Douglas

Douglas Borough Council

Isle of Man Local Government Superannuation Scheme

Funding Strategy Statement

12 December 2019

Contents

Introduction

What is this document?

This is the Funding Strategy Statement (FSS) of the Isle of Man Local Government Superannuation Scheme (the Scheme), which is administered by Douglas Borough Council (the Administering Authority).

This is an update of the Fund's existing FSS dated March 2017. It has been prepared by the Administering Authority in collaboration with the Scheme's Fund Actuary, Barnett Waddingham LLP, and after consultation with the Scheme's employers and investment adviser. It was approved by the Pensions Committee on 26 February 2020 and is effective from 27 February 2020.

What is the Isle of Man Local Government Superannuation Scheme?

The Scheme largely mirrors the Local Government Pension Scheme applicable in England and Wales with some local differences. The Scheme was set up to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the island. The Administering Authority runs the Scheme to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Scheme's assets grow over time with investment income and capital growth;
- uses the assets to pay Scheme benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the Isle of Man Superannuation Scheme Regulations - Statutory Document No. 0104/12 (the Regulations). Assets are also used to pay transfer values and administration costs.

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

Why does the Scheme need a Funding Strategy Statement?

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

Employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

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

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

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

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

- the Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- the Scheme's policies on admissions and cessations;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Scheme's Statement of Investment Principles.

How does the Scheme and this FSS affect me?

This depends on who you are:

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

What does the FSS aim to do?

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

- to ensure the long-term solvency of the Scheme, using a prudent long term view. This will ensure that sufficient funds are available to meet all members' and dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Scheme, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (this will also minimise the costs to be borne by Rate payers); and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Rate payer from an employer defaulting on its pension obligations.

How do I find my way around this document?

In the Basic funding issues section there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Scheme from time to time.

In the Calculating contributions for individual employers section there is an outline of how the Scheme calculates the contributions payable by different employers in different situations.

The Funding strategy and links to investment strategy section shows how the funding strategy is linked with the Scheme's investment strategy.

The appendices also cover various issues in more detail:

- the regulatory background, including how and when the FSS is reviewed
- who is responsible for what
- what issues the Scheme needs to monitor, and how it manages its risks
- some more details about the actuarial calculations required
- the assumptions which the Scheme's Fund Actuary currently makes about the future
- a glossary explaining the technical terms occasionally used here

If you have any other queries please contact the Director of Finance, Douglas Borough Council, P.O. Box 2, Town Hall, Ridgeway Street, Douglas, Isle of Man IM99 1AD in the first instance. For more information and documentation visit the website.

Basic funding issues

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

How is a deficit (or surplus) calculated?

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

- the value of the employer's share of assets, to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (also known as the value of liabilities). The Scheme's Fund Actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

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

The current approach for the Scheme is to notionally allocate each employer a share of Scheme assets directly proportional to their value of liabilities at each formal valuation. Therefore all employers in the Scheme will have the same funding level at the valuation date.

How does the actuary calculate an employer contribution rate?

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being built up from year to year net of employee contributions, referred to as the "*future service rate*" or the "*common contribution rate*"; plus

b) an adjustment for the difference between the assets built up to date and the value of past service benefits, referred to as the "*past service adjustment*". If there is a deficit the past service adjustment will be an increase in the employer's total contribution; if there is a surplus there may be a reduction in the employer's total contribution. Any past service adjustment will aim to return the employer to full funding over an appropriate period (the deficit recovery period).

How are contribution rates calculated for different employers?

The Scheme's Fund Actuary is required by the Regulations to report the common contribution rate, for all employers collectively at each triennial valuation. This is based on actuarial assumptions about the likelihood, size and timing of benefit payments to be made from the Scheme in the future, as outlined in Appendix E.

The Scheme's Fund Actuary is also required to adjust the common contribution rate for circumstances specific to each individual employer. However, due to the size of the Scheme and the small membership of all but one of the employers, the Scheme's approach is for all employers to pay the same contribution rate and therefore the same adjustment to the common contribution rate is made for all contributing employers. Further details are set out in Calculating contributions for individual employers.

Details of the outcome of the actuarial valuation as at 31 March 2019 can be found in the formal valuation report dated 11 November 2019, including an analysis at Scheme level of the common contribution rate. Further details of individual employer contribution rates can also be found in the formal report and are shown in the Scheme's Rates and Adjustments Certificate.

What else might affect the employer's contribution?

All employers in the Scheme are pooled for funding purposes. Pooling of contributions is discussed below (Calculating contributions for individual employers).

Additional costs may be required from employers on a case by case basis, for example any costs of non-ill-health early retirements must be paid by the employer.

If an employer is approaching the end of its participation in the Scheme then its contributions may be amended appropriately, so that the assets meet (as closely as possible) the value of its liabilities in the Scheme when its participation ends.

How does the Scheme recognise that contribution levels can affect employer service provision and Rates?

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

- Higher pension Scheme contributions may result in reduced local authority spending, which in turn could affect the resources available for local authority services, and/or greater pressure on Rate levels;
- Other employers will provide various services to the local community. If they are required to pay more in pension contributions to the Scheme, then this may affect their ability to provide the local services.

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

- The Scheme provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Scheme must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Scheme in respect of its current and former employees;
- The Scheme strives to maintain reasonably stable employer contribution rates where appropriate and possible;
- The Scheme wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Scheme employers. In that situation, those employers' services would in turn suffer as a result; and
- Local authority contributions to the Scheme should be at a suitable level, to protect the interests of different generations of Rate payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the local authority will wish to minimise the extent to which Rate payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Scheme's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Scheme achieves this by targeting stable long-term contribution rates for all employers in the Scheme.

The Scheme operates the same target funding level for all ongoing employers of 100% of its accrued liabilities, as valued on the ongoing basis.

Calculating contributions for individual employers

General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Scheme. With this in mind, there are two methods which the Administering Authority may permit, in order to improve the stability of employer contributions. These are:

- using a smoothed funding approach to avoid day to day fluctuations in valuation results; and
- the pooling of contributions amongst all employers.

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

Pooled contributions

The Isle of Man Local Government Superannuation Scheme is a relatively small scheme. The Administering Authority therefore decided that employers will be pooled for the purpose of determining employer contributions at the valuation.

The approach to pooling may be reviewed if the Administering Authority and the Fund Actuary considers a review to be appropriate, for example where a situation arises that an individual employer merits a bespoke approach.

Deficit recovery period

The deficit recovery period starts at the commencement of the Rates and Adjustments Certificate (1 April 2021 for the 2019 valuation). The Administering Authority would normally expect the same or a reducing period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods.

Adjustments for individual employers

Adjustments to individual employer contribution rates could be applied both through the calculation of employer-specific contribution rates and the calculation of the employer's asset share. However, the Administering Authority and the Fund Actuary have agreed that because of the circumstances of the Scheme no such individual employer contribution rates will be calculated at the present time. The relevant circumstances are the size of the Scheme, small memberships of most employers, and the costs associated with introducing individual employer rates.

Deficit recovery payments on cessation

For employers approaching cessation from the Scheme, the deficit should be recovered by monetary amounts over a period to be agreed with the Administering Authority.

Phasing in of contribution changes

Where employer contribution rates are subject to an increase from current levels, it may be possible for the increases to be phased in over a specified period. All phasing is subject to the Administering Authority being satisfied as to the strength of the employer's covenant. Phasing in the rise of employer contributions over a period of three years would be the norm.

Regular reviews

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

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), or other actions deemed suitable by the Administering Authority.

Admission bodies ceasing

Admission agreements for employers are generally assumed to be open-ended and to continue until the last pensioner dies. Contributions, expressed as capital payments, can continue to be levied after all the employees have retired. These admission agreements can however be terminated at any point.

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

- Last active member ceasing participation in the Scheme;
- The insolvency, winding up or liquidation of the admission body;
- Any breach by the admission body of any of its obligations under the agreement that they have failed to remedy to the satisfaction of the Scheme; or
- A failure by the admission body to pay any sums due to the Scheme within the period required by the Scheme.

On cessation, the Administering Authority will instruct the Scheme's Fund Actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the admission body; where there is a surplus it should be noted that current Regulations do not permit a refund payment to the admission body.

The approach involves a roll forward of results from the previous formal valuation but allows for individual employer membership experience.

The cessation will be carried out on a gilts basis. This has no allowance for potential future investment outperformance above gilt yields. This could give rise to significant cessation debts being required. Where appropriate, the Scheme with advice from the Fund Actuary may agree an alternative approach.

Any shortfall would usually be levied on the departing admission body as a single lump sum payment. If this is not possible then the Scheme would look to any bond, indemnity or guarantee in place for the employer.

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

Non ill-health early retirement costs

Employers are required to pay additional contributions ('strain costs') whenever an employee retires before the normal retirement age. The Fund Actuary's funding basis makes no allowance for premature retirement except on the grounds of ill-health.

Funding strategy and links to investment strategy

What is the Scheme's investment strategy?

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

Investment strategy is set by the Administering Authority, after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (SIP), which is available to members and employers on the Scheme's website.

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

The investment strategy is set on a Scheme level rather than an employer level.

What is the link between funding strategy and investment strategy?

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

Therefore, the funding and investment strategies are inextricably linked.

How does the funding strategy reflect the Scheme's investment strategy?

In the opinion of the Scheme's Fund Actuary, the current funding policy is consistent with the long-term investment strategy of the Scheme. The discount rate is set with consideration of the expected returns on the Scheme's long-term investment strategy, adjusted by an explicit prudence allowance as a margin for the uncertainty in future experience.

In the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility in market conditions which would lead to volatile valuation positions. The funding approach adopted for the Scheme is a smoothed approach which considers market conditions over a six month period straddling the valuation date, and this approach helps with the objective of setting reasonably stable contribution rates.

Does the Scheme monitor its overall funding position?

The Administering Authority monitors the relative funding position, but does not participate in interim valuations as a matter of policy. The costs of such an exercise are considered to outweigh any benefits. Should there be major changes to the employers in the Scheme, or from large reductions or increases to the numbers of Scheme members then an interim valuation would be considered.

Appendix A – Regulatory framework

A1 Why does the Scheme need a FSS?

The purpose of the FSS is:

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

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

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

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

A2 Does the Administering Authority consult anyone on the FSS?

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

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

a) A draft version of the FSS was issued to all participating employers and also the Department of Infrastructure on 12th December 2019 for comment;

b) Comments were requested within 34 days;

c) Following the end of the consultation period the FSS was updated where required and then published, in March 2020.

A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website, so available to employers, Scheme members and the general public;
- A link to the published document sent by e-mail to each participating employer in the Scheme; and
- A link to the published document sent to investment managers and independent advisers.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2022.

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

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

In any event, changes to the FSS would need agreement by the Pensions Committee and would be included in the relevant Committee meeting minutes.

A5 How does the FSS fit into other Scheme documents?

The FSS is a summary of the Scheme's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Scheme including the Statement of Investment Policy (SIP). In addition, the Scheme publishes a Pension Fund Annual Report with up to date information on the Scheme.

These documents can all be found on the website.

Appendix B – Responsibilities of key parties

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

B1 The Administering Authority should:-

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

B2 The individual employer should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the Fund Actuary, promptly by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

B3 The Scheme's Fund Actuary should:-

- prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the Regulations, and targeting each employer's solvency appropriately;
- provide advice relating to new employers in the Scheme, including the level and type of bonds or other forms of security (and the monitoring of these);
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;

- advise on the termination of employers' participation in the Scheme; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties:-

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

Appendix C – Key risks and controls

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

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

C1 Financial risks

Risk	Summary of control mechanisms
Scheme assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities over the long-term.	• Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing. • Monitor investment performance as crude proxy for valuation, and request updates when necessary.
Inappropriate long-term investment strategy.	• Set Scheme-specific benchmark (for asset allocation), informed by the modelling of assets and liabilities.
Fall in future expected asset returns, leading to rise in value placed on liabilities.	• Smoothed funding approach at whole Scheme level to reduce the effect of volatile asset markets. • Valuations every three years evaluates the long-term effects.
Active investment manager under-performance relative to benchmark.	• Quarterly investment monitoring to analyse market performance and active managers relative to their index benchmark. • A diverse portfolio of assets is used which dampens the effect of significant movements in part of the market.

Risk	Summary of control mechanisms
Pay and price inflation significantly more than anticipated.	• The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. • The valuation every three years evaluates the long-term effects. • Employers pay for their own salary awards. They are reminded that there is a gearing effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.
Effect of possible increase in employer's contribution rate on service delivery of admission/scheduled bodies.	• A smoothed funding approach is adopted to target stability of employer contributions. • Mitigate impact through deficit spreading and phasing in of contribution rises.
"Orphaned members" give rise to added costs for the Scheme, i.e. members whose ex-employer ceases to contribute to the Scheme.	• The Scheme seeks a cessation payment to minimise the risk of this happening in the future. • Any orphaned liabilities will be met by ongoing contributions from the remaining Scheme employers.

C2 Demographic risks

Risk	Summary of control mechanisms
Pensioners living longer, thus increasing cost to Scheme.	• Set mortality assumptions with some allowance for future increases in life expectancy. • The Scheme's Fund Actuary has direct access to the experience of a significant number of similar schemes which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.
Maturing Scheme – i.e. proportion of actively contributing employees declines relative to retired employees.	• Continue to monitor at each valuation. • Consider seeking monetary amounts rather than percentage of pay and consider alternative investment strategies.
Deteriorating patterns of early retirements.	• Employers are charged the extra cost of non-ill-health retirements following each individual decision.
Reductions in payroll causing insufficient deficit recovery payments.	• In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, where there is concern, a review of contributions may be carried out.

C3 Regulatory risks

Risk	Summary of control mechanisms
Changes to national pension requirements and/or tax rules, e.g. changes arising from public sector pensions reform.	• All consultation papers and comments where appropriate are considered. • The Administering Authority will consult employers where it considers that it is appropriate.

C4 Governance risks

Risk	Summary of control mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	• The Administering Authority has a close relationship with employing bodies and communicates required standards, e.g. for submission of data. It monitors membership movements on an annual basis. • The Fund Actuary may revise the Rates and Adjustments Certificate to increase an employer's contributions between triennial valuations. • Deficit contributions may be expressed as monetary amounts.
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way.	• The Administering Authority maintains close contact with its specialist advisers. • Advice is delivered via formal meetings involving elected Members, and recorded appropriately. • Actuarial advice is subject to professional requirements such as peer review.
Administering Authority failing to commission the Scheme's Fund Actuary to carry out a termination valuation for a departing admission body.	• The Scheme monitors membership closely to ensure a termination valuation will be requested when required.
An employer ceasing to exist with insufficient funding.	• The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. • The risk is mitigated by reviewing contributions well ahead of cessation if thought appropriate.

Appendix D – The calculation of employer contributions

In the Basic funding issues section there was a broad description of the way in which contribution rates are calculated. This Appendix considers these calculations in more detail.

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

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

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being built up from year to year net of employee contributions, referred to as the "*future service rate*" or "*common contribution rate*"; plus

b) an adjustment for the difference between the assets built up to date and the value of past service benefits, referred to as the "*past service adjustment*". If there is a deficit the past service adjustment will be an increase in the employer's total contribution; if there is a surplus there may be a reduction in the employer's total contribution. Any past service adjustment will aim to return the employer to full funding over an appropriate period (the deficit recovery period). See the Calculating contributions for individual employers section for deficit recovery periods.

The Scheme's Fund Actuary is required by the Regulations to report the common contribution rate, for all employers collectively at each triennial valuation. This is based on actuarial assumptions about the likelihood, size and timing of benefit payments to be made from the Scheme in the future, as outlined in Appendix E.

The Scheme's Fund Actuary is also required to adjust the common contribution rate for circumstances specific to each individual employer. However, due to the size of the Scheme and the small membership of all but one of the employers, the Administering Authority will allow all employers to pay the same contribution rate, and therefore the same adjustment to the common contribution rate is made for all contributing employers. Further details are set out in Calculating contributions for individual employers.

D2 How is the future service rate calculated?

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

The future service rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The calculation is on the "ongoing" valuation basis (see Appendix E), but where it is considered appropriate to do so the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a more prudent basis (see Calculating contributions for individual employers).

The approach used to calculate each employer's future service contribution rate may depend on whether or not new entrants are being admitted. Employers should note that it is only admission bodies and designating employers that may have the power not to automatically admit all eligible new staff to the Scheme, depending on the terms of their admission agreements and employment contracts.

D3 How is the funding level calculated?

The Scheme's Fund Actuary is required to report on the "solvency" of the whole Scheme in a valuation which should be carried out at least once every three years. As part of this valuation, the Scheme's Fund Actuary will calculate the funding level of each employer. All the employers within the Scheme are pooled and so are given the same funding level.

Funding level is defined to be the ratio of the value of the employer's asset share to the value placed on accrued benefits on the Scheme's Fund Actuary's chosen assumptions.

For funding purposes, a smoothed value of assets is used rather than the market value. The financial assumptions that are used in valuing the liabilities are smoothed around the valuation date so that the market conditions used are the average of the daily observations over the six month period straddling the valuation date. Therefore, the value of assets is smoothed in a similar way for consistency with the valuation of the liabilities.

For the value of each employer's asset share, see D5 below.

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

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

D4 What affects the whole Scheme's valuation results?

The results of these calculations for a given individual employer will be affected by a number of factors including (but not limited to):

- past contributions relative to the cost of accruals of benefits that have accrued;
- different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death; and
- the additional costs of any non-ill-health retirements relative to any extra payments made.

Actual investment returns achieved on the Scheme between each valuation are applied proportionately across all employers, to the extent that employers in effect share the same investment strategy. Transfers of liabilities between employers within the Scheme occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, at each triennial valuation the Scheme's Fund Actuary apportions assets between employers in direct proportion to their liabilities based on the whole Scheme's funding level.

Appendix E – Actuarial assumptions

E1 What are the actuarial assumptions?

The actuarial assumptions are expectations of future experience used to place a value on future benefit payments. This value is known as the liabilities. Assumptions are made about the level of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

Changes in assumptions will affect the measured value of future service accrual and past service liabilities, and hence the measured value of the past service deficit. However, different assumptions will not affect the actual benefits payable by the Scheme in future; they will simply affect the pace of funding of these benefits.

The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower liability values and lower employer costs. A more prudent basis will give higher liability values and higher employer costs.

E2 What basis is used by the Scheme?

The Scheme's standard funding basis is described as the "ongoing basis". This is described in more detail below. It anticipates employers remaining in the Scheme in the long term.

E3 What assumptions are made in the ongoing basis?

The same assumptions are adopted for all employers in deriving the past service deficit and the future service rate. The assumptions will in effect vary by member and so on an employer level, the assumptions on a whole will reflect each employer's own membership profile.

Investment return / discount rate

The key financial assumption is the anticipated return on the Scheme's investments, i.e. the discount rate. The discount rate is set with consideration of the expected returns on the Scheme's long-term investment strategy, adjusted by an expenses allowance and an explicit prudence allowance as a margin for the uncertainty in future experience.

For the purpose of the triennial funding valuation at 31 March 2019 and setting contribution rates effective from 1 April 2021, the Scheme's Fund Actuary has assumed that future investment returns earned by the Scheme over the long term will be 4.1% p.a. at the time of the valuation.

Salary growth

Based on the Average Weekly Earnings statistics published by the Office for National Statistics (ONS), the salary increase assumption at the 2019 valuation has been set to be 0.8% p.a. above Consumer Price Index (CPI) inflation.

Pension increases

The Scheme's pension increases are linked to CPI inflation. Note that the basis of such increases is set by the Isle of Man Government, and is not under the control of the Scheme or any employers.

There is currently no reliable market-derived measure for CPI inflation as there are no CPI-linked government bonds. Therefore, the CPI inflation assumption is derived with reference to Retail Price Index (RPI) inflation. The RPI inflation assumption is set based on the 20 year point on the Bank of England implied Retail Price Index (RPI) inflation curve. The 20 year point is used as 20 years is estimated to be consistent with the duration of an average public sector scheme's liabilities.

The RPI inflation assumption is then reduced by 1.0% to arrive at the CPI inflation assumption, to allow for the differences between the two inflation measures, including the "formula effect" which occurs as a result of CPI inflation being calculated using a different statistical methodology compared to RPI inflation.

Post-retirement mortality / Life expectancy

There are two aspects to consider in determining appropriate post-retirement mortality assumptions:

1. Choosing an appropriate mortality assumption applicable today taking into account characteristics of the Scheme's members (the base rate); and
2. Making an appropriate allowance for mortality to improve in future.

The base rates that have been adopted for the 2019 valuation are based on the mortality tables produced by the Continuous Mortality Investigation (CMI), a research arm of the Institute and Faculty of Actuaries. An analysis of member mortality was carried out using the Scheme's valuation data and the results were used to set the appropriate adjustments to the CMI's S3 series mortality tables.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with the CMI_2018 model with a long-term rate of improvement of 1.25% p.a.

Appendix F – Glossary

Term	Description
Actuarial assumptions/basis	The combined set of assumptions regarding the future made by the Fund Actuary to calculate the value of liabilities. The main assumptions will relate to the discount rate, salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value.
Administering Authority	The council with statutory responsibility for running the Scheme, in effect the Scheme's "trustees". This is Douglas Borough Council.
Admission bodies	Employers which voluntarily participate in the Scheme, so that their employees and ex-employees are members. There will be an admission agreement setting out the employer's obligations.
Common contribution rate	The Scheme-wide future service rate. It should be noted that this will differ from the actual contributions payable by individual employers.
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.
Deficit	The shortfall between the value of assets and the value of liabilities. This relates to assets and liabilities built up to date, and ignores the future accrual of benefits (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 past service adjustment (deficit recovery contribution), and vice versa.
Designating employer	Any local authority for a parish district or joint board is able to participate in the Scheme via resolution. An employee of a designating employer may only be an active member if he, or a class of employees to which he belongs, is designated by the authority or board as being eligible for membership of the Scheme. Previously known as Resolution Bodies.
Discount rate	The annual rate at which future assumed cashflows (in and out of the Scheme) are discounted to the present day to

	reflect future expected investment return. This is necessary to provide a value of liabilities which is consistent with the present day value of the assets, to calculate the deficit. A lower discount rate gives a higher value of liabilities, and vice versa. It is similarly used in the calculation of the future service rate and the deficit recovery rate.
Employer	An individual participating body in the Scheme, which employs (or used to employ) members of the Scheme. Normally the values of the assets and liabilities for each employer are individually tracked, together with its future service rate at each valuation.
Funding level	The ratio of the value of assets to the value of liabilities.
Future service rate	The actuarially calculated cost of each year's accrual of benefits by the current active members, excluding members' contributions. This is calculated using a chosen set of actuarial assumptions.
Gilt	A UK Government bond, i.e. a promise by the UK Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI).
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 Scheme can consider the employer's covenant to be as strong as its guarantor's.
Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the Scheme benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority.
Liabilities	The actuarially calculated present value of all Scheme benefit entitlements accrued to date of all members of the Scheme. It is calculated on a set of actuarial assumptions.
Isle of Man Local Government Superannuation Scheme	This is a public sector pension arrangement put in place via Government Regulations, for local government employees in the island. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements.
Maturity	A general term to describe a Scheme (or an employer's position within a Scheme) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for

	investment strategy and, consequently, funding strategy.
Members	The individuals who have built up (and may still be building up) entitlement in the Scheme. 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 the dependants of deceased ex-employees).
Past service adjustment	The part of the employer's annual contribution which relates to past service deficit recovery.
Pooling	Employers may be grouped together for the purpose of calculating contribution rates, so that their combined membership and asset shares are used to calculate 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.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's members, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its maturity also.
Rates and Adjustments Certificate	A formal document required by the Regulations, which must be updated at least every three years at the conclusion of the formal valuation. This is completed by the Fund Actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Scheme for the three year period until the next valuation is completed.
Resolution bodies	Now known as designating employers (see above).
Scheduled bodies	Local Authorities as listed in the Pension Fund Annual Report for the Scheme. These employers must offer their employees membership of the Scheme.
Solvency	In a funding context, this usually refers to a 100% funding level, i.e. where the value of assets equals the value of liabilities.
Valuation	An actuarial investigation to calculate the value of liabilities and common contribution rate, and to certify the level of employer contributions due. This is normally carried out in full every three years (the most recent was as at 31 March 2019), but can be approximately updated at other times.