

## **Funding Strategy Statement**

*This statement addresses the issue of managing the need to fund benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.*

*This Statement has been prepared by Bexley Council (the Administering Authority) to set out the funding strategy for the Bexley Council Pension Fund, in accordance with Regulation 76A of the Local Government Pension Scheme Regulations 1997 (as amended) and the guidance paper issued in March 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.*





# Bexley Pension Fund Funding Strategy Statement

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## 1. Introduction

The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS).

The key requirements which the Administering Authority has met in preparing this document can be summarised as follows:

- It has consulted with all relevant interested parties involved with the Bexley Council Pension Fund (the Scheme) prior to publishing the funding strategy;
- It has had regard to :-
  - ◆ the guidance issued by CIPFA for this purpose; and
  - ◆ the Statement of Investment Principles (SIP) for the Scheme published under Regulation 9A of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended);

The FSS will be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

Benefits payable under the Scheme 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 final salary scheme under which the benefits are specified in the governing legislation (the Local Government Pension Scheme Regulations 1997 (as amended), “the Regulations”). The required levels of employee contributions are also specified in the Regulations.

Employer contributions are determined in accordance with the Regulations (principally Regulation 77) which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate. Contributions to the Scheme 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

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.

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.

The intention is for this strategy to be both cohesive and comprehensive for the Scheme 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.

**MERCER**  
Human Resource Consulting

Professional advice is sought through the  
Actuarial Services of Mercer Human Resource  
Consulting

**CIPFA**

In producing this document regard has been  
given to the CIPFA guidance.

### 3. Aims and purpose of the Pension 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 and admitted bodies
- ◆ manage employers' liabilities effectively
- ◆ ensure that sufficient resources are available to meet all liabilities as they fall due, and
- ◆ maximise the 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 1997 (as amended) and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended).*

### 4. Responsibilities of the key parties

The **Administering Authority** should:

- ◆ 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 actuary
- ◆ prepare and maintain an FSS and a SIP, both after due consultation with interested parties, and
- ◆ monitor all aspects of the Scheme's performance and funding and amend FSS/SIP.

**The Individual Employer** should:

- ◆ 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, actual or proposed, which may affect future funding.

**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
- ◆ 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.

The roles of the Council's **Pensions Committee**, the Fund's **Investment Managers**, **Performance Measurement Company**, and **Investment Consultant** are noted in the SIP.

## 5. Solvency issues and target funding levels

To meet the requirements of the Regulations the Administering Authority's long-term funding objective is to achieve and then maintain assets equal to 100% of projected accrued liabilities, assessed on an ongoing basis including allowance for projected final pay.

The key assumptions making up the funding strategy and as adopted for the 2004 actuarial valuation are:

- Asset Outperformance Assumption (AOA) is a measure of how much extra return equity (and other) investments are expected to achieve above a minimum risk portfolio of gilt investments. The valuation assumes an AOA of 1.5% for both pre- and post-retirement liabilities.
- Salary Increases are assumed to exceed price increases by 1.75%. This includes an allowance for salary increments.
- Mortality rates have been reduced following the outcome of recent national investigations.

Underlying these assumptions are the following two tenets:

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

The current actuarial valuation of the Scheme is effective as at 31 March 2004. The results of the valuation indicate that overall the assets of the Scheme represented 83% of projected accrued liabilities at the valuation date.

Currently contribution rates for individual employers are set separately, so that



The Actuarial Valuation 2001

they take into account the differences in characteristics of the staff employed and the recruitment and retirement policies of the bodies concerned. Investments by the Fund are deemed to apply equally to all employing bodies as all have similar long term funding objectives. These assumptions have been considered with each employing body in preparing this FSS and have been confirmed.

Discussions also suggest that the policy of 50% direct funding of early retirement pensions (as well as 100% of all other early retirement costs) continue to be accepted.

The Administering Authority, following consultation with the participating employers, has generally adopted the following objectives to achieve the funding target:

- The deficit recovery period should be 20 years
- Increases in employer contributions should be phased in over a period of six years (two valuation periods).

In determining the deficit recovery period the Administering Authority has had regard to:

- the responses made to the consultation with employers on the FSS principles
- 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.

In the case of admitted bodies with few active members remaining it is normally considered more appropriate to recover the deficit as a lump sum over a shorter period rather than showing very high percentage employer contribution rates on the remaining active members' salaries.

For those admitted bodies with closed schemes or not providing a direct service on behalf of the administering authority, increases in employer contributions should be phased in over one valuation period (three years). This is considered a more prudent course of action for the Scheme as a whole.

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

The results of the 2004 valuation show the liabilities to be 83% covered by the current assets, with the funding deficit of 17% being covered by future deficit contributions due from participating employers.

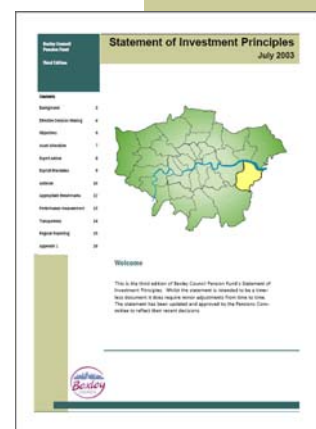
In assessing the value of the Scheme's liabilities in the valuation, allowance has been made for asset out-performance as described in Section 5, taking into account the investment strategy adopted by the Scheme, as set out in the SIP.

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.

Investment of the Scheme's assets in line with the least risk portfolio would minimise fluctuations in the Scheme's ongoing funding level between successive actuarial valuations.

If, at the valuation date, the Scheme had been invested in this portfolio, then in carrying out the valuation it would not be appropriate to make any allowance for out-performance of the investments. On this basis of assessment, the assessed value of the Scheme's liabilities at the 2004 valuation would have been significantly higher, by approximately 27% and the declared funding level would be correspondingly reduced to approximately 65%.

Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.



The Statement of Investment Principles

The current benchmark investment strategy, as set out in the SIP, is:

|                           | Benchmark % | Control Range % |
|---------------------------|-------------|-----------------|
| UK Equities               | 36          | +/- 7½          |
| Overseas Equities         | 24          | +/- 7½          |
| <b>Total Equities</b>     | <b>60</b>   | <b>+/- 5</b>    |
| UK Fixed Interest Gilts   | 16          | +/- 7½          |
| Overseas Bonds            | 0           | Up to 10        |
| Index-Linked Gilts        | 8           | +/- 7½          |
| Corporate Bonds           | 16          | +/- 7½          |
| Property                  | 0           | Up to 5         |
| Cash                      | 0           | Up to 5         |
| <b>Total Non-Equities</b> | <b>40</b>   | <b>+/- 5</b>    |
| <b>Total</b>              | <b>100</b>  |                 |

The funding strategy adopted for the 2004 valuation is based on an assumed asset out-performance of 1.5% in respect of all liabilities. The Administering Authority believes that this is a reasonable and prudent allowance for asset out-performance, based on the investment strategy adopted as set out in the SIP.

## 7. Identification of risks and counter-measures

The funding of defined benefits is by its nature uncertain. Funding of the Scheme 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 Scheme'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 the overall 1.5% per annum assumed in the long term.

The **KEY RISKS** that the scheme is subject to are:-

### Financial

- ◆ 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

### Demographic

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

### Regulatory

- ◆ 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 Inland Revenue rules

### Governance

- ◆ Administering Authority 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.

**COUNTER-MEASURES** that the Administering Authority has taken in response to each of these risks are:-

### Financial

- ◆ Consultation with the actuary and investment consultant
- ◆ Set asset allocations, active risk targets and investment control ranges
- ◆ Reviewed manager performance with advice from its performance measurement company
- ◆ Regularly compares actuarial assumptions to actual experience

### Demographic

- ◆ Mortality assumptions have been amended in line with recent experience and projections
- ◆ Reports annually on early retirement policy and requires employers to meet the majority of costs directly

### Regulatory

- ◆ Reporting changes to the Pensions Committee for consideration/action as necessary

### Governance

- ◆ Annual reports are made including membership numbers
- ◆ Specific budget provision has been made for training of the members of the Pensions Committee and attendance at seminars is encouraged
- ◆ Additional meetings of the Pensions Committee are held as necessary.

## 8. Monitoring and Review

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

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 Scheme 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
- if there have been any significant special contributions paid into the Scheme.



A full review of the FSS will occur no less frequently than every three years.





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