

London Borough of Newham Pension Fund

Funding Strategy Statement

1 Introduction

- 1.1.1 This Statement has been prepared by London Borough of Newham (LBN) (the Administering Authority) to set out the funding strategy for the London Borough of Newham Pension Fund (“the Fund”), in accordance with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 and the guidance papers issued in March 2004 and November 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.
- 1.1.2 The Local Government Pension Scheme Regulations provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:
- 1.1.3 After consultation with all relevant interested parties involved with the Fund the administering authority will review and publish their funding strategy.
- 1.1.4 In reviewing the FSS, the administering authority must also have regard to :-
- the guidance issued by CIPFA for this purpose; and
 - the Statement of Investment Principles (SIP) for the Fund published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009
- 1.1.5 The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the SIP.
- 1.1.6 Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.
- 1.1.7 The Fund is a defined benefit final salary scheme under which the benefits are specified in the governing legislation, “the Regulations”. The required levels of employee contributions are also specified in the Regulations.
- 1.1.8 Employer contributions are determined in accordance with the Regulations which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate. Contributions to the Fund should be set so as to “secure its solvency”, whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

2 Purpose of the FSS in policy terms

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

2.1.2 The purpose of this Funding Strategy Statement 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 requirement to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

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

3 Aims and purpose of the Fund

3.1 The aims of the Fund are to

- enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies
- manage employers' liabilities effectively
- ensure that sufficient resources are available to meet all liabilities as they fall due, and
- maximise returns from investments within reasonable risk parameters

3.2 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 (Benefits, Membership and Contributions) Regulations 2007 (as amended), the Local Government Pension Scheme Regulations 1997 (as amended) and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations as amended.

4 Responsibilities of the key parties

4.1 The Administering Authority

4.1.1 The administering authority shall:

- collect employer and employee contributions
- invest surplus monies in accordance with the Regulations
- 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
- prepare and maintain an FSS and a SIP, both after due consultation with interested parties, and
- monitor all aspects of the Fund's performance and funding and amend the FSS/SIP as and when appropriate.

4.2 The Investment & Accounts Committee of the London Borough of Newham

4.2.1 The Investment & Accounts Committee of the London Borough of Newham oversees the management of the fund's assets. Although not trustees, the Members of the Investment & Accounts Committee owe a fiduciary duty similar to that of trustees to the council-tax payers, who would ultimately have to meet any shortfall in the assets of the fund, as well as to the contributors and beneficiaries of the fund. The terms of reference for the Investment & Accounts Committee within the Council's Constitution (8.06 2) are:

- To make all decisions under Regulations made pursuant to Section 7, 12 or 24 of the Superannuation Act not otherwise falling to the Executive Director of Resources to determine as set out in the officers scheme of delegation;
- Approval of the authority's statement of accounts in accordance with the relevant Accounts and Audit Regulations made from time to time;
- The Committee shall be a member of the Local Authority Pension Fund Forum.

4.2.2 The Investment & Accounts Committee has responsibility for:

- Determining an overall investment strategy and strategic asset allocation, with regard to diversification and the suitability of asset classes;
- Appointing the investment managers, an independent custodian, the actuary and any external consultants considered necessary;

- Reviewing on a regular basis the investment managers' performance against benchmarks, and satisfying themselves as to the managers expertise and the quality of their internal systems and controls;
- Monitoring compliance with the SIP and reviewing its contents;
- Reviewing policy on social, environmental and ethical considerations, and on the exercise of voting rights;
- Considering application for admitted body status and determining deficit recovery periods if approval is considered appropriate;
- Determining deficit recovery periods in relation to newly formed scheduled bodies taking into consideration all relevant factors including any potential risk that may be associated with time limited guaranteed funding as in the case of Academy Employers; and
- Considering local matters in so far as they may impact on the risk to the Pension Fund and its constituent employers.

4.3 The Executive Director of Resources

4.3.1 The Executive Director of Resources and the appointed Consultants and Actuaries support the Committee. The day-to-day management of the fund's assets is delegated to investment managers.

4.4 The Individual Employer shall:

4.4.1 The Individual Employer shall:

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain, and
- notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding.

4.5 The Fund actuary

4.5.1 The Fund actuary shall:

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS;
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters, and
- advise on funding strategy, the preparation of the FSS, and the inter-relationship between the FSS and the SIP.

5 Solvency Issues and Target Funding Levels

5.1 The funding objective

5.1.1 To meet the requirements of the Regulations the Administering Authority's long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the "funding target") assessed on an ongoing basis including allowance for projected final pay.

5.2 Determination of the funding target and recovery period

5.2.1 The principal method and assumptions to be used in the calculation of the funding target are set out in the Appendix.

5.2.2 Underlying these assumptions are the following two tenets:

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

5.2.3 As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer (or employer grouping), following a principle of no cross-subsidy between the various employers in the Scheme. In attributing the overall investment performance obtained on the assets of the Scheme to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole.

5.2.4 The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates:

5.2.5 A maximum deficit recovery period of 20 years will apply. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may be applied in respect of particular

employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan below).

- 5.2.6 Employer specific deficit recovery periods have been agreed for Newham 6th Form College and Newham College of Further Education of 10 years in each case.
- 5.2.7 Allowance has been made in assessing the deficit contributions where the employer's membership of the Fund is closed to new employees. This applies in the case of all the current admission bodies:
- Greenwich Leisure Ltd
 - FM Conway
 - Carpenters TMO
 - Arc in the Park (Community Links)
 - Mitie
- 5.2.8 On the cessation of an employer's participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer will be due to the Scheme as a termination contribution, unless it is agreed by the Administering Authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Scheme to another participating employer. Details of the approach to be adopted for such an assessment on termination are set out in the separate Admission Bodies Policy document (currently under development).
- 5.2.9 The administering authority may also reduce the current deficit recovery period where it considers the risk of non-payment of pension fund contributions has altered. Usually this will follow a valuation assessment by the Fund Actuary.
- 5.2.10 In determining the above objectives the Administering Authority has had regard to:

- the responses made to the consultation with employers on the FSS principles
- relevant guidance issued by the CIPFA Pensions Panel
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose, and
- the Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.

5.3 Deficit recovery plan

5.3.1 If the assets of the scheme relating to an employer are less than the funding target at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall.

5.3.2 Additional contributions will be expressed as a level percentage of pensionable payroll or a series of one or more cash payments.

5.3.3 In determining the actual recovery period to apply for any particular employer, the Administering Authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of the employer;
- the assessment of the financial covenant of the Employer;
- any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.

5.4 The normal cost of the scheme (future service contribution rate)

5.4.1 In addition to any contributions required to rectify a shortfall of assets below the funding target contributions will be required to meet the cost of future accrual of benefits for members after the valuation date (the "normal cost"). The method and assumptions for assessing these contributions are also set out in the Appendix.

6 Link to investment policy set out in the Statement of Investment Principles

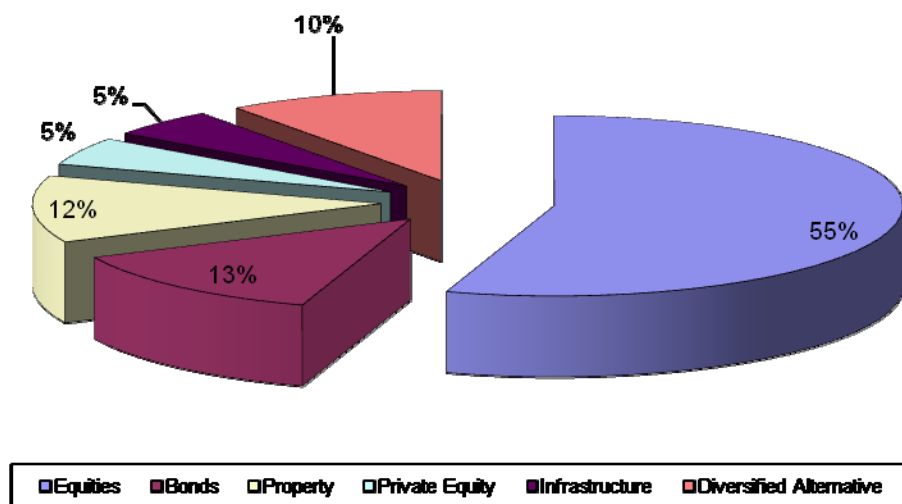
6.1 The results of the 2010 valuation show the liabilities to be 72% covered by the current assets, with the funding deficit of 28% being covered by future deficit contributions due from employers.

6.2 In assessing the value of the Fund's liabilities above, allowance has been made for asset out-performance as described in Section 5 and the

Appendix, taking into account the investment strategy adopted by the Fund, as set out in the SIP.

- 6.3 It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.
- 6.4 Investment of the Fund's assets in line with the least risk portfolio would minimise fluctuations in the Fund's ongoing funding level between successive actuarial valuations.
- 6.5 The Fund's SIP identifies the following asset classes which are deemed suitable for the scheme. The Fund has chosen a specific benchmark in order to determine the appropriate balance between different types of asset. The Fund invests through a range of pooled funds as well as directly in shares and has a mix of passive and active management. Stock selection is delegated to Investment Managers who may vary their allocation within set bands and must re-balance to the benchmark quarterly. The Fund invests through a range of pooled Funds as well as directly in shares and has a mix of passive and active management. The strategic asset mix for the Fund is in Graph 1 below:

6.6 Graph 1 Strategic Asset Mix



- 6.7 The benchmark adopted reflects the circumstances of the Newham fund in terms of its liability profile and solvency level. Although the fund is relatively mature (i.e. there are relatively high numbers of pensioners compared to contributing numbers) it is cash positive.
- 6.8 This position is likely to be maintained over the medium term of at least 10 years. As a result the fund is able to take a long-term perspective investing

in real assets such as equities and property to increase the value of the fund rather than Bonds which can produce a steady income stream.

6.9 The benchmark per asset class is in Table 1 below:

6.10 Table 1 - Asset Benchmark

Asset Class	Range of asset allocation
Equities	8-11%
Bonds	5-6 %
Property	9 %
Private Equity	10 %
Infrastructure	8 %
Diversified Alternatives Fund	7 %

7 Identification of risks and counter-measures

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

7.2 The Administering Authority has been advised by the actuary that the greatest risk to the Fund's funding is the investment risk inherent in the predominantly equity-based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that required on the basis of the 2010 valuation assumptions.

7.3 The following key risks to the funding strategy have been identified:

7.4 Financial

7.4.1 The main financial risk are that

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- Effect of possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies

7.4.2 The Fund and its Fund's investment advisers shall monitor such aspects to ensure that all assumptions are justified.

7.5 Demographic

7.5.1 The main demographic risks are that

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements

7.5.2 In the event that significant changes become apparent between valuations, the Fund, following advice from the actuary, shall notify participating employers of the anticipated impact on costs that will emerge at the next valuation.

7.6 Regulatory

7.6.1 The key risk are that

- Changes to Regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees
- Changes to national pension requirements and/or HMRC rules

7.6.2 The Fund shall keep abreast of potential changes. The actuary will be asked to assess the impact of changes and if significant, employers shall be notified.

7.7 Governance

7.7.1 Key risks are that

- The Administering Authority remains unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements)
- Administering Authority not advised of an employer closing to new entrants
- An employer ceasing to exist with insufficient funding or adequacy of a bond.

7.7.2 The funds policy is to engage in regular communication with employers, enabling a regular review of financial standing and other issues.

8 Monitoring and Review

8.1 The Administering Authority has taken advice from the actuary in preparing this Statement, and has also consulted with participating employers.

8.2 A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of then current economic conditions and will also reflect any legislative changes.

8.3 The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- if there have been significant changes to the Fund membership, or LGPS benefits
- if there have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy; and
- if there have been any significant special contributions paid into the Fund.

Appendix 1 Actuarial Valuation as at 31 March 2010

The following sets out the method and assumptions used in calculating the funding target and recovery plan

Method

The method we have adopted for employers open to new staff at this valuation is known as the “Projected Unit Method”. The key feature of this method is that in assessing the future service cost we calculate the contribution rate which meets the cost of one year of benefit accrual.

For employers that are closed to new staff we have used the Attained Age Method. The key feature of this method is that we assess the average contribution required to fund the benefits earned until retirement.

Financial assumptions

At this valuation we have used a market related funding model. The key features of the model are as follows:

Assumed future levels of retail price inflation are derived by considering the difference between index-linked gilt and fixed-interest gilt yields at the valuation date, as published by the Bank of England. At this valuation we have also included an adjustment known as an inflation premium. This inflation premium is deducted from the market implied inflation assumption to reflect the expectation that market implied inflation tends to overstate actual retail price inflation.

Pay increases are assumed to exceed future retail price inflation based on past experience and expectations of future experience.

Pension increases are assumed to be in line with CPI rather than RPI. It is assumed that CPI will be 0.5% per annum less than RPI, consistent with the historical average.

Investment return (discount rate)

The expected future return from equities is based on dividend yields at the valuation date in addition to an allowance for real capital growth in asset values.

Rather than take “spot” yields and market values of assets at the valuation date we have used smoothed yields and asset values spanning the 6 month period around the valuation date.

The discount rate used to discount future payments to and from the Fund and so determine the value placed on the liabilities reflects the risk adjusted expected return that will be earned by the actual investment strategy adopted by the Fund.

Individual Employers

It is important to consider how the financial assumptions in particular impact on individual participating employers. The general Fund practice, as set out in the FSS is to allocate investment performance pro rata across all employers based on

a “mirror image” investment strategy to the whole Fund. In completing the calculations for individual employers therefore, the same actuarial assumptions have been adopted regardless of the individual employer liability profiles.

Inflation (Retail Prices Index)

The inflation assumption will be taken to be the investment market’s expectation for inflation .This is derived by considering the difference in yields from conventional and index linked gilts using the Bank of England Inflation Curve and then adjusting by an inflation premium

Pay Inflation

As benefits are currently linked to pay levels at retirement, an assumption has to be made about future levels of pay inflation. Historically there has been a close link between price and pay inflation with pay increases in excess of price inflation averaging out at between 1% and 3% per annum depending on economic conditions.

At this valuation we have adopted a lower salary increase assumption, at 1.5% per annum above price inflation.

In addition, in anticipation of Government policy we have completed calculations assuming a short term “pay freeze” for 2 years for those earning over £21,000 per annum.

Pension increases

Previously, pension increases were assumed to be in line with retail price increases. The 2010 Emergency Budget announced that in future, the pension increase orders will be linked to the CPI rather than RPI. We have therefore assumed that pension increases will be 0.5% less than the price inflation assumption. i.e. 3.0% per annum

Mortality and other statistical assumptions

These are as described in the 2010 valuation report.

Summary of key assumptions for the 2010 actuarial valuation

Financial Assumptions	March 2010		March 2007	
	% p.a.	Real % p.a.	% p.a.	Real % p.a.
Investment Return				
Equities/absolute return funds	7.4%	3.9%		
Gilts	4.5%	1.0%		
Bonds & Property	5.6%	2.1%		
Risk Adjusted Discount Rate	6.7%	3.2%	6.0%	2.9%
Pay Increases	4.7%	1.5%	4.9%	1.6%
Price Inflation	3.5%	-	3.1%	
Pension Increases	3.0%	(0.5%)	3.1%	