your pension our world

London Pensions Fund Authority
Funding Strategy Statement

October 2021

Contents

The Funding Strategy Statement (“FSS”) is a summary of the Authority’s approach to funding liabilities in respect of the Fund. It is not an exhaustive statement of policy on all issues.

London Pensions Fund Authority Funding Strategy Statement

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 (the 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 to facilitate use of additional flexibilities under Regulations 64A and 64B of the LGPS Regulations 2013. It has been prepared with regards 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 2019 valuation of the Fund.

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.

FSSs 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, the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014;
- 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 Investment Strategy Statement (ISS); and
- Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

This is the framework within which the Fund's Actuary carries out triennial valuations to set employers' contributions and provides recommendations to the 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.

Purpose of the Funding Strategy Statement in policy terms

The purpose of the FSS is as set out by the Department for Communities and Local Government and the 2016 CIPFA Pensions Panel Guidance on preparing and maintaining a Funding Strategy Statement:

- "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** of maintaining **as nearly constant a primary employer contribution rate as possible***; and
- 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 the Authority 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 Fund

The aims of the Fund are to:

- manage employers' liabilities effectively; and
- ensure that sufficient resources are available to meet all liabilities as they fall due;
- 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 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 set out in the 2016 CIPFA Pensions Panel Guidance and defined in the Local Government Pension Scheme Regulations and in the Local
Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

* As set out in 2016 CIPFA Pensions Panel Guidance and defined in regulation 62 of the LGPS Regulations 2013.

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 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 an ISS, both after proper consultation with interested parties, including participating employers; and
- monitor the Fund's performance and funding and amend the FSS and 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 set out in their terms of reference.

The individual employer should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate in accordance with LGPS Regulations;
- pay all ongoing contributions, including employer contributions determined by the actuary and set out in the Rates and Adjustments Certificate, promptly by the due date;
- develop policies on discretions and exercise discretions as permitted within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain including payment of penalties for late payment;
- notify the Administering Authority 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 Pensions Administration Strategy;
- send timely and accurate data to the Authority, as required;
- 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, where agreement has been reached with relevant parties that these should be paid;
- manage early retirements to minimise extra costs falling on 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 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 employer's 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 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 an ongoing valuation basis 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 Authority 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;
- secondary rate (deficit recovery) contributions.

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 Fund's appointed actuarial advisor.

The assumptions used to value the liabilities of the various employers as at 31 March 2019 are set out below. Base market statistics used to derive the assumptions are smoothed around the valuation date so that market conditions used are the average of the daily observations over the period 1 January 2019 to 30 June 2019. Assets are also smoothed in a consistent way.

		Nominal	Real
Price inflation (CPI)	Market expectation of long-term future Retail Price Index (RPI) inflation as measured by the bank of England implied RPI inflation curve based on the difference between yields on fixed and index-linked gilts as at the valuation date less 1.0% to allow for the difference between RPI and CPI	2.6% p.a.	
Pay increases	Assumed to be in line with CPI +1.0% p.a.	3.6% p.a	1.0% p.a
Discount rate	Based on the long-term investment strategy of the Fund and the relative strength of each employer	1.7% to 5.3% p.a.	-0.9% to 2.7% p.a.

Other assumptions

The liabilities have been calculated using Club Vita 2019 mortality tables, which assign a mortality assumption to each individual member based on individual characteristics which distinguish them as being longer/shorter lived than others.

Allowance is made for members' mortality to improve in the future, using the 2018 version of the CMI model with a 0.5% initial addition to improvement parameter, a smoothing parameter of 7.0 and a long-term rate of improvement of 1.25% per annum.

Staff turnover and death in service 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.

Allowance for promotional salary increases has been included within the general salary increase assumption.

Ill-health retirements reflect the Fund's specific experience.

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.

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.

No allowance has been made for individual member transfers out based on member experience up to the 2019 valuation date.

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.

McCloud/Sargeant judgement allowance

On 20th December 2018 a judgement was made by the Court of Appeal in relation to two employment tribunal cases (McCloud and Sargeant), 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.

The Court of Appeal ruled that the transitional protection offered to some members as part of the scheme reforms amounted to unlawful discrimination. On 27th June 2019, the Supreme Court denied the Government's request to appeal the judgement.

It has been noted by the Government in its 15th July 2019 statement that it expects to have to amend all public service pension schemes in light of the judgement, including the LGPS. However, any remedy will either be imposed by the Employment Tribunal or negotiated and applied to all schemes, so it is not yet clear how this judgement may affect LGPS members' benefits.

The outcome of McCloud/Sargeant case is likely to mean changes to the LGPS benefit structure. The changes and timing of these changes are still highly uncertain but are likely to impose additional albeit not particularly material costs on the LGPS. Allowance has been made in the 2019 actuarial valuation via the prudence allowance built into the discount rate to meet these potential costs.

Other strategy considerations

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 the Authority 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 considered where an employer is directly related to another employer (e.g. common ownership).

Phasing in contribution changes may be agreed on an incremental basis to reduce the impact of large changes 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 active accrual. 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 1 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.

Where appropriate, LPFA may exercise its power to amend contributions under Regulation 64A of the LGPS Regulations 2013. LPFA's policy on amending contributions between valuations is set out in its Contribution Flexibility Policy.

Exiting the Fund

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 carry out an actuarial valuation to determine the assets and liabilities in respect of the benefits held by the exiting employer's current and former employees, 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 2019 valuation and, in particular they will take into account the amount of funding support available after the employer ceases.

Following the cessation of an employer in the Fund, LPFA may consider entering into a Deferred Debt Agreement under Regulation 64(7B) of the LGPS Regulations 2013. LPFA may also consider spreading any exit payment under Regulation 64B of the LGPS Regulations 2013. LPFA's policy on Deferred Debt Agreements and its policy on spreading exit payments are set out in our Admission and Cessation policy

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). LPFA's policy on terminations is set out in its Admission and Cessation policy.

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 Investment Strategy Statement.

LPFA does not account for each employer's assets separately. The Fund's Actuary is required to notionally 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. The key risks are summarised in Annex 2 and reviewed regularly.

Consultation and publication

The Authority 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. 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), other interested parties 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 completion of the triennial valuation, with the next full review due to be completed by 31st March 2023 in order to inform the 31st March 2022 triennial valuation.

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

ANNEX 1 - 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 maintain an ongoing valuation basis funding level of 100% for the Fund 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.

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.

The table below sets out the funding term and discount rate adopted for each category of employer for the 2019 actuarial valuation. Note that the definition of each category reflects the policy adopted for the 2019 actuarial valuation. This policy has now been superseded by LPFA's Employer Risk Management Framework, however the 2019 definitions are included below for completeness.

Category	Definition of category adopted for the 2019 actuarial valuation	Funding term	Discount rate
A	LGPS "Scheduled" and "Resolution/Designated Bodies" where, in the event of such an employer ceasing to participate in the Scheme, the liabilities 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" where, in the event of such an employer ceasing to participate in the Scheme, full deficiency funding is provided via a statutory body or government department (e.g. bodies with statutory guarantor). "Admitted Bodies" delivering "outsourced" functions as prescribed under the LGPS Regulations where the letting authority party to the admission agreement was a category A employer at the commencement of the agreement.	Up to 11 years from the 2019 valuation	100% of outperformance of the Fund-level discount rate over gilts
B	Admitted Bodies" or LGPS "Scheduled" and "Resolution/Designated Bodies" with no statutory underpin but where either; (a) the body can now provide, to the LPFA's satisfaction, evidence of financial security to justify the longer funding term than prevailing future working life (FWL) (e.g. a "parent company" guarantee, secured income streams or external bond/insurance cover for an appropriate amount, a charge over assets), or, (b) 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 body will equal funding period of the guarantor body if longer. For the avoidance of doubt, if a category A employer is fully underwriting the liabilities of the body then that category will apply. "Admitted bodies" delivering "outsourced" functions as prescribed under the LGPS Regulations where the letting authority party to the admission agreement was a category B employer at the commencement of the agreement.	Up to 11 years from the 2019 valuation	90% of outperformance of the Fund-level discount rate over gilts
C	"Admitted Bodies" with no external underpin. "Admitted bodies" delivering "outsourced" functions as prescribed under the LGPS Regulations where the letting authority party to the admission agreement was a category C employer at the commencement of the agreement.	Up to Future Working Life from the 2019 valuation	50-75% of outperformance of the Fund-level discount rate over gilts (depending on financial strength)

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.
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.

ANNEX 2 - Summary of key risks & controls

Risk	Controls
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.	Quarterly monitoring by the LPPI Investment team where underperformance will be reported to the LPFA Board. Quarterly LPFA Investment Panel meetings are held with the LPPI investment team and presentations made to the LPFA Board and at any other meetings as required. 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 triennial valuations and by the calculation of liabilities and funding level between formal valuations, monitored regularly against asset returns. LPFA 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. Quarterly risk framework reporting is used to assess risks to the funding level and total contributions which are also used to inform the LPFA Board and the investment strategy.
Pay increases and price inflation significantly more than anticipated.	Inter-valuation monitoring of funding level provides early warning of this risk. Inflation sensitivity analysis is included within monthly solvency reporting. A liability driven investment strategy is in place with the aim of mitigating inflation risk in the context of the triennial valuation basis, and the inflation hedge ratio is regularly monitored.
Liquidity risk: insufficient cash available to pay pensions leading to the forced selling of assets to pay pensions.	Liquidity reporting is included in regular reporting. Cashflow capacity is reported to LPFA Audit & Risk Committee (ARC) quarterly. The Fund aims to maintain a cash balance sufficient to cover at least three months' pension obligations. This risk is further mitigated by ensuring that there are sufficient liquid assets available to support unexpected but plausible cash outflows.
Employers become unstable, insolvent or abolished with insufficient funds to meet liabilities, whereby their liabilities fall on other Fund employers.	Adherence to the Risk based approach adopted at 2013 valuation. An admitted body policy is in effect and a process to ensure that employers have been categorised accurately. All cessation debts are proactively chased with a built-in escalation process. LPFA Board and LPFA ARC are regularly notified on high-risk employers. New admission agreements are added to a register prior to storing securely. Validity of all admission agreements are reviewed at each annual covenant check. This risk is further mitigated by sector specific annual covenant checks and by establishing a financial monitoring system for high risk employers; security is implemented as appropriate. Employer services continue to educate employers on their liabilities and responsibilities.
Impact of regulatory changes or government intervention on LGPS benefits and liabilities.	These risks will be dealt with as they arise and the LPFA Board will consider mitigations on a case by case basis.
Incorrect longevity and mortality assumptions.	Participation in Club Vita analysis of mortality in Fund. Mortality assumptions and allowance for future mortality improvements determined as part of the triennial valuation following advice from fund actuary.
Regulatory and compliance risk	LPP has governance, risk management and compliance functions that are responsible for building regulatory and compliance checks into business processes.

For more information, please contact:
communication@lpfa.org.uk