FUNDING STRATEGY STATEMENT

WANDSWORTH COUNCIL PENSION FUND (incorporating former Richmond Council Pension Fund)

CONTENTS

Funding Strategy Statement – Scope

Following the Shared Staffing Arrangement between Richmond and Wandsworth Councils, which commenced on the 1st October 2016, all assets and liabilities of the Richmond Pension Fund transferred to the Wandsworth Pension Fund (the Fund) under SI 2016 No 1241 as part of the joint pension fund arrangements. References to the "Council" should be read as meaning Richmond and Wandsworth Councils as appropriate.

Funding Strategy Statement – Purpose

As required by Regulation 62 of the Local Government Pension Scheme Regulations 2013 (the Regulations), every local authority that administers a pension fund is required to obtain an actuarial valuation of the assets and liabilities as at 31st March 2016 and every third anniversary thereafter. The main purpose of the valuation is to determine the rate at which the participating employers should contribute in the future to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the Fund. Revised contribution rates, as certified by the actuary, must be implemented on 1st April of the following calendar year.

The employer contribution rate is the net sum of two elements:

- the primary contribution rate, as defined in Regulation 62(5) of the Regulations, which is the amount to be paid by the employer in respect of the cost of benefits accruing in future to active members of the Fund; and
- the secondary rate, as defined in Regulation 62(7) of the Regulations, which is an individual adjustment to the primary contribution rate for the employer which, in the actuary's opinion, is appropriate to take account of any circumstances peculiar to the employer. For example, this may be an adjustment to reflect any surplus or deficit attributable to the individual employer.

1. Every valuation relies on a number of assumptions to calculate the funding level at the valuation date and the primary contribution rate. A degree of judgement is then required about the secondary rate to reflect any individual adjustments, for example for any surplus or shortfall. Regulation 58 of the Regulations requires every local authority that administers a pension fund to prepare, maintain and publish a written statement setting out their funding strategy, addressing these assumptions and judgements. The Fund's actuary, when undertaking triennial valuations, must then have regard to this statement.
2. The purpose of this statement, therefore, is to establish the general strategy for ensuring appropriate assumptions and judgements in valuations of the Wandsworth Council Pension Fund. In particular, the purpose of this statement is to:

    a. Establish a clear and transparent Fund-specific strategy that will identify how employers' pension liabilities are best met going forward;

    b. Support the desirability of maintaining as nearly constant a primary contribution rate as possible;

    c. Ensure that the regulatory requirements to set contributions to meet the future liability to provide Scheme member benefits in a way that ensures the solvency and long-term cost efficiency of the Fund are met; and

    d. Take a prudent longer-term view of funding those liabilities.

3. In preparing the funding strategy statement, each authority must have regard to its own Investment Strategy Statement (ISS) and to guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). Each authority will also normally consult with all employers participating in the Fund and any other bodies it deems appropriate.

4. This statement must be revised and published again to reflect any material change in policy or in the ISS. CIPFA recommend that it should be reviewed formally at least every three years, in advance of the triennial valuation.

Pension Fund – Purpose, Aims and Scope

5. The purpose of the Pension Fund is to pay pensions, retirement and death lump sums, other scheme benefits, refunds of employees' contributions, transfers of pension rights to other pension schemes, and administration costs, from payments of employees' and employers' contributions, payments from other funds in respect of transferred pension rights, and investment income and realisations, in accordance with the Regulations.

6. The aims of the Fund are therefore, with a prudent long-term view, to:
   a. ensure that sufficient resources are available to meet all liabilities as they fall due;
   b. maximise the returns from investments within reasonable risk limits;
   c. have regard to the desirability of maintaining as nearly constant employer primary contribution rates as possible and at reasonable cost to all relevant parties (such as the taxpayers, scheduled, resolution and admission bodies), while achieving and maintaining fund solvency and long-term cost efficiency; and
   d. enable and assist participating employers to manage their liabilities effectively.

7. The scope of the Fund, in terms of employers and active membership, is almost entirely limited to eligible employees in Council-funded functions, and predominantly direct employees of the Councils. Wandsworth Council, as the administering authority, had for many years tended to resist the admission to the Fund of other employers, in view of the risk that their liabilities would ultimately fall on the Council. But all Wandsworth and Richmond schools have a degree of autonomy in their financial affairs that warrants special consultation and consideration about the impact of funding proposals. Academies may be viewed as separate employers as they have financial independence from the Councils.

8. The funding objectives are to:
   a. ensure that pension benefits can be met as and when they fall due over the lifetime of the Fund;
   b. ensure the solvency of the Fund;
   c. set levels of employer contribution to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions, while taking into account the different characteristics of participating employers;
   d. build up the required assets in such a way that employer contribution rates are kept as stable as possible, with consideration of the long-term cost efficiency objective; and

e. adopt appropriate measures and approaches to reduce the risk, as far as possible, to the Fund, other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.

9. In developing the funding strategy, the administering authority should also have regard to the likely outcomes of the review carried out under Section 13(4)(c) of the Public Service Pensions Act 2013. Section 13(4)(c) requires an independent review of the actuarial valuations of the LGPS funds; this involves reporting on whether the rate of employer contributions set as part of the actuarial valuations are set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scheme so far as relating to the pension fund. The review also looks at compliance and consistency of the actuarial valuations.

Responsibilities of Key Parties

10. Wandsworth Council as the Fund's administering authority should:

    a. collect employer and employee contributions from employers, investment income and other amounts due to the Fund as stipulated in the Regulations;

    b. consider on a case by case basis whether to charge interest payable on late contributions in accordance with Regulation 71 of the Regulations

    c. ensure the investment of surplus monies is well-managed in accordance with the Regulations;

    d. pay the benefits due to Scheme members as stipulated in the Regulations;

    e. ensure that cash is available to meet liabilities as and when they fall due;

    f. manage the valuation process in consultation with the Fund's actuary;

    g. effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme employer;

    h. prepare and maintain a Funding Strategy Statement (FSS) and an Investment Strategy Statement (ISS);

    i. monitor all aspects of the Fund's performance and funding, and amend the FSS or ISS when necessary;

    j. enable the Local Pension Board to review the valuation process; and

    k. ensure that the requirements of regulation 64 are complied with in relation to ceasing employers.

11. Scheme employers (including schools), admission bodies and Wandsworth and Richmond Councils as employers should:

    a. deduct contributions from employees' pay correctly;

    b. pay all contributions, including their own as determined by the actuary, promptly by the due date;

c. publish and keep under review a discretions policy and exercise those discretions within the regulatory framework, keeping regard to how the exercise of the discretions could lead to a serious loss of confidence in the public service.

d. make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain;

e. have regard to the Pensions Regulator's focus on data quality and comply with any requirement set by the administering authority in this context,

f. notify the administering authority promptly of all changes or proposed changes which could affect future funding, for example changes in membership;

g. pay recharges for the cost of compensatory added years arrangements that the administering authority pays on behalf of the employer; and

h. pay any exit payments due on ceasing participation in the Fund.

12. Active Scheme members are required to make contributions into the Fund as set by the Ministry of Housing Communities & Local Government (MHCLG).

13. The Fund's actuary should set employer contribution rates at levels to ensure Fund solvency and long-term cost efficiency, having regard to:

    a. the Fund's existing and prospective liabilities;

    b. circumstances peculiar to a particular employer or pool of employers;

    c. the desirability of maintaining as nearly a constant primary contribution rate as possible; and

    d. this Funding Strategy Statement.

    The actuary should assist the administering authority in assessing whether employer contributions need to be revised between valuations as permitted or required by the Regulations.

    The actuary also prepares advice and calculations on other actuarial matters affecting the Fund, for example bulk transfers and individual benefit-related matters.

Fund Investment Policy

14. The investment objectives of the Fund according to the current ISS, i.e. "to maintain the solvency of the Fund at all times, and to deliver low and stable contribution rates over the long term", support the first three aims of the Fund as stated above.

15. The Fund's investment policy is "to appoint expert fund managers with clear performance benchmarks and place maximum accountability for performance against that benchmark with the investment manager". Managers are given discretion and are held accountable for stock selection decisions, within parameters, over periods ranging from a few months to a few years. The overall framework for asset allocation is decided by the Council and reviewed periodically.

16. The practical effect of this policy is that the majority of the Fund's investments are currently held in equities. As the Fund is still attracting new members and can afford to take a long view, this degree of equity weighting is considered acceptable. It is also considered generally desirable in view of the higher return that may reasonably be expected in the long term from investments carrying higher risk. This expectation is

supported by historical analysis showing that equities have out-performed bonds over most, but by no means all, periods. However; when determining asset allocation consideration is given to cash flow requirements to maximise the use of dividend and income payments to meet the shortfall between new contributions and current pension liabilities.

17. This investment policy, generally resulting in a heavy equity weighting, allows the actuary to assume an investment return above the yield on bonds for fund valuations. The amount of this assumption will be decided for each valuation, having regard to market expectations at the time but with a significant allowance for prudence.

18. The Fund's heavy equity weighting means accepting potentially more volatile valuation results, compared with funds invested largely in bonds. As the Councils are the major participating employer required to publish an annual balance-sheet, and as this balance-sheet is published for stewardship purposes and not to give assurance to lenders, the volatility in the pension reserve shown in the annual balance-sheet is not a concern. Volatility in triennial valuation results, however, tends to work against "the desirability of maintaining as nearly constant employer primary contribution rates as possible". The Fund's actuary adopts methods in order to mitigate this risk and these are discussed below. The additional risk is considered worth taking in pursuit of the aim to "maximise the returns from investments within reasonable risk limits", and hence to keep employer contribution rates as low as possible. A move entirely into bonds would markedly reduce volatility, but it would also compel the assumption of lower investment returns and thus require much greater employer contribution rates.

Funding Strategy

19. The factors affecting the Fund's finances are constantly changing, so it is necessary for its financial position and the contributions payable to be reviewed from time to time by means of an actuarial valuation to check that the funding objectives are being met.

20. The most recent actuarial valuation of the Fund was carried out as at 31 March 2019. A summary of the methods and assumptions adopted is set out in the sections below.

21. The actuarial valuation involves a projection of future cash flows to and from the Fund.

22. The main purpose of the valuation is to determine the level of employers' contributions that should be paid to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund.

Funding Method

23. The key objective in determining employers' contribution rates is to establish a funding target and then set levels of employer contribution rates to meet that target over an agreed period.

24. The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund.

25. For all employers, the method adopted is to consider separately the benefits accrued before the valuation date (past service) and benefits expected to be accrued after the valuation date (future service). These are evaluated as follows:
    a. The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service. It makes allowance for future increases to members' pay and pensions. A funding level in excess of 100% indicates a surplus of assets over liabilities; while a funding level of less than 100% indicates a shortfall; and

    b. The future service funding rate (also referred to as the primary rate as defined in Regulation 62(5) of the Regulations) is the level of contributions required from the individual employers which, in combination with employee contributions is expected to cover the cost of benefits accruing in future.

26. The adjustment required to the primary rate to calculate an employer's total contribution rate is referred to as the secondary rate, as defined in Regulation 62(7).

27. The approach to the primary rate will depend on specific employer circumstances and in particular may depend on whether an employer is an "open" employer – one which allows new recruits access to the Fund, or a "closed" employer – one which no longer permits new staff access to the Fund. The expected period of participation by an employer in the Fund may also affect the total contribution rate.

28. For open employers, the actuarial funding method that is adopted is known as the Projected Unit Method. The key feature of this method is that, in assessing the future service cost, the primary rate represents the cost of one year's benefit accrual only.

29. For closed employers, the actuarial funding method adopted is known as the Attained Age Method. The key difference between this method and the Projected Unit Method is that the Attained Age Method assesses the average cost of the benefits that will accrue over a specific period, such as the length of a contract or the remaining expected working lifetime of active members.

30. The approach to an individual employer may vary to reflect an employer's specific circumstance, however, in general the closed employers in the Fund are admission bodies who have joined the Fund as part of an outsourcing contract and therefore the Attained Age Method is used in setting their contributions. All other employers (for example councils, higher education bodies and academies) are generally open employers and therefore the Projected Unit Method is used. The administering authority holds details of the open or closed status of each employer.

Assumptions

31. The main output of the valuation is the employer contribution rates to be paid over many years into the future. So called "marked to market" valuations have the potential to produce quite different valuation results and levels of required employer contributions depending on actual market conditions on the day of the valuation. Thus, to determine the value of liabilities, rather than adopt assumptions based on "spot" yields and market conditions on the actual valuation date, the Fund's actuary uses the average yields over the 6 month period spanning the valuation date. Similarly, in the valuation of assets used

for valuation purposes the Fund's actuary derives average market values of assets over the same 6 month period. This approach is akin to carrying out daily valuations over a 6 month period and then determining the average valuation result. The purpose of this averaging or smoothing process is to help stabilise levels of employer contributions as required by the Regulations.

32. Details of the key assumptions for the 31 March 2019 valuation are summarised below.

Investment Performance/Discount Rate

33. As contributions are being invested now to provide for benefits payable in the future (and to make good any deficit), then part of the cost of providing the benefits can be met from investment returns. The higher the rate of return achieved by the assets, the lower the contributions that will be required in future to meet the cost of the benefits. Therefore, a key assumption in any valuation is the anticipated returns from assets in the future.

34. Investment managers may under-perform. Investment markets may perform worse than expected. Market yields may be lower. Some of these risks are controlled to some degree by the framework for investment management described in the ISS. The prudent long-term view and the desirability of maintaining as nearly constant employer contribution rates as possible, require an allowance for prudence within the discount rate assumption in order to counter these risks. The allowance will be higher when investment market values are considered to be high.

35. Allowance for the Fund's administration and investment expenses is made through the discount rate assumption via a deduction of 0.2%. Thus 0.2% of the investment return is assumed to meet these expenses.

36. At the time of drafting this FSS, it is still unclear how the McCloud/Sargeant judgements (see Regulatory Risks section) will affect current and future LGPS benefits. Therefore, as part of the Fund's 2019 valuation, the prudence allowance incorporated into the discount rate assumption included consideration of the risk of member benefits being uplifted as part of a remedy and becoming more expensive. As the remedy is still to be agreed the cost cannot be calculated with certainty, however, the Fund Actuary expects it is likely to be less than 0.05% of the discount rate assumption.

37. The discount rate adopted for the 31 March 2019 valuation was 4.5% p.a.

Pay and Price Inflation

38. Pay growth enhances the future pension benefits of the active members of the Fund. To make the valuation assumption as robust as possible, the actuary has regard to the trend in national real earnings growth, to the experience of promotional increases in local government generally, and to any differences in the recent experience of the Fund. Employers are naturally mindful of the direct effect of pay rises on their budgets and local taxes; they should also be alert to the impact on their pension contributions if pay rises exceed the valuation assumptions, particularly for employees with long periods of service.

39. The long-term pay increase assumption adopted as at 31 March 2019 was CPI plus 1% p.a. This includes an allowance for promotional increases.

40. Annual increases in pensioner and deferred pensioner benefits and active members' benefits earned after 31 March 2014 are linked to Consumer Price Inflation (CPI). At each valuation, market expectations of future Retail Price Inflation (RPI) can be measured using the Bank of England inflation curve. Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods and so as at 31 March 2019, a deduction of 1% p.a. was made to the RPI assumption to derive the CPI assumption. The CPI assumption adopted as at 31 March 2019 was 2.6% p.a.

Longevity

41. Life expectancy is a key determinant in the valuation of liabilities. There are two aspects in determining this assumption:

    a. an assumption on the mortality rates applicable at the current date; and

    b. an assumption on the future improvements in longevity.

42. The actuarial valuation reflects recent experience of pensioner mortality in the Pension Fund. Mortality investigations over the last few years have concluded that the population across the UK is living longer but the recent improvements in life expectancy have been slower than previously predicted. However, experience does vary across the country and from Fund to Fund. The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review. For the past two funding valuations, the Fund has commissioned a bespoke longevity analysis by Barnett Waddingham's specialist longevity team in order to assess the mortality experience of the Fund and help set an appropriate mortality assumption for funding purposes.

43. For the 31 March 2019 valuation, longevity is assumed to increase in line with the Actuarial Profession's Continuous Mortality Investigation ("CMI") 2018 projected improvements with a smoothing parameter of 7.5, a long term rate of improvement of 1.25% p.a., and an initial addition to improvements of 0.5% p.a. p.a.

Assets

44. The asset value used for funding purposes is the market value of the accumulated fund at the valuation date, adjusted to reflect average market conditions during the six months straddling the valuation date. This is referred to as the smoothed asset value and is calculated as a consistent approach to the valuation of the liabilities. The asset value used for funding purposes also allows for a 10% asset shock reserve to allow for adverse short term financial experience in the period to the next valuation. 10% of the Fund's asset value is therefore reserved to meet these short term risks and not taken into account in the valuation.

Employer Contribution Rates

Funding Level

45. The funding level determined in the actuarial valuation is the result of comparing the funding assets with the existing and future liabilities already accrued in respect of the

service of Scheme members up to the valuation date. The prudential target is to achieve/maintain 100% funding with assets and liabilities in balance.

46. When the funding level shows a significant surplus or shortfall, the employer contribution rate will normally include a secondary contribution, with a view to restoring balance within a reasonable recovery period.

Surplus and Shortfall Recovery Periods

47. CIPFA guidance does not prescribe an optimum target period for securing full funding. It notes the need to avoid short-term horizons, provide stability in employer contributions, and to take advantage of the constitutional permanence of local government and the scheme's statutory status. Where this is thought prudentially appropriate and relevant to local circumstances, the guidance suggests, these considerations would allow longer-term recovery periods for shortfalls than those in the private sector.

48. A funding shortfall implies that employment costs for the workforce have previously been understated, so prudence implies that any shortfall should be recovered within the remaining working-life of the current workforce. The calculation of the average remaining working-life may allow for weighting by compound-interest factors at the rate used for the valuation. Adoption of this recovery period could be reinforced by the desirability of maintaining as nearly constant employer contribution rates as possible: for example, a high proportion of retirements over the subsequent three to nine years would force sharply increasing contribution rates in respect of the remaining workforce, if the valuation assumptions proved sustainable.

49. On the other hand, the desirability of stable contribution rates might support the adoption of a longer recovery period, to the extent that any shortfall were considered attributable to recent unusually adverse volatility in the investment markets that may prudently be expected to reverse before the next valuation.

50. The deficit recovery period or surplus amortisation period that is adopted for any particular employer will depend on:

    a. the significance of the surplus or deficit relative to that employer's liabilities;

    b. the covenant of the individual employer (including any security in place) and any limited period of participation in the Fund;

    c. the remaining contract length of an employer in the Fund (if applicable); and

    d. the implications in terms of stability of future levels of employers' contribution.

51. Stable contribution rates are not the only mechanism available to the Councils for protecting local taxpayers from the impact of market volatility. Reserves for pension liabilities may be established as soon as market conditions suggest significant adverse impact at the next valuation, and these could be applied to offset the effect of the consequential increase in employer contributions. Other participating employers and schools are also empowered to establish provisions and reserves to have a similar effect within their own budgets. For these employers and for the Councils, the scope for such provisions and reserves depends upon the degree of other financial pressures at the time.

In the event of the funding level showing a surplus, this should be spread over a period with consideration of both prudence and the desirability of maintaining as nearly constant employer contribution rates as possible.

52. For the 2019 valuation, most employers in the Fund were at least 100% funded. For the employers with a funding deficit, contributions were set to restore the employer to a fully funded position in no longer than a 12 year period.

Stepped Contribution Changes

53. Phasing periods will be influenced by the credit worthiness of each employer and be explicitly expressed at each valuation.

Pooling or Individual Adjustment

54. The main purpose of pooling is to produce more stable employer contribution levels, although recognising that ultimately there will be some level of cross-subsidy of pension cost amongst pooled employers.

55. Where the Fund identifies a group of employers with similar characteristics and potential merits for pooling, it is possible to form a pool for these employers. Advice should be sought from the Fund Actuary to consider the appropriateness and practicalities of forming the funding pool.

56. Conversely, the Fund may consider it no longer appropriate to pool a group of employers. This could be due to divergence of previously similar characteristics or an employer becoming a dominant party in the pool (such that the results of the pool are largely driven by that dominant employer). Where this scenario arises, advice should be sought from the Fund Actuary.

    Funding pools should be monitored on a regular basis, at least at each actuarial valuation, in order to ensure the pooling arrangement remains appropriate.

57. The Fund currently pools most of the academies in the Fund for funding purposes. Any academies in the Fund which were in the Richmond Fund prior to the merger are not currently included in the pool.

Risk sharing

58. There are employers that participate in the Fund with a risk-sharing arrangement in place with another employer in the Fund.

59. For example, there are employers participating in the Fund with pass-through provisions: under this arrangement the pass-through employer does not take on the risk of underfunding as this risk remains with the letting authority or relevant guaranteeing employer. When the pass-through employer ceases participation in the Fund, it is not generally responsible for making any exit payment, nor receiving any exit credit, as any deficit or surplus ultimately falls to the letting authority or relevant guaranteeing employer

60. At the 2019 valuation, risk-sharing arrangements were allowed for by allocating any deficit/liabilities covered by the risk-sharing arrangement to the relevant responsible employer.

Early Retirement Costs

61. The Councils ensure due control of all early retirement costs by charging against the revenue account of the employing service a lump sum representing the present value of releasing benefits before the date on which they could have been taken by the employee without reduction. Costs of awarding additional pension at the time of retirement are treated similarly and are awarded subject to the Councils' Policy Statement on the use of discretions within the LGPS

Employer Commencement

62. When a new employer joins the Fund, the Fund Actuary is required to set the contribution rates payable by the new employer and allocate a share of Fund assets to the new employer as appropriate. It is desirable for the Administering Authority and new employers that the terms for admission to the fund are clear and that the process of joining the fund is efficient. To this end the Council will have in place a draft admissions policy that will be available for consultation by 31 March 2021.

63. Generally, when a new employer joins the Fund, they will become responsible for all the pensions risk associated with the benefits accrued by transferring members and the benefits to be accrued over the contract length. This is known as a full risk transfer.

64. Subject to agreement with the administering authority where required, new admission bodies and the relevant letting authority may make a commercial agreement to deal with the pensions risk differently. Under a pass through arrangement for example, all of the pensions risk remains with the letting authority and the new employer is only responsible for paying contributions into the Fund over the course of the contract in addition to any other costs as agreed between the two parties and the Fund. The practicalities of any risk-sharing arrangement should be clearly agreed and documented.

Employer Cessation

65. When a Scheme employer's participation in the Fund terminates and the Scheme employer becomes an 'exiting employer', the Regulations require that a termination valuation is carried out. The purpose of this valuation is to determine the level of any surplus or deficit in an exiting employer's share of the Fund as at the exit date and whether the exiting employer is liable to pay an exit payment or is entitled to receive an exit credit.

66. In assessing the value of the liabilities attributable to the exiting employer, the Fund Actuary may adopt differing approaches depending on the employer and the specific details surrounding the employer's cessation scenario. For example, the Fund Actuary may adopt a discount rate based on gilt yields and adopt different assumptions to those used at the previous valuation in order to protect the other employers in the Fund from

having to fund any future deficits which may arise from the liabilities that will remain in the Fund.

67. For exits on or after 1 April 2020, the actuary will add 1% to the value of the exiting employer's liabilities as a prudent margin until the additional liabilities arising due to the McCloud case and GMP equalisation are known.

68. The administering authority's policy is for any deficit upon termination to be recovered through a single lump-sum payment to the Fund (unless agreed otherwise by the Councils at their sole discretion). In circumstances of late payment, the administering authority will require payment of the appropriate interest amount and expenses, in addition to the termination deficit identified, as calculated by the Fund actuary. In the event that an exiting employer cannot pay an exit payment this may be recovered from the DFE in relation to academies or the indemnity/bond in relation to admission bodies

69. In certain circumstances, the administering authority may allow another Scheme employer (or in the case of an exiting Multi Academy Trust, the Fund may allow a successor Multi Academy Trust) to subsume the assets and liabilities of an exiting employer, including responsibility for any surplus or deficit at exit (i.e. the Scheme employer will assume responsibility for all of the assets and liabilities of the exiting employer and for the future funding of those assets and liabilities). In these circumstances, no payment will be made to or from the exiting employer

70. The Local Government Pension Scheme (LGPS) (Amendment) Regulations 2018 were introduced in May 2018 which require administering authorities to make an exit credit payment to exiting employers where the employer's assets exceed its liabilities. Cessation valuations that identify a potential exit credit will be reviewed on a case by case basis before any payment is made and only where there is no passthrough arrangements in place. Considerations will be based on any previous agreements made and discussions between the administering authority, the exiting employer and the guarantor (if relevant).

71. If a pass through arrangement is in place (as set out above) then no deficit payment or exit credit is applicable and the letting authority absorbs all assets and liabilities.

Bulk transfers

72. Bulk transfers of staff into or out of the Fund can take place from other LGPS Funds or non-LGPS Funds. In either case, the Fund Actuary for both Funds will be required to negotiate the terms for the bulk transfer – specifically the terms by which the value of assets to be paid from one Fund to the other is calculated.

73. The agreement will be specific to the situation surrounding each bulk transfer but in general the Fund will look to receive the bulk transfer on no less than a fully funded transfer (i.e. the assets paid from the ceding Fund are sufficient to cover the value of the liabilities on the agreed basis).

74. A bulk transfer may be required by an issued Direction Order. This is generally in relation to an employer merger, where all the assets and liabilities attributable to the transferring employer in its original Fund are transferred to the receiving Fund.

Risks and Counter-Measures

75. There are many risks that could impact upon employer contribution rates. The key risks and the measures that could be taken to counter them are discussed below. Many of these are the subject of assumptions that have to be made in the course of each actuarial valuation. Although these assumptions refer to the long term, the risk for employers potentially crystallises at the next triennial valuation. If the assumptions made at one valuation do not appear to be sustainable three years later, and then have to be superseded by more adverse assumptions, there will be consequential increases in contribution rates. Conversely, substantial prudence at one valuation may be rewarded by a reduction in contribution rates three years later.

76. Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of employer contributions, it is recognised that there are risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.

77. The major risks to the funding strategy are financial, although there are other external factors including demographic risks, regulatory risks and governance risks.

Financial risks

78. The main financial risk is that the actual investment strategy fails to produce the expected rate of investment return (in real terms) that underlies the funding strategy. This could be due to a number of factors, including market returns being less than expected and/or the fund managers who are employed to implement the chosen investment strategy failing to achieve their performance targets.

79. The valuation results are most sensitive to the real discount rate (i.e. the difference between the discount rate assumption and the price inflation assumption). Broadly speaking an increase/decrease of 0.5% per annum in the real discount rate will decrease/increase the valuation of the liabilities by 10%, and decrease/increase the required employer contribution by around 2.5% of payroll per annum.

80. However, the Investment and Pension Fund Committee regularly monitors the investment returns achieved by the fund managers and receives advice from the independent advisers and officers on investment strategy.

81. The Committee may also seek advice from the Fund Actuary on valuation related matters.

Demographic risks

82. Allowance is made in the funding strategy via the actuarial assumptions for a continuing improvement in life expectancy. However, the main demographic risk to the funding strategy is that it might underestimate the continuing improvement in longevity. For example, an increase of one year to life expectancy of all members in the Fund will increase the liabilities by approximately 4%.

83. The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review. For the past two funding valuations, the Fund has commissioned a bespoke longevity analysis by Barnett Waddingham's specialist longevity team in order to assess the mortality experience of the Fund and help set an appropriate mortality assumption for funding purposes.

84. The liabilities of the Fund can also increase by more than has been planned as a result of the additional financial costs of early retirements and ill-health retirements. However, the administering authority monitors the incidence of early retirements; and procedures are in place that require individual employers to pay additional amounts into the Fund to meet any additional costs arising from early retirements.

Maturity risk

85. The maturity of a Fund (or of an employer in the Fund) is an assessment of how close on average the members are to retirement (or already retired). The more mature the Fund or employer, the greater proportion of its membership that is near or in retirement. For a mature Fund or employer, the time available to generate investment returns is shorter and therefore the level of maturity needs to be considered as part of setting funding and investment strategies.

86. The cashflow profile of the Fund needs to be considered alongside the level of maturity: as a Fund matures, the ratio of active to pensioner members falls, meaning the ratio of contributions being paid into the Fund to the benefits being paid out of the Fund also falls. This therefore increases the risk of the Fund having to sell assets at inopportune times in order to meets its benefit payments.

87. The Government has published a consultation (Local Government Pension Scheme: changes to the local valuation cycle and management of employer risk) which may affect the Fund's exposure to maturity risk. More information on this can be found in the Regulatory risks section below.

Regulatory Risks

88. The benefits provided by the Scheme and employee contribution levels are set out in Regulations determined by central government. The tax status of the invested assets is also determined by the government. The funding strategy is therefore exposed to the risks of changes in the Regulations governing the Scheme and changes to the tax regime which may affect the cost to individual employers participating in the Scheme. However, the Councils, as Fund employers, take advantage of opportunities to respond to consultation on proposed changes, taking account of their likely impact on local authority budgets in particular.

89. There are a number of general risks to the Fund and the LGPS, including:
    a. If the LGPS was to be discontinued in its current form it is not known what would happen to members' benefits.

    b. The potential effects of GMP equalisation between males and females, if implemented, are not yet known.

c. More generally, as a statutory scheme the benefits provided by the LGPS or the structure of the scheme could be changed by the government.

d. The State Pension Age is due to be reviewed by the government in the next few years.

90. At the time of preparing this FSS, specific regulatory risks of particular interest to the LGPS are in relation to the McCloud/Sargeant judgements, the cost cap mechanism and the timing of future funding valuations consultation. These are discussed in the sections below.

McCloud/Sargeant judgements and cost cap

91. The 2016 national Scheme valuation was used to determine the results of HM Treasury's (HMT) employer cost cap mechanism for the first time. The HMT cost cap mechanism was brought in after Lord Hutton's review of public service pensions with the aim of providing protection to taxpayers and employees against unexpected changes (expected to be increases) in pension costs. The cost control mechanism only considers "member costs". These are the costs relating to changes in assumptions made to carry out valuations relating to the profile of the Scheme members; e.g. costs relating to how long members are expected to live for and draw their pension. Therefore, assumptions such as future expected levels of investment returns and levels of inflation are not included in the calculation, so have no impact on the cost management outcome.

The 2016 HMT cost cap valuation revealed a fall in these costs and therefore a requirement to enhance Scheme benefits from 1 April 2019. However, as a funded Scheme, the LGPS also had a cost cap mechanism controlled by the Scheme Advisory Board (SAB) in place and HMT allowed SAB to put together a package of proposed benefit changes in order for the LGPS to no longer breach the HMT cost cap. These benefit changes were due to be consulted on with all stakeholders and implemented from 1 April 2019.

However, on 20 December 2018 there was a judgement made by the Court of Appeal which resulted in the government announcing their decision to pause the cost cap process across all public service schemes. This was in relation to two employment tribunal cases which were brought against the government in relation to possible discrimination in the implementation of transitional protection following the introduction of the reformed 2015 public service pension schemes from 1 April 2015. Transitional protection enabled some members to remain in their pre-2015 schemes after 1 April 2015 until retirement or the end of a pre-determined tapered protection period. The claimants challenged the transitional protection arrangements on the grounds of direct age discrimination, equal pay and indirect gender and race discrimination.

The first case (McCloud) relating to the Judicial Pension Scheme was ruled in favour of the claimants, while the second case (Sargeant) in relation to the Fire scheme was ruled against the claimants. Both rulings were appealed and as the two cases were closely linked, the Court of Appeal decided to combine the two cases. In December 2018, the Court of Appeal ruled that the transitional protection offered to some members as part of the reforms amounts to unlawful discrimination. On 27 June 2019 the Supreme Court denied the government's request for an appeal in the case. A remedy is still to be either imposed by the Employment Tribunal or negotiated and applied to all public service schemes, so it is not yet clear how this judgement may affect LGPS members' past or future service benefits. It has, however, been noted by government in its 15 July 2019 statement that it expects to have to amend all public service schemes, including the LGPS.

At the time of drafting this FSS, it is not yet known what the effect on the current and future LGPS benefits will be.

Consultation: Local government pension scheme: changes to the local valuation cycle and management of employer risk

92. On 8 May 2019, the Government published a consultation seeking views on policy proposals to amend the rules of the LGPS in England and Wales. The consultation covered:

    a. amendments to the local fund valuations from the current three year (triennial) to a four year (quadrennial) cycle;

    b. a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle;

    c. proposals for flexibility on exit payments;

    d. proposals for further policy changes to exit credits; and

    e. proposals for changes to the employers required to offer LGPS membership.

    The consultation is currently ongoing: the consultation was closed to responses on 31 July 2019 and an outcome is now awaited. This FSS will be revisited once the outcome is known and reviewed where appropriate.

Governance risks

93. The Fund aims to maintain good communication with all employers and meet all government requirements as set out in the Regulations

Version	Nature of Change	Implemented
V1	Initial Creation	April 2005
V2	Reflecting the 2007 Valuation	April 2008
V3	Reflecting the 2010 Valuation and a move to risk based outcome modelling	April 2011
V4	Reflecting the 2013 Valuation and a move to economic rate discount model	April 2014 subject to amendment
V5	Reflecting the 2016 Valuation and the transfer of assets and liabilities from the Richmond Council Pension Fund	April 2017 subject to amendment

V6	Reflecting changes proposed by the Fund's Actuary November 2017	November 2017
V7	Reflecting the 2019 Valuation	April 2020