Funding Strategy Statement 2018/19

1. Introduction

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 58 of the Local Government Pension Scheme Regulations 2013 (“the Regulations”) and the guidance papers issued in September 2016 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.

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:

After consultation with all relevant interested parties involved with the Fund the administering authority will review and finalise the Strategic Asset Allocation and benchmarking exercise and publish their funding strategy.

In reviewing the FSS, the administering authority must also have regard for:
- the guidance issued by CIPFA for this purpose; and
- the Statement of Investment Principles (SIP) for the Fund and the Investment Strategy Statement

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.

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.

The Scheme is a defined benefit arrangement with a final salary element for service accrued prior to 1 April 2014 and career average revalued earnings (‘CARE’) benefits accruing on and after this date. There is also a ’50:50’ option under which members can elect to pay 50% of the contribution rate to accrue 50% of the benefits. The required levels of employee contributions are also specified in the Regulations.

Employer contributions are determined in accordance with the Regulations which also require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate certifying required contributions to be paid by the employers within the Fund.

Contributions to the Fund should be set so as to ensure solvency and long-term cost efficiency of the fund whilst supporting 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

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 Fund Actuary.

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 ensure the solvency and long-term cost efficiency of the Fund are met; and
- to take a prudent longer-term view of funding those liabilities.

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

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

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 2013, Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 as amended.

4. Responsibilities of the key parties

14.1 The Administering Authority

The administering authority is required to:

- collect employer and employee contributions, investment income and other amounts due to the pension fund as stipulated in LGPS Regulations
- pay from the pension fund the relevant entitlements as stipulated in LGPS Regulations
- invest surplus monies in accordance with the LGPS Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- take measures as set out in the regulations to safeguard the fund against the consequences of employer default
- manage the valuation process in consultation with the fund's actuary
- prepare and maintain an FSS and an SIP/ISS, both after proper consultation with interested parties
- monitor all aspects of the fund's performance and funding, and amend the FSS/ISS accordingly
- effectively manage any potential conflicts of interest arising from its dual role as both fund administrator and scheme employer
- enable the local pension board to review the valuation process as set out in their terms of reference.

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

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 are:

- to make all decisions under Regulations made pursuant to Section 7, 12 or 24 of the Superannuation Act not otherwise falling to the Director of the Exchequer and Transactional Services 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.

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/ ISS 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 such 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.

14.3 The Executive Director of Financial Sustainability

The Executive Director of Financial Sustainability and the appointed Consultants and Actuaries support the Committee. The day-to-day management of the Fund's assets is delegated to investment managers.

14.4 The Individual Employer:

The Individual Employer is required to:

- 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 permitted 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.
- pay any exit payments on ceasing participation in the fund.

14.5 The Fund actuary

The Fund actuary should:

- prepare valuations including the setting of employers' contribution rates at a level to ensure fund solvency and long-term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and the LGPS Regulations
- prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters such as pension strain costs, ill health retirement costs, compensatory added years costs, etc

- provide advice and valuations on the exiting of employers from the fund
- provide advice to the administering authority on bonds or other forms of security against the financial effect on the fund of employer default
- assist the administering authority in assessing whether employer contributions need to be revised between valuations as permitted or required by the regulations ensure that the administering authority is aware of any professional guidance or other professional requirements that may be of relevance to his or her role in advising the fund.

5. Solvency Issues and Target Funding Levels

14.6 The funding objective

The LGPS Regulations require each administering authority to secure fund solvency and long-term cost efficiency by means of employer contribution rates established by mandatory valuation exercises and express the desirability of maintaining as nearly constant a primary employer contribution rate as possible.

The administering authorities therefore prudentially seek to achieve an appropriate balance, in the light of actuarial advice, to ensure the income stream from contributions and investments achieves the ultimate aim of ensuring that the administering authority can meet its liabilities to pay pension benefits as and when they fall due over the life of the pension scheme.

Under Section 13(4) (c) of the Public Service Pensions Act 2013, the Government Actuary's Department (GAD) (as the person appointed by the responsible authority) must, following an actuarial valuation, report on whether the rate of employer contributions to the pension fund is set at an appropriate level to ensure the solvency of the pension fund and long-term cost efficiency of the scheme so far as relating to the pension fund.

In assessing whether the above condition is met, GAD may have regard to the following considerations:

- the implied average deficit recovery period
- the investment return required to achieve full funding over different periods, e.g. the recovery period
- if there is no deficit, the extent to which contributions payable are likely to lead to a deficit arising in the future
- the extent to which the required investment return above is less than the administering authority's view of the expected future return being targeted by
- a fund's investment strategy, taking into account changes in maturity/strategy as appropriate.

14.7 Determination of the funding target and recovery period

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

Underlying these assumptions are the following:

- 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.
- solvency issues for different employer bodies
- 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.

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

- the need to set appropriate employer contribution levels and deficit recovery periods
- the underlying investment strategy of the assets backing the liabilities of these employers
- the financial standing of those employers (and where applicable, the parent company or any guarantor) and:
- their ability to meet the cost of current membership
- their longer-term commitment to fund any deficit, including any
- potential deficit at exit; and
- their ability to insure against default
- the short- and long-term effects of high contribution rates on the non-local- authority employers in terms of their financial viability.

For the Fund 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 the above guidance and Deficit Recovery Plan below).

Where a deficit is transferred to a new employer, or a deficit emerges over the period the employer participates in the scheme, a deficit recovery period of no longer than the shorter of the length of the contract (representing the expected future life of the employer in the Fund), with a maximum of 10 years will be applied, or other shorter period as may be determined by the Fund's actuary. For example for a short term contractor this is likely to be considered as the maximum length of the contract.

Employer specific deficit recovery periods have previously been agreed for Newham 6th Form College and Newham College of Further Education of a maximum of 10 years in each case. The other employers in the Fund where a maximum 10 year recovery period also currently applies are:

- Active Newham
- Better Together
- Birkin Services
- Churchill
- Early Start
- iXact
- Enabled Living
- Every Child
- Language Shop
- Mint
- NCFE
- Pabulum
- PRS
- Olive Dining
- RM Education
- The Good Support Company
- Wilson Jones

On the cessation of any 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. Similarly, and in accordance with recent changes to the LGPS (Amendment) Regulations 2018, an exit credit will be paid to an employer if there is a surplus determined by the termination assessment. There is no tax charge on this exit credit. Details of the approach to be adopted for admission bodies are covered in the Admission Bodies Policy. For all other employers any assessment on termination will be decided by the Fund Actuary reflecting the nature of the employer within the Fund and any remaining liabilities that may then fall due to other employers.

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.

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.

14.8 Deficit recovery plan

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.

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

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.

14.9 The normal cost of the scheme (primary contribution rate)

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 Investment Strategy Statement

The results of the 2016 valuation show the liabilities to be 85% covered by the current assets, with the funding deficit of 15% being covered by future deficit contributions due from employers.

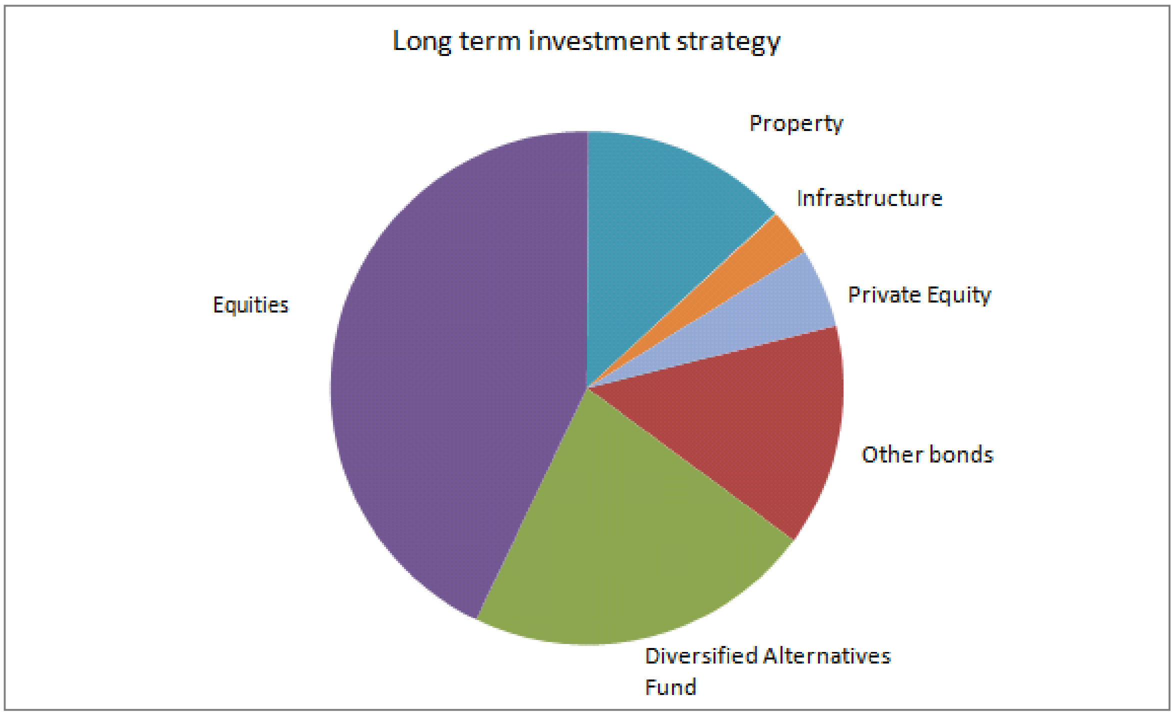
In assessing the value of the Fund's liabilities above, allowance has been made for asset out-performance as described in Section 5 and the Appendix, taking into account the investment strategy adopted by the Fund, as set out in the SIP/ISS.

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 p ossible 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.

Investment of the Fund's assets in line with the least risk portfolio should minimise fluctuations in the Fund's on-going funding level between successive actuarial valuations.

The Fund's SIP identifies the following asset classe s which are dee med suitable for the scheme. The Fund h as chosen a specif ic benchmark in o rder to dete rmine the a ppropriate 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 strategic asset mix for the Fund is in Graph 1 below:



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 pe nsioners compared to co ntributing numbers) it is cash positive.

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.

The benchmark per asset class is in Table 1 -Target Returns for Asset Class below:

Future Assumed Returns at 2016		**Risk Adjusted Discount Rate Weighting (rounded)**
Equities	7.4% per annum	48%

Other Bonds	3.3% per annum	14%
Diversified Alternatives Fund	5.8% per annum	22%
Property	5.9% per annum	13%
Infrastructure	5.4% per annum	3%

7. Identification of risks and counter-measures

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.

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 2016 valuation assumptions.

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

14.10 Financial

The main financial risks are:

- Investment risk – the risk of investments not performing (income) or increasing in value (growth) as forecast. Examples of specific risks would be:
- assets not delivering the required return (for whatever reason, including manager underperformance)
- systemic risk with the possibility of interlinked and simultaneous financial market volatility
- insufficient funds to meet liabilities as they fall due
- inadequate, inappropriate or incomplete investment and actuarial advice taken and acted upon counterparty failure.

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income – yield curve, credit risks, duration risk and market risks
- alternative assets – liquidity risk, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risks
- macroeconomic risks.

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

14.11 Liability Risk

The main demographic risks are that:

- Longevity horizon continues to expand
- There is a deteriorating pattern of early retirements.
- Inflation increase faster than allowed for
- Wage and salary inflation increase faster than allowed for.

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.

14.12 Employer Risk

Risks that arise from the ever-changing mix of employers; Examples being from

- short-term and ceasing employers
- the potential for a shortfall in payments and/or
- orphaned liabilities.

14.13 Liquidity/maturity risk

The LGPS is going through a series of changes, each of which will impact upon the maturity profile of the LGPS and have potential cash flow implications. Changes result in workforce reductions will reduce membership, reduce contributions and possibly prematurely increase retirements, some examples are;

- The increased emphasis on outsourcing and other alternative models for service delivery, which result in active members leaving the LGPS
- transfers of responsibility between different public sector bodies
- scheme changes that might lead to increased opt-outs
- the implications of spending cuts
- all of these will result in workforce reductions that will reduce membership, reduce contributions and
- prematurely increase retirements in ways that may not have been taken account of fully in previous forecasts.

14.14 Governance Risk

Key risks are that:

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

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

14.15 Regulatory and compliance risks

The key risks are:

- Changes to Regulations, e.g. more favourable benefits packages, potential new entrants to scheme, e.g. part-time employees
- Changes to national pension requirements or Regulations governing the Scheme

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.

8. Consultations and Publication

LGPS Regulations with regard to the FSS, in effect, provide that the written statement setting out an administering authority's funding strategy can only be considered after consultation with such persons as the authority considers appropriate.

The Administering Authority has set out its plans to deal with the employers of the Fund. It will also inform their Local pension Board of the valuation process and explain the outcomes.

9. Monitoring and Review

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

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.

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.

FSS Appendix 1 - Actuarial Valuation as at 31 March 2016

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.

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 0.8% per annum less than RPI, consistent with the historical average.

Investments 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.

Pay Inflation

As benefits accrued prior to 1 April 2014 are 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 CPI. However, we have allowed for a short- term overlay for salaries to rise in line with CPI over the period to 31 March 2020.

Pension increases

As future pension increases are expected to be based on the Consumer Prices Index (CPI) rather than RPI, we have made a further assumption about CPI which is that it will be 0.9% pa below RPI.

Mortality and other statistical assumptions

These are as described in the 2016 initial results report.

Summary of key assumptions for the 2016 actuarial valuation

Financial Assumptions	2016	2013
Discount Rate	5.4% per annum	6.0% per annum
Retail Price Inflation (RPI)	3.3% per annum	3.5% per annum
Consumer Price Inflation (CPI)	2.4% per annum (RPI less 0.9%)	2.7% per annum
Pension and Deferred Pension Increases	2.4% per annum (RPI less 0.9%)	2.7% per annum
Short Term Pay Increases	In line with CPI assumption for the 4 years to 31 March 2020	In line with CPI assumption for the 2 years to 31 March 2015
Long Term Pay Increases	3.9% per annum (CPI plus 1.5% per annum)	4.5% per annum (CPI plus 1.8% per annum)