London Pensions Fund AuthorityFunding Strategy Statement

your pension our world

Funding Strategy Statement

 October 2016

# Contents

**2 - Introduction**

1. **- Regulatory Framework**
2. **- Purpose of the Funding Strategy Statement in Policy Terms**
3. **- Aims and Purpose of the Pension Fund**
4. **- Responsibilities of the Key Parties**
5. **- Solvency Issues, Target Funding Levels and Long-Term Cost Efficiency**

**9 - Links to Investment Policy**

**9 - Key Risks and Controls**

**9 - Consultation and Publication**

**11 - ANNEX 1: Extract from the Scheme Regulations**

**16 - ANNEX 2: Employer Funding Categories**

**18 - ANNEX 3: Risk Register**

The FSS is a summary of the Fund’s approach to funding liabilities. It is not an exhaustive statement of policy on all issues.

If you have any queries please contact Tony Williams, Head of Employer Risk Services, in the first instance at tony.williams@localpensionspartnership.org.uk or call on 020 7369 6237, or by writing to him at:

**2nd Floor, 169 Union Street**

**London, SE1 0LL**

# Introduction

This is the Funding Strategy Statement (FSS) of the London Pensions Fund Authority Pension Fund (“the Fund”), for which the London Pensions Fund Authority is the Administering Authority. It was prepared in collaboration with the Fund’s Actuary, Barnett Waddingham, and after consultation with the Fund’s employers and has been reviewed and updated as part of the 2016 Fund Valuation. It has been prepared with regard to the 2016 CIPFA Pensions Panel Guidance on Preparing and Maintaining a Funding Strategy Statement. The Actuary has had regard to this Statement in carrying out the Valuation.

# Regulatory Framework

Members’ accrued benefits are guaranteed by statute. Members’ contributions are fixed in the Regulations at a level which covers only part of the cost of accruing benefits. Employers currently pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers pay for their own liabilities.

* Funding Strategy Statements were introduced such that the first Statement was to be published by 31st March 2005 and it forms part of a framework which includes:
* the Local Government Pension Scheme Regulations 2013 and the Local Government Pension Scheme (Transitional Provisions) Regulations 2008;
* the Public Service Pensions Act 2013;
* the Rates and Adjustments Certificate, which is issued in addition to the Fund’s triennial valuation report;
* actuarial factors for valuing early retirement costs and the cost of buying extra service or pension;
* the Statement of Investment Principles (SIP) or Investment Strategy Statement (ISS); and
* Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

|  |
| --- |
| 1 2 |

This is the framework within which the Fund’s 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 Fund. The FSS applies to all employers participating in the Fund or to employers who have ceased contributing without paying a cessation debt and are not fully funded on an ongoing basis.

# Purpose of the Funding Strategy Statement in Policy Terms

The purpose of the FSS is:

* To establish a clear and transparent fund-specific strategy which will identify how employers’ pension liabilities are best met going forward.
* To support the regulatory framework taking into account the requirement to set contributions so as to ensure solvency and long term cost efficiency under relevant legislation and the desirability to maintain as nearly constant a primary employer contribution rate as possible.
* To take a prudent longer-term view of funding those liabilities.

These objectives are desirable individually, but may be mutually conflicting. This statement, therefore, sets out how LPFA has balanced the conflicting aims of ensuring solvency, affordability of contributions, transparency of processes, desirability of stability of employers’ contributions and prudence in the funding basis.

# Aims and Purpose of the Pension Fund

The aims of the Fund are to:

* manage employers’ liabilities effectively and, in particular
* ensure that sufficient resources are available to meet all liabilities as they fall due;
* safeguard the fund against the consequences of employer default
* set contributions to ensure fund solvency and long term cost efficiency, which should be assessed in light of the risk profile to the fund and the Authority and employers’ risk profiles (Public Service Pensions Act)
* enable primary employer contribution rates to be kept as stable as possible and at reasonable cost to the taxpayers, scheduled, designated, resolution and admitted bodies (LGPS Regulations)
* seek returns from investments within reasonable risk parameters.

The purpose of the Fund is to:

* receive monies in respect of contributions, transfer values and investment income; and
* pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses;
* as defined in the Local Government Pension Scheme Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

# Responsibilities of the Key Parties

The sound management of the Fund can only be achieved if all interested parties exercise their statutory duties and responsibilities conscientiously and diligently. Although a number of these parties, including investment fund managers and external auditors, have responsibilities to the Fund, the following may be considered to be of particular relevance for inclusion as a specific reference:

The Administering Authority should:

* collect employer and employee contributions, investment income and other amounts due to the fund;
* operate a pension fund paying benefits as they become due;
* invest surplus monies in accordance with the Regulations and agreed strategy;
* ensure that cash is available to meet liabilities as and when they fall due;
* manage the valuation process in consultation with the Fund’s Actuary;
* notify employers of the expected timing of key events and actions related to completion of the valuation process. Good communication between all parties and stakeholders is essential in building strong relationships throughout the valuation process;
* prepare and maintain an FSS and a SIP/ISS, both after proper consultation with interested parties, including participating employers and
* monitor all aspects of the Fund’s performance and funding and amend the FSS and SIP/ISS accordingly.
* take measures to safeguard the fund against the consequences of employer default
* manage potential conflicts of interest arising from its dual role as fund administrator and scheme employer
* enable the Local Pension Board to review the Valuation process as they see fit

The Individual Employer should:

* deduct contributions from employees’ pay correctly after determining the appropriate employee contribution rate in accordance with LGPS Regulations;

|  |
| --- |
| • develop policies on certain discretions and exercise discretions as permitted within the regulatory 34 |

* pay all ongoing contributions, including employer contributions determined by the actuary and set out in the Rates and Adjustments, promptly by the due date;
* notify the Administering Authorities promptly of all changes to membership or, as may be proposed, which affect future funding;
* comply with the valuation timetable where required and respond to communications as necessary to complete the process; and follow all requirements laid down in the Performance Administration Strategy;
* discharge their responsibility for compensatory added years which the administering authority pays on their behalf and is subsequently recharged to them;
* comply with The Pensions Regulator requirements outlined within Code of Practice 14;
* pay any exit payments on ceasing participation in the Fund

**The Fund Actuary should:**

* prepare valuations including the setting of employers’ contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS and LGPS Regulations;
* set contribution rates in order to secure the Fund’s solvency and long term cost efficiency having regard to the desirability of maintaining as nearly constant a primary contribution rate as possible;
* prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
* provide advice and valuations on the exiting of employers from the fund;
* assist the administering authority in assessing whether any increase is required in an individual employers contributions under Regulation 64(4) of the 2013 LGPS Regulations;
* agree a timetable for the valuation process with the Administering Authority and provide timely advice and results

# Solvency Issues, Target Funding Levels and Long-Term Cost Efficiency

The principal issues facing the solvency of the Fund include the ability to finance liabilities as and when they arise, the rate or volatility of variations in employer contribution rates, the pace at which deficits are recovered (or surpluses used up), and the returns on the Fund’s investments within reasonable risk parameters.

Securing solvency and long term cost efficiency are regulatory requirements with a constant as possible employer primary contribution rate a desirable outcome. The authority will prudentially seek to ensure the income stream from contributions and investments achieve the aim of ensuring benefits can be paid as and when they fall due. The rate of employer contributions will be set to target a funding level of 100% for the whole Fund over an appropriate time period and using appropriate actuarial assumptions. The rate of employer contributions will be sufficient to make provision for the cost of benefit accrual, with an adjustment for any surplus or deficit in the Fund.

The fund will set funding strategy appropriately having regard to factors such as:

* Strength of covenant and security of future income streams.
* Guarantor arrangements from scheme employers.
* Prospective period of participation in the fund, and specifically the implications if the employer has closed membership of the scheme to new employees.

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

All fund employers are expected to fully meet their pension obligations outlined within the LGPS Regulations on both an ongoing and cessation basis using the methodology applied by the funds appointed actuarial advisor.

|  |
| --- |
| 5 6 |

The assumptions used to value the liabilities of the various employers as at 31 March 2016 are set out below:

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **Nominal** | **Real** |
| **Price Inflation** **(CPI)** | Market expectation of long term future RPI inflation as measured by the difference between yields on fixed and index-linked Government bonds as at the valuation date less 0.9% to allow for the difference between RPI and CPI | **2.4%** |  |
| **Pay Increases** | Assumed to be in line with CPI until 31 March 2020 and then 1.5% p.a. in excess of CPI | **2.4% until 31** **March 2020 then** **3.9%** | **0% until 31** **March 2020 then** **1.5%** |
| **Discount Rate** | Based on the long-term investment strategy of the Fund and the relative strength of each employer | **2.2% - 5.7%** | **-0.2% - 3.3%** |

* Staff turnover, death in service, salary scales and ill-health retirements reflect updated expectations of future experience, taking into account the most recent study of national LGPS experience, as assessed by the Government Actuary’s Department.
* Employers will manage early retirements to minimise extra costs falling on the Fund and the capitalised cost of early retirements, other than on ill-health terms up to the levels of experience assumed by the Actuary, and augmentation of service or pension will be funded by the employer, by lump sum payment at the time of retirement.
* The liabilities have been calculated using Club Vita 2016 mortality tables, utilising the full range of 940 bands assigned to the individual members of the LPFA fund.
* Allowance is made for members’ mortality to improve in the future, using the 2015 version of the CMI model with a long-term rate of improvement of 1.5% per annum.
* 75% of males and 70% of females are assumed to have an eligible dependant at retirement or earlier death. For members that have already retired, allowance is made for their dependant to have died since retirement.
* At retirement members will commute 50% of the maximum pension allowed by HMRC at a rate of 12:1.
* For each tranche of benefit, members have an age at which they are able to take their benefits unreduced. This is their rule of 85 age for service prior to 1st April 2008, it will be their rule of 85 age (for older members) or 65 (for younger members) for service between 1st April 2008 and 31st March 2014 and it will be their State Pension Age (but with some transitional protection for older members) for service after 1st April 2014. It is assumed that each member will retire at the average of these ages (weighted by pension).
* 75% of ill-health retirements assumed to be at Tier 1, 15% at Tier 2 and 10% at Tier 3.
* LPFA recover pension increases from some employers with no remaining active members and these payments are allocated to the appropriate employer’s notional asset allocation. Where appropriate LPFA would also seek to recover such payments in accordance with the relevant LGPS regulations from other employers in accordance with actuarial advice and dependent on the level of guarantee provided by the former employer.

**Pooling of employers will be implemented as follows:**

* Where an employer has ceased to participate and their pension obligations have been subsumed to a continuing employer, these employers will be pooled and considered as one entity
* Where an employer is directly related to another employer (e.g. common ownership), pooling will be considered
* Single deficit recovery periods are to apply within a pool where possible to avoid additional divergence over time from underlying employer positions; and
* Appropriate rate adjustments are to be made within pools where different phasing options have been chosen to avoid additional divergence from underlying employer positions.

Phasing in contribution increases may be agreed on an incremental basis to reduce the impact of large increases and to meet the regulatory requirement and FSS objective for rates to be as nearly constant as possible. Each employer shall be reviewed on its own merits.

Past service deficit contributions are to be paid as cash sums by all employers unless they specifically request a change to a percentage requirement, are actively open to new members, can demonstrate a stable or increasing active membership and pensionable payroll and LPFA agree to such an approach;

In the event of an employer being in surplus, consideration will be given to the funding position that would apply if they were to cease participation. Should the employer also be in surplus on that measure, this surplus may be released back to the employer through an adjustment to their contribution rate. Should the employer be in deficit on that measure, no deduction is to be made from their future service contribution rate.

Where employers have a deficit, their spread period will first be considered based on the funding categories set out in Annex 2 and, combined with the cost of new benefits, this will give the implied total contributions (whether expressed wholly as a percentage of salary or as a combination of salary and cash elements).

In order to improve the funding position as quickly as possible, where implied total contributions have decreased, employers will generally be required to maintain their previous contributions to ensure 100% funding is achieved at the earliest opportunity. However, reductions may be considered in particular circumstances.

The Administering Authority may consider and implement an individual funding target with consideration to the expected deficit when the employer ceases.

On the cessation of an employer’s participation in the Fund, the Fund Actuary will be asked to assess the remaining deficit, as required by the LGPS Regulations. The assumptions used for this valuation will not necessarily be consistent with the long-term funding assumptions used for the 2016 valuation and, in particular, they will take into account the amount of funding support available after the employer ceases.

|  |
| --- |
| 7 8 |

Following the cessation of an employer in the Fund, the Administering Authority may consider agreeing to a formal payment plan with the employer or guarantor as appropriate, rather than receiving full payment of any cessation debt. Any such arrangement would only be allowed where evidence of financial security e.g. through a first charge on assets or appropriate guarantee from a government department is provided to the LPFA’s satisfaction.

# Links to Investment Policy

Funding and investment strategy are inextricably linked. The Investment Strategy is set after taking investment advice, to reflect the liabilities of the Fund and these may be set to achieve the funding strategy agreed with employers. The Investment Strategy is set out in the published Statement of Investment Principles or Investment Strategy Statement.

LPFA does not account for each employer’s assets separately. The Fund’s Actuary is required to apportion the assets between the employers at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer. In addition, any bulk transfers between employers or individual transfers of which the Actuary is aware are allowed for through notional transfers between the employers.

This approach aims to broadly replicate the assets that would have resulted had each employer participated in their own ring-fenced section but some approximations are required with regard to internal transfers and the timing of cashflows.

The limitations in the process are recognised, but having regard to the extra administration cost of building in new protections, it considers that the Fund Actuary’s approach addresses the risks of employer cross-subsidisation to an acceptable degree.

# Key Risks and Controls

LPFA has an active risk management programme in place to identify, measure and control key financial, demographic, regulatory, and governance risks as well as employer and liquidity risk. This is summarised in the risk register in Annex 3 and reviewed regularly.

# Consultation and Publication

LPFA has prepared and updated the FSS in collaboration with the Fund’s Actuary, and consulted the employers in the Fund through written correspondence at various stages in the original process and held a special forum to address the funding principles. The FSS has been published on the LPFA web site and printed copies are available on request.

A copy has been sent to each employer, the Fund’s Actuary, investment managers and advisers, the Department for Communities and Local Government (DCLG), and other interested parties, including members of various Employer and Fund Member Panels and the Local Pensions Board.

Scheme members will be informed of the publication and the key elements of the strategy in the annual report to members. A summary of the funding principles which underpin the strategy will also be published in the Annual Report and Accounts.

**Monitoring and Review**

The investment performance of the Fund is monitored relative to the growth in the liabilities on a monthly basis.

The key funding principles will be monitored on an annual basis and a statement of significant variance will be incorporated into the actuarial report as part of the LPFA’s annual report and accounts.

As a policy statement, the FSS is reviewed in detail at least every three years ahead of triennial valuations being carried out, with the next full review due to be started by 31st March 2019 at the latest in order to inform the valuation process due as at that date.

The FSS will though be reviewed in the event of any significant or material change arising prior to the next valuation and a revised statement issued accordingly.

|  |
| --- |
| 9 10 |

**This Funding Strategy Statement was first published on 10th February 2005 and a revised version published in March 2008, March 2011 and February 2014.**

# ANNEX 1 Extract from the LGPS Regulations and Public Service Pensions Act 2013

**Funding strategy statement**

**58.** —(1) An administering authority must, after consultation with such persons as it considers appropriate, prepare, maintain and publish a written statement setting out its funding strategy.

1. The statement must be published no later than 31st March 2015.
2. The authority must keep the statement under review and, after consultation with such persons as it considers appropriate, make such revisions as are appropriate following a material change in its policy set out in the statement, and if revisions are made, publish the statement as revised.
3. In preparing, maintaining and reviewing the statement, the administering authority must have regard to—
4. the guidance set out in the document published in October 2012 by CIPFA, the Chartered

Institute of Public Finance and Accountancy and called “Preparing and Maintaining a Funding Strategy Statement in the Local Government Pension Scheme 2012 (42) ; and

1. the statement of investment principles published by the administering authority under regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (43) .

**Actuarial valuations of pension funds**

62. —(1) An administering authority must obtain—

(a) an actuarial valuation of the assets and liabilities of each of its pension funds as at 31st

March 2016 and on 31st March in every third year afterwards; (b) a report by an actuary in respect of the valuation; and (c) a rates and adjustments certificate prepared by an actuary.

1. Each of those documents must be obtained before the first anniversary of the date (“the valuation date”) as at which the valuation is made or such later date as the Secretary of State may agree.
2. A report under paragraph (1)(b) must contain a statement of the demographic assumptions used in making the valuation; and the statement must show how the assumptions relate to the events which have actually occurred in relation to members of the Scheme since the last valuation.
3. A rates and adjustments certificate is a certificate specifying—(a) the primary rate of the employer’s contribution; and (b) the secondary rate of the employer’s contribution, for each year of the period of three years beginning with 1st April in the year following that in which the valuation date falls.
4. The primary rate of an employer’s contribution is the amount in respect of the cost of future accruals which, in the actuary’s opinion, should be paid to a fund by all bodies whose employees contribute to it so as to secure its solvency, expressed as a percentage of the pay of their employees who are active members. (6) The actuary must have regard to—
5. the existing and prospective liabilities arising from circumstances common to all those bodies;
6. the desirability of maintaining as nearly constant a primary rate as possible; (c) the current version of the administering authority’s funding strategy mentioned in regulation 58 (funding strategy statements); and

(d) the requirement to secure the solvency of the pension fund and the long term cost efficiency of the Scheme, so far as relating to the pension fund.

1. The secondary rate of an employer’s contributions is any percentage or amount by which, in the actuary’s opinion, contributions at the primary rate should, in the case of a Scheme employer, be increased or reduced by reason of any circumstances peculiar to that employer.
2. A rates and adjustments certificate must contain a statement of the assumptions on which the certificate is given as respects—
3. the number of members who will become entitled to payment of pensions under the provisions of the Scheme; and
4. the amount of the liabilities arising in respect of such members, during the period covered by the certificate.

(9) The administering authority must provide the actuary preparing a valuation or a rates and adjustments certificate with the consolidated revenue account of the fund and such other information as the actuary requests.

**Special circumstances where revised actuarial valuations and certificates must be obtained**

*Please click* [*here*](http://www.lgpsregs.org/index.php/regs-legislation/statutory-instruments/lgpsregs2013-amends-by-reg?showall=&start=1#reg64) *for a list of the Statutory Instruments which have amended this regulation since its introduction.*

64. -(1) Subject to paragraph (2A), if a person—

1. ceases to be a Scheme employer (including ceasing to be an admission body participating in the Scheme), or
2. is or was a Scheme employer, but irrespective of whether that employer employs active members contributing to one or more other funds, no longer has an active member contributing towards a fund (“a relevant fund”) which has liabilities in respect of benefits in respect of current and former employees of that employer, that person becomes “an exiting employer” in relation to the relevant fund for the purposes of this regulation and is liable to pay an exit payment.

(2) When a person becomes an exiting employer, the appropriate administering authority must obtain—

1. an actuarial valuation as at the exit date of the liabilities of the fund in respect of benefits in respect of the exiting employer’s current and former employees; and
2. a revised rates and adjustments certificate showing the exit payment due from the exiting employer in respect of those benefits.

(2A) An administering authority may by written notice (“a suspension notice”) to an exiting employer suspend that employer’s liability to pay an exit payment for a period of up to 3 years starting from the date when that employer would otherwise become an exiting employer, if the condition in paragraph (2B) is met.

(2B) The condition mentioned in paragraph (2A) is that in the reasonable opinion of the administering authority the employer is likely to have one or more active members contributing to the fund within the period specified in the suspension notice.

(2C) If an administering authority serves a suspension notice on an employer, unless that suspension notice is withdrawn, paragraph (2) does not apply in respect of that employer, but the employer must continue to make such contributions towards the liabilities of the fund in respect of benefits in respect of the employer’s current and former employees as the administering authority reasonably requires.

|  |
| --- |
| 11 12 |

(3) Where for any reason it is not possible to obtain all or part of the exit payment due from

the exiting employer, or from an insurer, or any person providing an indemnity, bond or guarantee on behalf of the exiting employer, the administering authority must obtain a further revision of any rates and adjustments certificate for the fund showing:

1. in the case where a body is an admission body falling within paragraph 1(d) of Part 3 of Schedule 2 to these Regulations (Scheme employers: bodies providing services as a result of transfer of a service), the revised contribution due from the body which is the related employer in relation to that admission body; and
2. in any other case, the revised contributions due from each Scheme employer which contributes to the fund, with a view to providing that assets equivalent to the exit payment due from the exiting employer are provided to the fund over such period of time as the administering authority considers reasonable.

(4) Where in the opinion of an administering authority there are circumstances which make it likely that a Scheme employer (including an admission body) will become an exiting employer, the administering authority may obtain from an actuary a certificate specifying the percentage or amount by which, in the actuary’s opinion—

(a) the contribution at the primary rate should be adjusted; or (b) any prior secondary rate adjustment should be increased or reduced, with a view to providing that assets equivalent to the exit payment that will be due from the Scheme employer are provided to the fund by the likely exit date or, where the Scheme employer is unable to meet that liability by that date, over such period of time thereafter as the administering authority considers reasonable.

1. When an exiting employer has paid an exit payment into the appropriate fund, no further payments are due from that employer in respect of any liabilities relating to the benefits in respect of any current or former employees of that employer as a result of these Regulations.
2. Paragraph (7) applies where—
3. a Scheme employer agrees to pay increased contributions to meet the cost of an award of additional pension under regulation 31 (award of additional pension); or
4. it appears likely to an administering authority that the amount of the liabilities arising or likely to arise in respect of members in employment with a Scheme employer exceeds the amount specified, or likely as a result of the assumptions stated, for that authority, in a rates and adjustments certificate by virtue of regulation 62(8) (actuarial valuations of pension funds: assumptions).
5. The administering authority must obtain a revision of the rates and adjustments certificate concerned, showing the resulting changes as respects that Scheme employer.
6. For the purposes of this regulation—

“exiting employer” means an employer of any of the descriptions specified in paragraph (1); “exit payment” means the assets required to be paid by the exiting employer over such period of time as the administering authority considers reasonable, to meet the liabilities specified in paragraph (2);

“exit date” means the date on which the employer becomes an exiting employer; and “related employer”means any Scheme employer or other such contracting body which is a party to the admission agreement (other than an administering authority in its role as an administering authority).

(8A) Paragraph (8B) applies where the exiting employer is the Merseyside Integrated Transport Authority (“the ITA”) and the liabilities of the fund in respect of benefits due to the ITA’s current and former employees (or those of any predecessor authority) have been or are to be transferred to the Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority as a result of the establishment of the combined authority by article 3(1) of the Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority Order 2014.

(8B) Where this paragraph applies, no exit payment is due under paragraph (1) and paragraph (2) does not apply.

Supply of copies of valuations, certificates etc

66. —(1) An administering authority must publish and send copies of any valuation, report, certificate or revised certificate obtained under regulations 62 (actuarial valuations of pension funds) or 64 (special circumstances where revised actuarial valuations and certificates must be obtained) to:

1. the Secretary of State;
2. each body with employees who contribute to the fund in question; and (c) any other body which is, or may become liable to make payments to that fund.

(2) An administering authority must also send to the Secretary of State—

1. (a) a copy of the consolidated revenue account with which the actuary was provided under regulation 62(9); and
2. (b) a summary of the assets of the fund at the valuation date (unless such a summary is contained in the report under regulation 62(1)(b)).

**Public Sector Pensions Act 2013**

**12 Employer cost cap**

**This section has no associated Explanatory Notes**

(1)Scheme regulations for a scheme under section 1 which is a defined benefits scheme must set a rate, expressed as a percentage of pensionable earnings of members of the scheme, to be used for the purpose of measuring changes in the cost of the scheme.

(2)In this section, the rate set under subsection (1) is called the “employer cost cap”.

(3)The employer cost cap is to be set in accordance with Treasury directions.

(4)Treasury directions may in particular specify—

(a)how the first valuation under section 11 of a scheme under section 1 is to be taken into account in setting the cap;

(b)the costs, or changes in costs, that are to be taken into account on subsequent valuations of a scheme under section 1 for the purposes of measuring changes in the cost of the scheme against the cap;

(c)the extent to which costs or changes in the costs of any statutory pension scheme which is connected with a scheme under section 1 are to be taken into account for the purposes of this section.

(5)Treasury regulations must make—

(a)provision requiring the cost of a scheme (and any connected scheme) to remain within specified margins either side of the employer cost cap, and

(b)for cases where the cost of a scheme would otherwise go beyond either of those margins, provision specifying a target cost within the margins.

(6)For cases where the cost of the scheme would otherwise go beyond the margins, scheme regulations may provide for—

(a)a procedure for the responsible authority, the scheme manager (if different), employers and members (or representatives of employers and members) to reach agreement on the steps required to achieve the target cost for the scheme, and

(b)the steps to be taken for that purpose if agreement is not reached under that procedure.

(7)The steps referred to in subsection (6) may include the increase or decrease of members’

benefits or contributions.

(8)Treasury regulations under this section may— (a)include consequential or supplementary provision; (b)make different provision for different schemes.

|  |
| --- |
| 13 14 |

(9)Treasury regulations under this section are subject to the negative Commons procedure.

13 Employer contributions in funded schemes

This section has no associated Explanatory Notes

(1)This section applies in relation to a scheme under section 1 which is a defined benefits scheme with a pension fund.

(2)Scheme regulations must provide for the rate of employer contributions to be set at an appropriate level to ensure— (a)the solvency of the pension fund, and

(b)the long-term cost-efficiency of the scheme, so far as relating to the pension fund.

(3)For that purpose, scheme regulations must require actuarial valuations of the pension fund.

(4)Where an actuarial valuation under subsection (3) has taken place, a person appointed by the responsible authority is to report on whether the following aims are achieved—

(a)the valuation is in accordance with the scheme regulations;

(b)the valuation has been carried out in a way which is not inconsistent with other valuations under subsection (3);

(c)the rate of employer contributions is set as specified in subsection (2).

(5)A report under subsection (4) must be published; and a copy must be sent to the scheme manager and (if different) the responsible authority.

(6)If a report under subsection (4) states that, in the view of the person making the report, any of the aims in that subsection has not been achieved— (a)the report may recommend remedial steps;

(b)the scheme manager must—

(i)take such remedial steps as the scheme manager considers appropriate, and

(ii)publish details of those steps and the reasons for taking them;

(c)the responsible authority may—

(i)require the scheme manager to report on progress in taking remedial steps;

(ii)direct the scheme manager to take such remedial steps as the responsible authority considers appropriate.

(7)The person appointed under subsection (4) must, in the view of the responsible authority, be appropriately qualified.

# ANNEX 2 Employer Funding Categories and Termination Requirements

The period over which any current past service deficit is to be recovered and the discount rate to be used in calculating contribution rates will be dependent on a number of factors, including the statutory nature of any overriding level of guarantee, or where other forms of security such as a bond or charge on assets can be provided with due consideration of the maturity profile of the Fund. The overall aim of the fund and the funding strategy is to achieve a funding level of 100% for the Fund over a reasonable period of time and within the prudential framework in which the Fund operates. Those employers with a strong covenant will be able to benefit in full from our overall investment approach and LPFA also need to ensure that other employers who are not as secure are not unduly subsidised by those employers. Given there is a wide range of credit risk posed by the various scheme employers the LPFA have determined the need for some employers to contribute more in order to mitigate those risks and consequently ensure equitable treatment of all scheme employers.

**Category A ~ Indicative funding term of up to 14 years as at the 2016 valuation.**

LGPS “Scheduled” and “Resolution/Designated Bodies” where liabilities in the event of such an employer ceasing to participate in the Scheme are guaranteed by a government department or similar body. These are statutory entities that are either required to, or can choose to, offer the LGPS under the LPFA Fund.

“Admitted Bodies” upon whose withdrawal, full deficiency funding is provided via a statutory body or government department (e.g. bodies with statutory guarantor or an admitted body delivering “outsourced” functions as prescribed under the LGPS where a statutory body/government department are part of the admission agreement).

**Category B ~ Target funding term up to 14 years as at the 2016 valuation**

“Admitted Bodies” or LGPS “Scheduled” and “Resolution/Designated Bodies” with no statutory underpin but where either;

1. the body can now provide, to the LPFA’s satisfaction, evidence of financial security to justify the longer funding term than prevailing FWL (e.g. a “parent company” guarantee, secured income streams or external bond/insurance cover for an appropriate amount, a charge over assets), or,
2. the body is part of a directly related group of bodies within the LPFA Fund and where another one of those bodies has now formally accepted default funding for the body in question through “pooled sub-funding” within the Fund. In this case the funding period for the “first” will equal FWL of the “second” if longer.

**Category C ~ Target funding term up to Future Working Life as at the 2016 valuation. “Admitted Bodies” with no external underpin.**

## Notes

1.In any case an appropriately shorter funding period will be substituted by LPFA, e.g. where the body is known to be of short or fixed-term life (e.g. the duration of the relevant service contract held by the “Admitted Body”).

2.The LPFA may choose to apply a longer or shorter funding term or different funding basis for a given employer as a result of specific advice received from the Fund’s Actuary.

3.Category A and B employers have the option to request a shorter funding period over which any prevailing deficiency is recovered.

15 16

4.It is the known/evidenced position for a given employer at the time in question that will inform funding decisions taken under the above and the position will be kept under review.

5.External advice may be needed to provide the “satisfaction” required under Category B (a)

6.Where employers under any category close (or are already closed) to new members, specific guidance will be sought from the Fund’s Actuary as to the appropriate revised contributions required, to ensure liabilities are fully funded. The period over which recovery is made can be adjusted to take account of evidence of financial security or appropriate guarantees subject to external advice being obtained where necessary. The general aim will be to ensure that the relevant cessation deficit is met in full in accordance with regulation 64(2), i.e. that the value of the assets in respect of current and former employees of a particular employing authority is neither materially more nor materially less than the anticipated liabilities of the fund in respect of those employees at the date of cessation.

7.An adjustment to the discount rate applicable to and contributions payable by, a particular employer will be made, dependent on overall employer covenant strength, the level of security put in place and whether they remain open or closed to new members.

# Termination requirements

**Background**

One of the greatest risks to the Fund (and its participating employers) is that a body ceases to exist with an outstanding deficit that it cannot pay and which will not be met by any bond, indemnity or guarantor. Previous sections of this policy are drafted with a view to safeguarding against this. However, it is also important that the Fund has the flexibility to terminate an admission agreement at the appropriate point to protect the other employers in the Fund and to allow it to levy an exit payment (assuming there are appropriate grounds for doing so under the relevant LGPS Regulations).

**Policy**

The Fund will take legal advice on the appropriate termination requirements to be included in admission agreements and these will be incorporated into all new admission agreements. These will include the option for an admission agreement to be terminated by the Fund in any of, but not limited to, the following circumstances:

* Where the admission body is not paying monies in a timely manner or encountering significant financial difficulties;
* Where the admission body is not meeting administrative requirements relating to the provision of information;
* Where the admission body is not meeting its requirement to provide or review any bond/ indemnity or guarantor;
* Where no further active members exist;

On an employer exiting the fund a degree of flexibility will be used to ensure cessation liabilities are met in full. In particular those agreements could be effected over an extended period subject to appropriate guarantees and legal agreements being in place.

Proposals to exit the fund will be considered to ensure they achieve both the best outcome for the fund and the remaining participating employers.

Any proposal to exit will ultimately require LPFA board approval and would need to take account of appropriate legal, actuarial and financial evidence coupled with a detailed risk analysis before approval of any offer could be considered.

17

## Risk

Investment Risk: Failure to achieve anticipated investment returns; failure of investment strategy to deliver investment objectives leading to the forced selling of assets to pay pensions. Investment Risk: Failure to achieve anticipated investment returns; failure of investment strategy to deliver investment objectives leading to the forced selling of assets to pay pensions.

Pay and Price inflation significantly more than anticipated. This manifests itself in two areas: 1) From an employer’s perspective and; 2) General inflation and the impact on the Fund.

Increasing numbers of un-reduced, early retirement cases.

Employers become unstable, insolvent or abolished with insufficient funds to meet liabilities, whereby the liabilities fall on other Fund employers.

Government departments unaware of the pension liabilities employers hold and consequently do not take them into consideration when reviewing funding levels. This can be exacerbated by loss of government backing, changes in funding structure and public sector spending cuts.

Incorrect longevity and mortality assumptions.

Regulatory and Compliance Risk

## Controls

Quarterly monitoring by the LPPI Investment team where underperformance will be reported to the LPFA Board. LPPI should only anticipate long term return on a relatively prudent basis to reduce risk of under-performing. This will be supplemented by analysing progress at three yearly valuations and by the inter-valuation roll-forward of liabilities between formal valuations, monitored regularly against returns. There is a review of managers and fees in line with revised strategy. An internal equity strategy has been developed and is in place. Quarterly meetings are to be held with the investment team and presentations are made to the LPFA Board and at any other meetings as required. LPPI further control this risk with a diversified strategic asset allocation and by having a Treasury Management strategy in place. The results of the Triennial Valuation will further inform strategy. A sophisticated Asset and Liability Management system is used to assess risks to the funding ratio which are used to inform the Board and the investment strategy.

The Triennial Actuarial Valuation and the Inter-Valuation monitoring provides early warning of this risk. Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities for any bias in pensionable pay rises towards long serving employees. When we notify employers about valuation results we detail the valuation assumptions which will raise their awareness of the impact of salary increases in excess of assumed rates. Management produce an inflation sensitivity analysis within a monthly solvency report. A liability driven investment strategy is in place with the aim of mitigating inflation risks.

Employers are charged the extra capital cost of non-ill health retirements on each decision at the time retirement takes place.

Liquidity reporting is included as a part of the Financial monitoring report.

Liquidity limits are reported to IC quarterly. The fund aims to maintain a cash balance sufficient to cover at least 3 months’ pension obligations.

This risk is further mitigated by ensuring that there are liquid (3 months or less) assets available, which are sufficient to support unexpected but plausible cash outflows.

Employer Services team manager has reviewed with DCLG and other Government departments, thus ensuring that all parties are aware of the extent of employers liabilities and related issues. Ongoing discussions will be held as part of the valuation process.

Participation in Club Vita analysis of mortality in Fund. Board assessment of mortality assumptions completed as part of the Triennial valuation in conjunction with advice from Fund actuaries. LPFA Board are currently reviewing 2016 valuation assumptions.

LPP has Governance, Risk Management and Compliance functions that are responsible for building regulatory and compliance checks into business processes.

18

# ANNEX 3 - Risk Register



your pension our world