected in the Strategic Allocation in **Appendix A** demonstrates the importance of Asset allocation on returns over the long-term.

The Statement is subject to review at least annually and from time to time on any material changes to any aspects of the Fund, its liabilities, finances and its attitude to risk which they judge to have a bearing on the stated investment policy. In preparing this statement, the Committee has considered advice from the investment adviser.

The responsibilities of relevant parties are set out in **Appendix B**.

The Fund’s Statement of Investment Beliefs are set out in **Appendix D**.

Related Fund policies and statements are as follows and are publicly available on the Fund’s website:

- Funding Strategy Statement (on website).
- Governance Compliance Statement (within Annual Report on website).
- Policy Statement on Communication Strategy (within Annual Report on website).
- Policy Statement on Governance Strategy (within Annual Report on website).

2. Fund Objectives

The primary objectives of the Fund are to:

- (a) Ensure that sufficient assets are available to meet liabilities as they fall due;
- (b) Maximise the return at an acceptable level of risk.

The level of employer contribution is assessed every three years through an actuarial valuation of the Fund. This valuation establishes the solvency position of the Fund, that is, the extent to which the assets of the Fund are sufficient to meet the Fund’s pension liabilities accrued to date. The objective is that the Fund should be at least 100% funded on an ongoing basis, taking account of any additional contributions paid by employer bodies to cover any past service deficit. The full funding projection is achieved over a 15-year time frame.

In addition, the Fund has the following objectives:

- To be a leading performer in the LGPS sector.
- To provide excellent customer service.

Funding Strategy Statement

The Funding Strategy Statement (FSS) and Investment Strategy Statement (ISS) are intrinsically linked and together aim to deliver stable contribution rates for employers and a reduced reliance on employer contributions over time. The FSS can be viewed on the website.

All Local Government Pension Scheme (LGPS) funds must produce, consult on and publish a document called a ‘Funding Strategy Statement’ (FSS). The purpose of the FSS is:

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

However, there will be conflicting objectives which need to be balanced and reconciled. For example, for most employer’s objective a) implies low contribution rates, because they would see pension liabilities being ‘best met’ by gaining as much help as possible from the investment strategy over the long-term, which would lead you towards an equity-biased investment strategy. By contrast, objectives b) and c) imply stability and prudence of employer contribution rates, which would lead you towards a bond biased investment strategy.

Therefore, the best that can be achieved is a sensible balance between these different objectives.

3. Risk

The risk tolerance of the Fund is determined through working with the Pensions Committee, the investment managers, officers and independent advisers by the setting of investment beliefs, funding and investment objectives. This is incorporated into the Strategic Investment Allocation Benchmark (SIAB), bands and benchmarks. Risk taken against that benchmark is monitored by the Pensions Committee using a risk register and risk management tools as advised by the Fund’s fund managers, investment advisers and the Fund’s Actuary.

The fund is exposed to Investment, operational, governance and funding risks. These risks are identified, measured, monitored and then managed. This is carried out using risk registers with section responsibility and oversight from the Chief Financial Officer.

The principal risks affecting the Fund are as follows:

Funding Risks Liabilities versus the Strategic Investment Allocation Benchmark (SIAB)

- a) The risk of deterioration in the funding level of the Fund. This could be due to assets failing to grow in line with the developing cost of meeting liabilities or economic factors such as unexpected inflation increasing the pension and benefit payments.

The Fund manages this risk by setting a strategic asset allocation benchmark assisted by the Fund’s investment advisor. The strategic asset allocation benchmark seeks to achieve the appropriate balance between generating the required long-term return, while taking account of market volatility and the nature of the Fund’s liabilities. It assesses risk relative to that benchmark by monitoring the Fund’s asset allocation and investment returns relative to the benchmark.
- b) The risk of changing demographics such as improvement in longevity and other demographic factors, increasing the cost of benefits.

The Fund monitors this by reviewing mortality and other demographic experience and assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.
- c) Systemic risk, i.e., the possibility of failure of asset classes and/or active investment managers results in an increase in the cost of meeting the liabilities.

The Fund mitigates systemic risk through a diversified portfolio with exposure to a wide range of asset classes, portfolio holdings and different management styles.
- d) Inflation risk the fund mitigates inflation risk through holding a portfolio of growth and inflation linked assets. Inflation risk is considered at least triennially in the setting of the SIAB and triennially as part of the actuarial valuation.
- e) Future Investment Returns (Discount rate) risk the funding and investment strategies are inter-linked and discount rate risk is mitigated through derivation based on the underlying long-term investment strategy. Discount rates are considered at least triennially in the setting of the SIAB and triennially as part of the actuarial valuation.
- f) Currency risk that the currency of the Fund’s SIAB underperforms relative to sterling (i.e., the currency of the liabilities). The currency risk of the benchmark is considered at least triennially in the setting of the SIAB. Recommended changes will be expressed through changes in the benchmark and implemented by the investment managers

Asset Risks (the portfolio versus the SIAB)

- a) Concentration risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- b) Illiquidity risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- c) Currency risk that the currency of the Fund’s assets underperforms relative to the SIAB.
- d) Manager underperformance when the fund managers fail to achieve the rate of investment return assumed in setting their mandates.
- e) Responsible Investment (RI) risks, including climate-related risks, that are not given due consideration by the Fund or its investment managers.

The Fund manages these asset risks by:

- Constraining how far Fund investments deviate significantly from the SIAB by setting diversification guidelines and the SIAB strategic ranges.
- By investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within the Fund’s expected parameters.
- By investing across a range of liquid assets, including quoted equities and bonds; the Fund has recognised the need for some access to liquidity in the short term.
- Robust financial planning and clear operating procedures for all significant activities including regular review and monitoring manager performance against their mandate and investment process.
- In appointing several investment managers, the Fund has considered the risk of underperformance by any single investment manager.
- The Fund actively addresses environmental, social and governance (ESG) risks through implementation of its Responsible Investment (RI) beliefs.

The Fund is aware that investing in overseas equities introduces an element of currency risk, but given the level of diversification within the Fund, the Pensions Committee is comfortable taking this risk in general but may act to mitigate potentially significant risks as and when they are identified.

The Fund invests in accordance with the investment restrictions stipulated by the Local Government Pension Scheme Regulations.

Operational Risk

- a) Transition risk of incurring unexpected costs in relation to the transition of assets amongst managers.

When carrying out significant transitions, the Fund takes professional advice and considers the appointment of specialist transition managers to mitigate this risk when it is cost effective to do so.
- b) Risk of a serious operational failure by asset managers and/or LGPS Central.

These risks are managed by having robust governance arrangements with LGPS Central and by quarterly monitoring with asset managers.
- c) Custody risk of losing economic rights to Fund assets, when held in custody or when being traded.

These risks are managed by:

- The use of a global custodian for custody of assets.
- The use of formal contractual arrangements for all investments.

When the Fund’s investments are pooled in LGPS Central, the Asset servicer contract will include depositary protection over investment vehicles.

- d) Credit default with the possibility of default of a counterparty in meeting its obligations. The Fund monitors this type of risk by means of:
- Maintaining a comprehensive risk register with regular reviews.
 - In-depth due diligence prior to making any investment.

The Fund monitors and manages risks in all areas through a process of regular scrutiny/oversight and reporting of KPIs of its service providers and audit of the operations they conduct for the Fund.

e) Cashflow management risks

The Fund is becoming more mature and although its cashflow has been positive after taking investment income, the table below shows that this will not be the case in 2021/22 due mainly to the impact of several employers who will be paying their contributions 3 years in advance in 2020/21 and the improved overall funding position. Therefore, managing cashflow will become an increasingly important consideration in setting the investment strategy. Mitigating actions are already being taken to manage the cashflow shortfall such as investing in assets that produce cashflows such as Property, Infrastructure and fixed income that can be used to meet these payments.

The table below sets out the cashflow position of the Fund over the last six fiscal years and is continually monitored.

| Cashflow Management | 2021-22 | 2020-21 | 2019-20 | 2018-19 | 2017-18 | 2016-17 |
|--------------------------|---------|---------|---------|---------|---------|---------|
| | £m | £m | £m | £m | £m | £m |
| Contributions receivable | 60.7 | 170.7 | 87.7 | 81.8 | 185.2 | 107.8 |
| Benefits payable | -122.7 | -117.0 | -11.5 | -106.3 | -98.0 | -95.5 |
| | -62.0 | 53.7 | -23.8 | -24.5 | 87.2 | 12.3 |
| Investment income | 50.0 | 50.0 | 48.3 | 51.7 | 35.8 | 29.4 |
| Net cashflow | -12.0 | 103.7 | 24.5 | 27.2 | 123.0 | 41.7 |

4. Investment Strategy

Funding Policy

The objectives of the Worcestershire funding policy are expressed in its FSS. The Fund has a strong employer covenant, being funded largely by tax-raising local authorities. Therefore, the Committee can adopt a long-term view, without concern about the ability of its sponsors to meet their liabilities.

Given the on-going restructuring of public bodies the Fund is now maturing increasingly faster. Positive cashflow are declining (investment income is available if the Fund does go Cashflow negative) and this position is being closely monitored. However, at this time it is not felt necessary to change the investment strategy of the Fund.

As the Fund has a deficit of assets against liabilities (91% funded at the 2019 Triennial Valuation), the Committee wishes to achieve the maximum assistance from investments in reducing this shortfall. This would suggest a higher risk strategy to generate returns, but this is moderated by the realisation that such a strategy can also lose significant amounts of money in the short-medium term.

It is all the employer organisations in the Fund who feel the result of unstable employer rates, and for the precepting authorities, ultimately the local taxpayer either through the Council Tax or through service levels. Therefore, another very important consideration is the need for relative stability of investment returns, given that employee rates are fixed by statute and the tools available in the actuarial valuation process for smoothing of returns are limited. This can be achieved by investments that are inherently more stable, such as bonds. However, it is also aided by diversification (so that the ups and downs on particular investments do not arise together), and by seeking returns from both markets ('beta') and investment managers ('alpha') whose returns are skill based and relatively independent of the market.

Consequently, the Committee has set an overall investment goal that reflects these four factors.

Investment Strategies/Pots

In order that the Fund delivers on its key objectives (ensuring that each employer takes the appropriate level of investment risk, giving each the best opportunity possible to achieve its long-term funding objective whilst increasing certainty of cost), the Fund has introduced three distinct investment strategies (Growth, Medium and Cautious risk). These are detailed in **Appendix A**.

Each investment strategy has its own strategic asset allocation benchmark. The strategic benchmark is consistent with the Fund's views on the appropriate balance between generating required long-term returns, whilst taking account of market volatility, risk and the nature of the Fund's liabilities.

The Fund is required to monitor its investment strategy relative to the agreed asset allocation benchmark in order to ensure that it remains consistent with the overall objective. The Fund undertakes a fundamental review of the strategic asset allocation every three years following actuarial valuations. The Fund also monitors compliance with this statement at least quarterly and monitors progress towards the long-term funding objective for relevant groups of employers on a regular basis.

In addition to the fundamental review of the strategic asset allocation undertaken every three years, the Fund will monitor progress of employers within the Growth and Medium Strategies on a regular basis. This gives the Fund the opportunity to adjust the strategic asset allocation in the event that a group of employers are ahead or behind their funding plan.

This is an important mechanism used by the Fund to ensure that each employer continues to take the appropriate level of investment risk, giving each the best opportunity possible to achieve its long-term funding objective whilst increasing certainty of cost. The progress of employers in Cautious Risk Strategy

will be monitored every year as these employers are already invested in their ‘target funding plan’.

A full explanation of the process undertaken to assess employer funding progress will be provided in the Fund’s Investment Risk Management document which will be published on the website.

Investment Goal

The Worcestershire Pension Fund’s investment objective is to achieve a relatively stable ‘real’ return above the rate of inflation over the long-term, in such a way as to minimise and stabilise the level of contributions required to be paid into the Fund by employer bodies in respect of both past and future service liabilities.

Process for Ensuring Suitability of Investments

The Committee has translated its objectives into a suitable Strategic Investment Allocation Benchmark (SIAB) and structure for the Fund (set out in **Appendix A**) considering both the liability structure and the objectives set out above. The Fund benchmark is consistent with the Pensions Committee’s views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund’s liabilities. The Investment beliefs in **Appendix D** also assist in formulating the investment strategy.

The Pensions Committee monitors investment strategy relative to the agreed asset allocation benchmark and strategic ranges. If ranges are breached, then appropriate action is taken by the Chief Financial Officer. In addition to ongoing monitoring the investment strategy is formally reviewed annually by Pensions Committee. Furthermore, specific consideration is given to investment strategy in the light of information arising from each triennial actuarial valuation. The Investment Sub-Committee will be monitoring asset allocation on a quarterly basis.

5. Diversification

The fund will be diversified across multiple asset classes with different risk return expectations and correlations to deliver the targeted return of the Fund. **Appendix A** shows the Strategic Investment Allocation Benchmark (SIAB) and strategic ranges.

6. Day-to-Day Management of the Assets

Investment Management Structure

The Pensions Committee retains responsibility for the investment strategy of the scheme but has delegated oversight of its implementation to the Chief Financial Officer. The day to day management of the Funds’ investments is delegated to the Fund’s external Investment Managers.

External Investment Managers

The Fund has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The investment managers are required to comply with LGPS investment regulations.

Suitable Investments

Subject to the LGPS regulations on allowable investments the Fund may invest in a wide range of assets and strategies including quoted equity, Government and Non-Government bonds, money markets, traded options, financial futures and derivatives, alternative strategies including Infrastructure and Property Pooled Funds. The fund uses external managers to carry out stock lending ensuring suitable controls/risk parameters are put in place to prevent losses. Where an asset class/strategy is not expected to help in delivering the risk adjusted investment return required it will not be held.

When new asset classes are considered and are not listed above then approval will be sought from the Pensions Committee after receiving advice on its suitability and diversification benefits.

The Fund may also make use of contracts for difference and other derivatives either directly or in pooled funds when investing in these products, for the purpose of efficient portfolio management or to hedge specific risks.

The Fund, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate, they are consistent with the overall asset allocation for the Fund. The Fund’s investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles and a mix of asset types across a range of geographies in order to provide diversification of returns.

Expected Return on the Investments

Over the long-term, it is expected that the investment returns will be at least in line with the assumptions underlying the actuarial valuation (the discount rate). The individual mandates are expected to match or exceed the specific targets set for each portfolio over time.

Investment Restrictions

The investment management arrangements prohibit the holding of investments not defined as ‘investments’ in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. Operating within the investment regulations, the Fund determines investments that are acceptable and approved as such by the Pensions Committee.

Additional Assets

Assets in respect of members’ additional voluntary contributions are held separately from the main Fund assets. These assets are held with Scottish Widows and Utmost Life.

The Fund monitors, from time to time, the suitability and performance of these vehicles.

Realisation of Investments

In general, the Fund’s investment managers have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments. The Fund’s liquidity characteristics are monitored on a regular basis and the majority of the Fund’s investments may be realised quickly if required. A number of the Fund’s alternative investments in Pooled Infrastructure and Property Funds, may be difficult to realise quickly in certain circumstances. The Fund will ensure that the Liquidity of the investments is suitable to meet future cash flow requirements.

Monitoring the Performance of Fund Investments

The performance of the external investments is independently measured. In addition, officers of the Fund meet external investment managers (both segregated and pooled) regularly to review their arrangements and the investment performance. The Pensions Committee meets at least quarterly to review markets, asset classes and funds.

7. Day-to-Day Custody of the Assets

The Fund has appointed a global custodian with regard to the safekeeping of the assets in the Fund and other investment administrative requirements.

8. Stock Lending

Stock lending is undertaken in respect of the Fund’s quoted equities holdings through the custodian/asset servicer. There is a formal stock lending agreement and approved collateral. Stock lending may also take place in pooled investment vehicles held by the Fund.

For the assets managed by LGPS Central on the Funds behalf, the Company has an active securities lending programme. To ensure that the Company can vote its shares at important meetings, it has worked with service providers to establish procedures to restrict lending for certain stocks and recall shares in advance of shareholder votes. The Company monitors the meetings and proportion of the securities on loan, and will restrict and/or recall lent stock in select circumstances, with due consideration to the advantages of voting the shares versus the cost implications of recalling or restricting the loan of the stock.

9. Approach to Pooling

The Fund has joined the LGPS Central pool with the understanding that the pooled investments will benefit from lower investment costs, greater investment capability and access to more uncorrelated asset classes. Becoming an FCA registered investment manager will lead to improved governance, transparency and reporting giving the Pension Fund assurance that its investments are being carried out effectively.

LGPS Central Ltd has been set up as an arms-length company, accredited by the Financial Conduct Authority, to manage the pooled investment assets of eight LGPS funds across the centre of England. The Worcestershire Pension Fund is one of the eight partner funds, all of whom hold equal shares in the company. LGPS Central started trading on 3 April 2018 and all partner funds will gradually start to migrate assets to the company over the next few years.

The Fund is participating in the LGPS Central pool with the belief that the Fund will benefit from lower investments costs achieved through the aggregation of assets. In addition, the Fund will have greater access to a broader range of investable asset classes, including new and innovative products and services. LGPS Central and the partner funds have put in place a robust governance framework to ensure the company operates effectively and delivers timely and transparent reporting to shareholders and client funds.

The Fund will retain full responsibility and control over its strategic investment allocation policy with LGPS Central being responsible for implementing the strategy via the engagement and dismissal of managers and the day to day monitoring of manager investment performance. Subject to satisfactory due diligence and value for money considerations being satisfied, the Fund intends to continue to invest its assets with LGPS Central. Investment strategy will be determined by the fund with advice from the fund manager/operator and independent adviser.

10. Responsible Investment (RI) and Stewardship

What do we mean?

The term 'responsible investment' refers to the integration of financially material environmental, social and corporate governance ('ESG') factors into investment processes. It has relevance both before and after the investment decision and is a core part of our fiduciary duty. It is distinct from 'ethical investment', which is an approach in which the moral persuasions of an organisation take primacy over its investment considerations.

We define the concept of stewardship in the same way as the Financial Reporting Council (FRC), the organisation that oversees the UK Stewardship Code which was updated in 2020:

'Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.'

Responsible Investment and LGPS Central

From 1 April 2018 the implementation of the Fund's investment strategy was undertaken by LGPS Central, an investment management company set up by 8 Local Authorities (including Worcestershire County Council) in line with the latest scheme regulations. The Fund will seek to ensure that LGPS Central is set up to deliver objectives of this RI policy alongside that of the other Funds involved.

It is expected that the Fund's ability to invest in a responsible way will be enhanced through LGPS Central due to the inherent benefits of scale, collectivism and innovation that will result from the project. In order to broaden its stewardship activities, LGPS Central has appointed EOS by Federated Hermes (EOS) as its (LGPS Central's) stewardship provider, with the remit of engaging companies on ESG issues, and executing the LGPS Central Voting Principles (see below).

RI Beliefs and Guiding Principles (see Appendix D)

The Fund's RI Beliefs (see **Appendix D**) underpin its RI approach. Taking these beliefs as foundational, the Fund has adopted two RI aims: (1) primarily, to support the Fund's investment objectives; (2) secondarily, to be an exemplar for RI within the financial services industry and raise standards across the marketplace.

The Fund intends to realise these aims through actions taken both before the investment decision (which we refer to as the **Selection** of investments) and after the investment decision (the **Stewardship** of investments). Actions will be taken with reference to an evidence base, using the best available objective data sets. We aim to be **Transparent** to all stakeholders and accountable to our clients through regular **Disclosure** of RI activities, using best practice frameworks where appropriate. These ambitions yield the Fund's three RI pillars: Selection, Stewardship and Transparency & Disclosure.

Selection

The Fund believes that effective management of financially material RI risks should support the Fund's requirement to protect returns over the long-term. Investment managers will seek to incorporate RI into their investment process. With regard to climate change risks, the Fund recognises that the scale of the potential impacts is such that a proactive and precautionary approach is needed in order to address them. The Fund considers RI to be relevant to the performance of the entire Fund across asset classes.

There are some investment opportunities arising from environmental and social challenges which can be captured so long as they are aligned with the Fund's investment objectives and strategy.

The Fund recognises the need to operate at a market-wide level to promote improvements that will help it

to deliver sustainable long-term growth.

- The Fund will set longer-term performance objectives for its investment managers.
- The Fund will seek to ensure that its long-term interests are aligned with that of its investment managers on all issues including on ESG considerations.
- Policies relating to ESG will be considered as part of the Fund's long-term investment planning process, following a thorough and robust investment appraisal.

We will use an **evidence-based** long-term investment appraisal to inform decision-making in the implementation of RI principles across our Investment strategy to make better more informed investment decisions and encourage/influence better corporate practices that lead to value creation and good risk management.

- The Fund will consider the potential financial impact of ESG related issues on an ongoing basis (e.g. climate change or executive remuneration).
- The Fund will consider the potential financial impact of investment opportunities that arise from ESG related factors (e.g. investment in renewable energies or housing infrastructure).
- The Fund will consider investment opportunities that have positive impacts and recognises that the changing external environment presents new opportunities i.e. Renewable energy and social impact investments.

Stewardship

Engagement

Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. The Fund adopts a policy of risk monitoring and engagement with companies on financially material RI issues, in order to positively influence company behaviour and enhance shareholder value; influence that would be lost through a divestment approach. The Fund extends this principle of 'engagement for positive change' to the due diligence, appointment and monitoring of external fund managers.

The Fund believes that it will improve its effectiveness by acting collectively with other like-minded investors because it increases the likelihood that it will be heard by the company, fund manager or other relevant stakeholder compared with acting alone. To this end, the Fund uses its membership of the Local Authority Pension Fund Forum (LAPFF) and being a partner to the LGPS Central pool to assist it in pursuing engagement activities.

The Fund will engage investee companies on issues, including ESG issues that are material to long-term value creation and robust risk management in order to safeguard and grow the Fund

- The Fund is committed to compliance with the UK Stewardship Code¹ and working within the spirit of the Principles of Responsible Investment ('PRI').
- We will hold our investment managers to account to ensure compliance with this policy.
- The Fund is committed to collective engagement through its membership of the Local Authority Pension Fund Forum (LAPFF), the LGPS Central pool and other opportunities that arise from time to time.
- The Fund will exercise its voting rights in all markets where practicable.

Shareholder Voting

On the 21 June 2019 the Pensions Committee agreed that LGPS Central would via EOS vote shares in certain discretionary and pooled funds on the Fund's behalf. These votes will be executed in line with LGPS Central's published **Voting Principles**. The Fund believes that the advantage of a consistent signal and working collectively through the pool will have a positive influence on company behaviour.

Shares held in passively managed portfolios will be voted according to the voting policies of the Fund's appointed fund manager, Legal & General Investment Management (LGIM). The Pensions Committee is satisfied that LGIM's approach to shareholder voting is sufficiently robust and aids in the delivery of the Fund's RI objectives.

Transparency & Disclosure

The Fund is committed to the UK Stewardship Code and has provided a statement of compliance which has been approved by the Financial Reporting Council (FRC). <http://www.worcestershire.gov.uk/worcestershirepensionfund/download/downloads/id/97/stewardship-compliance-statement.pdf>

The 2020 version of the UK Stewardship Code was published in November 2019 and is 'effective' from January 2020. The Fund intends to align its disclosure so as to achieve compliance with the 2020 version of the Stewardship Code.

LGPS Central provides quarterly reporting for all funds managed by LGPS Central detailing how votes have been cast in different markets and a vote by vote disclosure for full transparency. Engagement and voting disclosure is also done specifically for listed securities held across Worcestershire Pension Fund portfolios.

How will we monitor our performance on Responsible Investment?

The Fund will ultimately be **transparent and accountable** in terms of its performance on Responsible Investment. This will be achieved through the following approach:

- The Fund will publish its Investment Strategy Statement on its website in line with the scheme regulations.
- Decisions relating to the setting of investment policy will be explained.
- The Fund will monitor closely its appointed investment managers whom the Fund rely on to implement its RI policy.
- The Fund will undertake an annual review of corporate governance, voting and engagement activity undertaken by the Fund and its underlying managers.
- The Fund will publish an annual summary of voting and engagement activity.
- The Fund will ensure that its decision makers are properly trained and kept abreast of ESG issues to make informed decisions.
- The Fund will include ESG as standing item on Pensions Investment Sub-Committee (or equivalent) agendas (with a view to reporting on manager performance in relation to ESG investing and noting any hot topics/issues arising).
- The Fund will undertake a fundamental review of any specific ESG issues that are considered by the Investment Sub-Committee to be of potentially material financial impact.
- The Fund will consider and respond to feedback from stakeholders in relation to issues of concern.

11. Compliance with this Statement

The Fund will monitor compliance with this statement. It will ensure its investment decisions are exercised with a view to giving effect to the principles contained in the statement, so far as is reasonably practicable.

12. Compliance with Myners’

Following from the Myners’ Report of 2000 into institutional investment in the UK, the Government, after consultation, indicated it would take forward all of the report recommendations identifying investment principles to apply to pension schemes.

These principles cover the arrangements for effective investment management decision-making, setting and monitoring clear investment objectives focus on asset allocation, arrangements to receive appropriate expert advice, explicit manager mandates, shareholder activism, use of appropriate investment benchmarks, measurement of performance, transparency in investment management arrangements and regular reporting.

The Myners’ principles have since been updated, and the Fund continues to support and comply with them. Details of compliance are set out in the Fund’s Governance Compliance Statement within the Annual Report, which can be found on the Fund’s website.

List of Appendices

Appendix A – Strategic Allocation Investment Benchmark (SIAB) and Ranges

Appendix B – Roles and Responsibilities

Appendix C – List of Advisers

Appendix D – Statement of Investment Beliefs

Appendix A – Strategic Allocation Investment Benchmark and Ranges

| Asset Allocation | Growth % | Medium % | Cautious % | Manager, Method & Performance Target |
|----------------------------------|----------|----------|------------|--|
| Actively Managed Equities | | | | |
| Far East Developed | 10.0% | 5.0% | 0.0% | Nomura Asset Management – FTSE All World Asia Pacific Index + 1.5% |
| Emerging Markets | 10.0% | 5.0% | 0.0% | LGPS Central active global emerging markets equity mandates with BMO, UBS and Vontobel – FTSE – Emerging Market Index +2.0% |

| | | | | |
|---|-------|-------|------|---|
| Passively Managed Equities – Market Capitalisation Indices | | | | |
| United Kingdom | 20.5% | 15.5% | 0.0% | Legal and General Asset Management – FTSE All Share Index |
| North America | 8.0% | 5.5% | 0.0% | Legal and General Asset Management – FTSE All World North America – Developed Series Index |
| Europe ex UK | 6.5% | 4.0% | 0.0% | Legal and General Asset Management – FTSE All World Europe ex UK Index – Developed Series Index |

| | | | | |
|---|-------|------|------|--|
| Passively Managed Equities – Alternative Indices | | | | |
| Global | 15.0% | 5.0% | 0.0% | Legal and General Asset Management: – 40% GPAE – FTSE-RAFI Dev. 1000 Equity Fund – 30% GPBK – MSCI World Mini Volatility Index – 30% STAJ – CSUF – STAJ MF36726/36727 |

| Asset Allocation | Growth % | Medium % | Cautious % | Manager, Method & Performance Target |
|---------------------|----------|----------|------------|--|
| Fixed Income | | | | |
| Fixed Income | 10.0% | 40.0% | 80.0% | – LGPSC Global Active Investment Grade Corporate Bond (Fidelity & Neuberger Berman) – Fund 50% GBP IG Corporate (Ex EM Issues) / 50% Global IG Corporate ((ex IG Corporate & EM Issues) hedged to GBP +0.80% – EQT Corporate Private Debt |

| | | | | |
|--|-------|-------|-------|--|
| Actively Managed Alternative Assets | | | | |
| Property & Infrastructure | 20.0% | 20.0% | 20.0% | Through a mix of Green Investment Bank, Invesco, Hermes, Walton Street and Venn Partners, Stonepeak, Firststate, AEW etc |

| | | | | |
|--------------|---------------|---------------|---------------|--|
| TOTAL | 100.0% | 100.0% | 100.0% | |
|--------------|---------------|---------------|---------------|--|

Tolerance Ranges

| Asset Type | Growth | Medium & Cautious | Role (s) within the Strategy |
|---|--------|-------------------|---|
| Equities | +/-5% | +/-2.5% | Long-term growth more than inflation expected; generate investment income i.e. dividends |
| Growth Fixed Income | +/-5% | +/-2.5% | Provide protection from changes in real yields both in terms of capital value and income |
| Property | +/-5% | +/-2.5% | Diversification; generate investment income; provide some inflation-sensitive exposure; illiquidity premium |
| Infrastructure | +/-5% | +/-2.5% | Provides the Fund with access to a diversified (but long-term, illiquid) return source and a stream of inflation related income |
| Index Linked Gilts | +/-5% | +/-2.5% | Provide protection from changes in real yields both in terms of capital value and income |
| Diversified Growth / Multi Asset | +/-5% | +/-2.5% | Diversification and dynamic asset allocation |

Appendix B – Roles and Responsibilities

Pensions Committee

The Pensions Committee discharges the responsibilities of the Council as Administering Authority of the Fund pursuant to Section 101 and Regulations under Section 7 of the Superannuation Act 1972.

The Pensions Committee discharges the responsibilities for management of the administration of the Fund. However, it will take views from the Investment Sub-Committee to enable it to discharge its duties effectively.

The Pensions Committee discharges the responsibilities for the strategic management of the Fund’s assets. However, it will take strategic advice from the Investment Sub-Committee to enable it to discharge its duties effectively. The dates of Pensions Committee meetings will be synchronised with those of the Pension Sub-Committee to ensure investment decisions are reviewed without unnecessary delay.

The Council appoints the Chairman and Vice-Chairman of the Pensions Committee. The Chairman of the meeting has a second or casting vote in the case of equality of votes.

The Pensions Committee is a formal committee of the Council and comprises a total of 8 voting members:

- 5 Worcestershire County Councillors.
- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund).
- 1 co-opted voting employer representative and
- 1 co-opted voting employee representative from a relevant Union.

The 5 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time to time and the nominations of the relevant Group Leaders and the 3 co-optees are co-opted by the Chairman of the Committee.

The Pensions Committee will be advised by on a regular basis by an Independent Financial Adviser and the Fund’s Actuary.

Pensions Committee Terms of Reference

The Pensions Committee will meet at least quarterly or otherwise as necessary to take decisions on:

- Changes to the Investment Strategy Statement, including the strategic benchmark for asset allocation, Investment Manager benchmarks and Investment Manager targets.
- Transition of investments to LGPS Central or other Pooling arrangements.
- The termination and appointment of Investment Managers and associated professional service providers.
- The termination and appointment of the Fund’s Independent Financial Adviser, Performance Measurement Consultant, Global Custodian and Actuary.
- The Pensions Administration Strategy Statement, Policy Statement on Communication Strategy, Policy Statement on Governance Strategy, Funding Strategy Statement and Governance Compliance Statement.
- The Triennial and Interim Actuarial Valuations.

- The approval of the Pension Fund Annual Report and Accounts.
- The approval of the Pension Fund annual and triennial budgets.
- Key outstanding risks as identified in the Pension Fund Risk Register.
- The Pension Administration Advisory Forum arrangement and regular Forum reports, which consider and address outstanding member and employer issues and concerns.
- The Pension Sub-Committee arrangement and regular Sub-Committee reports, which monitor performance of the Fund’s assets.
- Requests for admission of qualifying Community and Transferee Bodies wishing to join the Fund.
- Key pension policy discretions that are the responsibility of the Administering Authority.

All elected members and voting co-optees of the Pensions Committee are subject to the Worcestershire County Council Code of Conduct for Members and must therefore register and keep updated their Disclosable Pecuniary Interests as required by the law and Code and disclose potential conflicts of interest as required by that Code.

Members of the Pensions Committee are expected to hold the appropriate knowledge and skills to discharge their responsibility effectively – see Section 8.

The responsibility for advising the Pensions Committee is delegated to the Chief Financial Officer.

Members of the Pensions Committee have equal access to Pensions Committee agenda papers and associated appendices in accordance with the legislation and constitutional Rules relating to access to information for committees. Formal meetings of the Committee will take place in public unless it has resolved to move into exempt session in accordance with the applicable access to information provisions.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 formally introduced the concept of asset pooling. Over time, as assets move into pooled structures the Pensions Committee will also become responsible for:

- The selection, appointment and dismissal of an investment pooling operator to manage the assets of the Fund.
- Determining what the administering authority requires the pool to provide to enable it to execute its local investment strategy effectively.
- Receiving and considering reports and recommendations from the Joint Committee and Practitioners Advisory Forum, established to oversee the pool, to ensure that the Fund’s investor rights and views are represented effectively.
- Identifying and managing the risk associated with investment pooling.
- Ensuring that appropriate measures are in place to monitor and report on the ongoing costs of investment pooling; and
- Ensuring the responsible investment, corporate governance and voting policies of the Fund are delivered effectively.

Local Pensions Board

The purpose of the Board is to assist the Administering Authority in its role as a scheme manager of the Scheme. Such assistance is to:

- a) secure compliance with the Regulations, any other legislation relating to the governance and administration of the Scheme, and requirements imposed by the Pensions Regulator in relation to the Scheme and;
- b) to ensure the effective and efficient governance and administration of the Scheme.

The Board consists of eight members appointed by the Chief Financial Officer, as follows:

- Four Member Representatives; and
- Four Employer Representatives.

The Pensions Board is not a decision-making body, nor does it hold a scrutiny function.

Core Functions

The first core function of the Board is to assist the Administering Authority in securing compliance with the Regulations, any other legislation relating to the governance and administration of the Scheme, and requirements imposed by the Pensions Regulator in relation to the Scheme. Within this extent of this core function the Board may determine the areas it wishes to consider including but not restricted to:

- a) Review regular compliance monitoring reports which shall include reports to and decisions made under the Regulations by the Committee.
- b) Review management, administrative and governance processes and procedures to ensure they remain compliant with the Regulations, relevant legislation and in particular the Code.
- c) Review the compliance of scheme employers with their duties under the Regulations and relevant legislation.
- d) Assist with the development of and continually review such documentation as is required by the Regulations.
- e) Assist with the development of and continually review scheme member and employer communications as required by the Regulations and relevant legislation.
- f) Monitor complaints and performance on the administration and governance of the scheme.
- g) Review the application of the Internal Dispute Resolution Process.
- h) Review the complete and proper exercise of Pensions Ombudsman cases.
- i) Review the implementation of revised policies and procedures following changes to the Scheme.
- j) Review the arrangements for the training of Board members and those elected members and officers with delegated responsibilities for the management and administration of the Scheme.
- k) Review the complete and proper exercise of employer and administering authority discretions.
- l) Review the outcome of internal and external audit reports.
- m) Review draft accounts and Fund annual report.
- n) Review the compliance of particular cases, projects or process on request of the Committee.
- o) Any other area within the statement of purpose (i.e. assisting the Administering Authority) the Board deems appropriate.

The second core function of the Board is to ensure the effective and efficient governance and

administration of the Scheme. Within this extent of this core function the Board may determine the areas it wishes to consider including but not restricted to:

- a) Assist with the development of improved customer services.
- b) Monitor performance of administration, governance and investments against key performance targets and indicators.
- c) Review the effectiveness of processes for the appointment of advisors and suppliers to the Administering Authority.
- d) Monitor investment costs including custodian and transaction costs.
- e) Monitor internal and external audit reports.
- f) Review the risk register as it relates to the scheme manager function of the authority.
- g) Assist with the development of improved management, administration and governance policies.
- h) Review the outcome of actuarial reporting and valuations.
- i) Assist in the development and monitoring of process improvements on request of Committee.
- j) Assist in the development of asset voting and engagement processes and compliance with the UK Stewardship Code.
- k) Any other area within the statement of purpose (i.e. ensuring effective and efficient governance of the scheme) the Board deems appropriate.
 - 1. In support of its core functions the Board may make a request for information to the Committee regarding any aspect of the Administering Authority's function. Any such request should be reasonably complied with in both scope and timing.

In support of its core functions the Board may make recommendations to the Committee which should be considered, and a response made to the Board on the outcome within a reasonable period of time.

Worcestershire County Council Pension Investment Sub-Committee (ISC)

The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

The Council appoints the Chairman and Vice-Chairman of the Pension Investment Sub-Committee. The Chairman of the meeting has a second or casting vote in the case of equality of votes.

The Pension Investment Sub-Committee is a formal committee of the Council and comprises a total of 6 voting members:

- 5 Worcestershire County Councillors.
- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund) (voting).
- 1 co-opted employee representative from a relevant Union. (non-voting).

The 5 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time to time and the nominations of the relevant Group Leaders and the co-optees are co-opted by the Chairman of the Committee.

The ISC will be advised by an Independent Financial Adviser who will attend all meeting and on an ad hoc basis by the Fund’s Actuary.

The composition of the Pension Investment Sub-Committee is intended to reflect the abilities and knowledge of the individuals in matters relating to the investment of the Fund’s assets rather than political representation. All members of the Sub-Committee are entitled to vote if necessary for the Panel to fulfil its role and provide advice to the Pensions Committee regarding the administration of the Fund’s assets.

The responsibility for advising the Pensions Committee is delegated to the Chief Financial Officer.

Terms of Reference

The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund’s investment objectives.

The ISC may also be occasionally requested to by the Worcestershire County Council Pension Fund Committee to undertake research and report back on a specific investment area.

All decision taken, and recommendations will be reported back to the next available ordinary meeting of the Worcestershire County Council Pension Fund Committee in the form of the minutes of the ISC.

The ISC will be responsible for:

- a. Reviewing strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee.
- b. Reporting regularly to Committee on the performance of investments and matters of strategic importance.
- c. Monitor investment managers’ investment performance and recommend decision to terminate mandates on performance grounds to Committee.
- d. Monitor the Transition of investments to LGPS Central or other Pooling arrangements.
- e. Researching and providing a report back to the Worcestershire County Council Pension Fund Committee on any specific investment areas requested.

The ISC will have delegated authority to:

- f. Approve and monitor tactical positions within strategic allocation ranges.
- g. Implement investment management arrangements in line with strategic policy including the setting of mandate parameters and the appointment of managers.
- h. Approve amendments to investment mandates within existing return and risk parameters.
- i. Delegate specific decisions to officers as appropriate.

The ISC would meet quarterly ahead of the main Committee meetings to review manager performance and make decisions within the strategic asset allocations agreed.

The ISC is advised by an Independent Financial Adviser who attends all meetings and on an ad hoc basis by the Fund’s Actuary.

One of the regular quarterly meetings will include an annual meeting to consider the Fund’s full year’s performance.

The Fund’s Investment Strategy Statement (ISS) sets out the arrangements in place for the management of the investments of the Worcestershire County Council Pension Fund.

The day to day management of the Fund’s investments is divided between external Investment Managers, operating in accordance with mandates set out in the Investment Strategy Statement.

The Chairman of the Investment Sub-Committee will attend the Pensions Committee to ensure flow of information between the two bodies.

Members of ISC must not have a conflict of interest and are required to provide the Chief Financial Officer with such information as the Chief Financial Officer reasonably requires for the purposes of ensuring no conflict of interest exists prior to appointment to the ISC and on an ongoing annual basis.

Members of the ISC are required to hold the appropriate knowledge and skills to discharge their responsibility effectively.

Pension Administration Advisory Forum

The Pension Administration Advisory Forum provides the Pensions Committee with advice concerning the administration of the Fund. It is neither a decision-making body nor formal committee and will not normally meet in public. No voting rights apply to the Pension Administration Advisory Forum as the purpose of the Forum is to provide transparency of information to scheme employers and for scheme employers to provide advice to, and raise concerns with, the employer representative.

The Pension Administration Advisory Forum comprises:

- All Fund employers who wish to attend following invitation by the Administering Authority.
- The Fund’s Actuary (ad hoc basis).
- The Administering Authority’s Pensions Administration Manager and HR & OD Service Commissioning Manager.
- And the employer representative and employee representative of the Pensions Committee.

Pension Administration Advisory Forum Terms of Reference:

The Forum meets at least twice a year or otherwise as necessary to:

- Discuss an Annual Administration Report and respond to any issues raised by employers.
- Discuss Government Consultations relating to the administration and benefits of the LGPS.
- Discuss the outcomes of the triennial/interim valuations and respond to any issues raised by employers.
- Discuss the minutes and updates from the Pensions Committee and ensure flow of information between the Pensions Committee and the Forum.
- To advise on service delivery to all stakeholders.
- To bring stakeholders perspective to all aspects of the Pension Fund business.
- To ask the Administering Authority and the Pensions Committee to consider topics which affect the Pension Fund.

Appendix C – Advisers as of March 2020

MJ Hudson Allenbridge – Philip Hebson
Investment policy, general investment matters

Mercers
Actuarial matters

Local Authority Pension Fund Forum (LAPFF)
Company governance issues

BNY Mellon
Custodian, Stock lending

Appendix D – Statement of Investment Beliefs

The Fund’s investment beliefs outline key aspects of how it sets and manages the Fund’s exposures to investment risk. They are as follows:

Financial Market Beliefs

- There exists a relationship between the level of investment risk taken and the rate of expected investment return. As taking calculated risks does not guarantee returns, investment losses or below expected returns are possible outcomes.
- Markets are dynamic and are not always efficient, and therefore offer opportunities for skilled active managers.
- In making investments in illiquid assets, a return premium should be sought.
- Diversification is a key technique available to institutional investors for improving risk-adjusted returns.
- The fund believes that investing for the long-term can add value to the fund as it allows the fund manager to focus on long-term value and use short term volatility to establish favourable investments.
- Where an asset class/strategy is not expected to help in delivering the risk adjusted investment return required it should not be held.

Investment Strategy/Process Beliefs

Clear investment objectives are essential. Return and risk should be considered relative to the Fund’s liabilities, funding position and contribution strategy.

Risk should be viewed both qualitatively and quantitatively. Focus should be given to the risk of loss and also to the nature and likelihood of extreme events so that the Fund is not a forced seller of assets.

- Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection.
- Listed Equities are expected to generate superior long-term returns relative to Government bonds and our beliefs in this Listed Equities are expanded below:
 - a. Passively managed market cap-based investment has a balancing role to play in most pension schemes’ equity allocations, bringing liquidity, transparency and reducing average fee levels;
 - b. Market cap weighted indices have their drawbacks; adding carefully selected systematic, factor tilted equity strategies can improve risk-adjusted returns, benefiting from disciplined rebalancing (the ‘rebalancing premium’);
 - i. Exposure to ‘valuation factors’ can improve risk adjusted returns over time. Even if outweighed by technical factors in the short-term, diversified exposure to valuation-based factor tilts can add excess return per unit of risk over a reasonable timeframe;
 - ii. Exposure to the ‘low volatility factor’ can reduce absolute equity volatility and improve risk-adjusted returns. Strategies can be implemented which manage downside risk while achieving market returns over time;

- iii. Exposure to the 'small size factor' can improve risk-adjusted returns. A diversified tilt towards medium and smaller sized businesses is generally rewarded over time;
- iv. Carefully selected exposure to actively managed growth strategies can improve the balance of overall equity exposure and improve risk adjusted returns;
- c. Exposure to emerging markets provides diversification and the opportunity for higher returns due to the higher risk premium typically earned for investing in these markets;
- d. With sufficient research and governance, active equity management can be incorporated to add value relative to market cap weighted indices; overall active equity exposure should be focused predominantly on stock-specific risk;
- e. Currency exposure associated with investing in equities can add volatility. Whilst it can be desirable to retain exposure to some currencies, hedging a proportion of non-domestic currency exposure can reduce the volatility of equity investing;
 - Alternative asset class investments are designed to further diversify the portfolio and improve its risk-return characteristics.
 - Active management can add value over time, but it is not guaranteed and can be hard to access managers who consistently out-perform the relevant benchmark. Where generating 'alpha' is particularly difficult, passive management is preferred.
 - Operational, counterparty, conflicts of interest and reputational risk need assessment and management, in addition to investment risk.
 - Concentrated portfolios (smaller numbers of holdings or less external managers) allow for greater investment focus, lower investment costs and enable more focused engagement with Responsible investment.
 - Managing fees and costs matter especially in low-return environments. Fee arrangements with our fund managers – as well as the remuneration policies of investee companies – should be aligned with the Fund's long-term interests.

Organisational Beliefs

- Effective governance and decision-making structures that promote decisiveness, efficiency and accountability are effective and add value to the Fund.
- When outperformance of a desired benchmark is not possible the Fund will use index funds, financial instruments or proxies (Investments that share similar characteristics) to gain exposure to the asset class in the most cost-effective way.
- Investment costs are necessary to generate outperformance in asset classes where outperformance is achievable. Investment costs are a certain cost that should be fully transparent and managed by the operator in the best interests of the Pension Fund.

Responsible Investment Beliefs

- **Long-termism**
A long-term approach to investment will deliver better returns and the long-term nature of the Fund's liabilities allows for a long-term investment horizon

- **Responsible investment**
Responsible investment is supportive of risk adjusted returns over the long-term, across all asset classes. Responsible investment should be integrated into the investment processes of the Fund and its investment managers.
- **Diversification, risk management and stewardship**
Diversification across investments with low correlation improves the risk return profile. A strategy of engagement, rather than exclusion, is more compatible with fiduciary duty and more supportive of responsible investment, because the opportunity to influence companies through stewardship is waived in a divestment approach. Even well diversified portfolios face systematic risk. Systematic risk can be mitigated over the long-term through widespread stewardship and industry participation.
- **Corporate governance and cognitive diversity**
Investee companies and asset managers with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is clear evidence showing that decision making, and performance are improved when company boards and investment teams are composed of cognitively diverse individuals.
- **Fees and remuneration**
The management fees of investment managers and the remuneration policies of investee companies are of significance for the Fund, particularly in a low return environment. Fees and remuneration should be aligned with our long-term interests, and value for money is more important than the simple minimisation of costs.
- **Risk and opportunity**
Risk premia exist for certain investments; taking advantage of these can help to improve investment returns. There is risk but also opportunity in holding companies that have weak governance of financially material ESG issues. Opportunities can be captured so long as they are aligned with the Fund's objectives and strategy, and so long as there is a sufficient evidence base upon which to make an investment decision.
- **Climate change¹**
Financial markets could be materially impacted by climate change and by the response of climate policymakers. Responsible investors should proactively manage this risk factor through stewardship activities, using partnerships of likeminded investors where feasible.

¹By highlighting climate change, rather than other RI risk factors, we are not asserting that climate risk has, for all assets, greater economic significance than other factors. Our motivation for referring specifically to climate change risk derives from our recognition that it is a risk factor of particular importance to several stakeholders, and we have communicated our investment beliefs about climate change for reasons of transparency.

Contacts and Further Information

For more information about the
Worcestershire Pension Fund, please contact:

by email: pensions@worcestershire.gov.uk

by post: Worcestershire Pension Fund,
County Hall, Spetchley Road,
Worcester, WR5 2NP

[Find out who to contact](#)



Find out more online:

www.worcestershirepensionfund.org.uk

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