

# City of Westminster Pension Fund Funding Strategy Statement



## **Contents**

Introduction	
Purpose of the Funding Strategy Statement	2
Aims and purposes of the Fund	
Funding objectives	]
Key parties	6
Funding strategy	8
Funding method	8
Valuation assumptions and funding model	(
Pooling of individual employers	12
New employers	13
Admission bodies	13
New academies	
Cessation valuations	15
Links with the Investment Strategy Statement (ISS)	16
Risks and counter measures	18
Financial risks	18
Demographic risks	18
Regulatory risks	19
Governance	22
Monitoring and review	22

2 of 22



### Introduction

This is the Funding Strategy Statement for the City of Westminster Pension Fund (the Fund). It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 as amended (the Regulations) and describes Westminster City Council's strategy, in its capacity as administering authority, for the funding of the City of Westminster Pension Fund.

The Fund's employers and the Fund Actuary, Barnett Waddingham LLP, have been consulted on the contents of this statement.

This statement should be read in conjunction with the Fund's Investment Strategy Statement (ISS) and has been prepared with regard to the guidance (*Preparing and Maintaining a funding strategy statement in the LGPS 2016 edition*) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).



## **Purpose of the Funding Strategy Statement**

The purpose of this Funding Strategy Statement (FSS) is to:

- Establish a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;
- Support the desirability of maintaining as nearly constant a primary contribution rate as possible, as required by Regulation 62(6) of the Regulations;
- Ensure that the regulatory requirements to set contributions to meet the future liability to provide
   Scheme member benefits in a way that ensures the solvency and long-term cost efficiency of the Fund are met; and
- Take a prudent longer-term view of funding those liabilities.



## 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;
- Enable primary contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to all relevant parties (such as the taxpayers, scheduled, resolution and admitted bodies), while achieving and maintaining Fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the Fund and employers, and the risk appetite of the administering authority and employers alike; and
- Seek returns on investment within reasonable risk parameters.

The purpose of the Fund is to:

- Pay pensions, lump sums and other benefits to Scheme members as provided for under the
- Meet the costs associated in administering the Fund; and
- Receive and invest contributions, transfer values and investment income.

## **Funding objectives**

Contributions are paid to the Fund by Scheme members and the employing bodies to provide for the benefits which will become payable to Scheme members when they fall due.

The funding objectives are to:

- Ensure that pension benefits can be met as and when they fall due over the lifetime of the Fund;
- Ensure the solvency of the Fund;
- Set levels of employer contribution rates to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions, while taking into account the different characteristics of participating employers;
- Build up the required assets in such a way that employer contribution rates are kept as stable as possible, with consideration of the long-term cost efficiency objective; and
- Adopt appropriate measures and approaches to reduce the risk, as far as possible, to the Fund, other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.

In developing the funding strategy, the administering authority should also have regard to the likely outcomes of the review carried out under Section 13(4)(c) of the Public Service Pensions Act 2013. Section 13(4)(c) requires an independent review of the actuarial valuations of the LGPS funds; this involves reporting on whether the rate of employer contributions set as part of the actuarial valuations are set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scheme so far as relating to the pension Fund. The review also looks at compliance and consistency of the actuarial valuations.

City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019 5 of 22 PUBLIC



## **Key parties**

The key parties involved in the funding process and their responsibilities are set out below.

#### The administering authority

The administering authority for the Fund is Westminster City Council. The main responsibilities of the administering authority are to:

- Operate the Fund in accordance with the LGPS Regulations;
- Collect employee and employer contributions, investment income and other amounts due to the Fund as stipulated in the Regulations;
- Invest the Fund's assets in accordance with the Fund's Investment Strategy Statement;
- Pay the benefits due to Scheme members as stipulated in the 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 actuarial valuation process in conjunction with the Fund Actuary;
- Prepare and maintain this FSS and also the ISS after consultation with other interested parties;
- Monitor all aspects of the Fund's performance;
- Effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme employer; and
- Enable the Local Pension Board to review the valuation process as they see fit.

#### Scheme employers

In addition to the administering authority, a number of other Scheme employers participate in the Fund.

The responsibilities of each employer that participates in the Fund, including the administering authority, are to:

- Collect employee contributions and pay these together with their own employer contributions, as certified by the Fund Actuary, to the administering authority within the statutory timescales;
- Notify the administering authority of any new Scheme members and any other membership changes promptly;
- Develop a policy on certain discretions and exercise those discretions as permitted under the Regulations;
- Meet the costs of any augmentations or other additional costs in accordance with agreed policies and procedures; and
- Pay any exit payments due on ceasing participation in the Fund.

#### Scheme members

Active Scheme members are required to make contributions into the Fund as set by the Ministry of Housing, Communities and Local Government (MHCLG).

City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019 6 of 22 PUBLIC



#### **Fund Actuary**

The Fund Actuary for the Fund is Barnett Waddingham LLP. The main responsibilities of the Fund Actuary are to:

- 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 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 and valuations relating to new employers, including recommending the level of bonds
  or other forms of security required to protect the Fund against the financial effect 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 which may be of relevance to their role in advising the Fund; and
- Advise on other actuarial matters affecting the financial position of the Fund.



## **Funding strategy**

The factors affecting the Fund's finances are constantly changing, so it is necessary for its financial position and the contributions payable to be reviewed from time to time by means of an actuarial valuation to check that the funding objectives are being met.

The most recent valuation of the Fund was as at 31 March 2019.

The individual employer contribution rates are set out in the Rates and Adjustments Certificate which forms part of the Fund's 2019 valuation report.

The actuarial valuation involves a projection of future cashflows to and from the Fund. The main purpose of the valuation is to determine the level of employers' contributions that should be paid to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund. A summary of the methods and assumptions adopted is set out in the sections below.

### **Funding method**

The key objective in determining employers' contribution rates is to establish a funding target and then set levels of employer contribution rates to meet that target over an agreed period.

The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund.

For all employers, the method adopted is to consider separately the benefits accrued before the valuation date (past service) and benefits expected to be accrued after the valuation date (future service). These are evaluated as follows:

- The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service. It makes allowance for future increases to members' pay and pensions. A funding level in excess of 100% indicates a surplus of assets over liabilities; while a funding level of less than 100% indicates a deficit; and
- The future service funding rate (also referred to as the primary rate as defined in Regulation 62(5) of the Regulations) is the level of contributions required from the individual employers which, in combination with employee contributions is expected to cover the cost of benefits accruing in future.

The adjustment required to the primary rate to calculate an employer's total contribution rate is referred to as the secondary rate, as defined in Regulation 62(7). Further details of how the secondary rate is calculated for employers is given below in the Deficit recovery/surplus amortisation periods section.

The approach to the primary rate will depend on specific employer circumstances and in particular may depend on whether an employer is an "open" employer - one which allows new recruits access to the Fund, or a "closed" employer – one which no longer permits new staff access to the Fund. The expected period of participation by an employer in the Fund may also affect the total contribution rate.

For open employers, the actuarial funding method that is adopted is known as the Projected Unit Method. The key feature of this method is that, in assessing the future service cost, the primary rate represents the cost of one year's benefit accrual only.

City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019 8 of 22 PUBLIC



For closed employers, the actuarial funding method adopted is known as the Attained Age Method. The key difference between this method and the Projected Unit Method is that the Attained Age Method assesses the average cost of the benefits that will accrue over a specific period, such as the length of a contract or the remaining expected working lifetime of active members.

The approach by employer may vary to reflect an employer's specific circumstance, however, in general the closed employers in the Fund are admission bodies who have joined the Fund as part of an outsourcing contract and therefore the Attained Age Method is used in setting their contributions. All other employers (for example the Council, higher education bodies and academies) are generally open employers and therefore the Projected Unit Method is used. The administering authority holds details of the open or closed status of each employer.

### Valuation assumptions and funding model

In completing the actuarial valuation it is necessary to formulate assumptions about the factors affecting the Fund's future finances such as price inflation, pay increases, investment returns, rates of mortality, early retirement and staff turnover etc.

The assumptions adopted at the valuation can therefore be considered as:

- The demographic (or statistical) assumptions which are essentially estimates of the likelihood or timing
  of benefits and contributions being paid, and
- The financial assumptions which will determine the estimates of the amount of benefits and contributions payable and their current (or present) value.

#### Future price inflation

The base assumption in any valuation is the future level of price inflation over a period commensurate with the duration of the liabilities, as measured by the Retail Price Index (RPI). This is derived using the 20 year point on the Bank of England implied Retail Price Index (RPI) inflation curve, with consideration of the market conditions over the six months straddling the valuation date. The 20 year point on the curve is used as this is consistent with the average duration of an LGPS Fund.

#### **Future pension increases**

Pension increases are linked to changes in the level of the Consumer Price Index (CPI). Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods. A deduction of 1.0% p.a. is therefore made from the RPI assumption to derive the CPI assumption.

#### Future pay increases

As some of the benefits are linked to pay levels at retirement, it is necessary to make an assumption as to future levels of pay increases. Historically, there has been a close link between price inflation and pay increases with pay increases exceeding price inflation in the longer term. The long-term pay increase assumption adopted as at 31 March 2019 was CPI plus 1.0% p.a. which includes allowance for promotional increases.

#### Future investment returns/discount rate

To determine the value of accrued liabilities and derive future contribution requirements it is necessary to discount future payments to and from the Fund to present day values.

The discount rate that is adopted will depend on the funding target adopted for each Scheme employer.

Version 1 City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019
PUBLIC 9 of 22



The discount rate that is applied to all projected liabilities reflects a prudent estimate of the rate of investment return that is expected to be earned from the Fund's long-term investment strategy by considering average market yields in the six months straddling the valuation date. The discount rate so determined may be referred to as the "ongoing" discount rate.

It may be appropriate for an alternative discount rate approach to be taken to reflect an individual employer's situation. This may be, for example, to reflect an employer targeting a cessation event or to reflect the administering authority's views on the level of risk that an employer poses to the Fund. The Fund Actuary will incorporate any such adjustments after consultation with the administering authority.

A summary of the financial assumptions adopted for the 2019 valuation is set out in the table below:

Financial assumptions as at 31 March 2019	
RPI inflation	3.6% p.a.
CPI inflation	2.6% p.a.
Pension/deferred pension increases and CARE revaluation	In line with CPI inflation
Pay increases	CPI inflation + 1.0% p.a.
Discount rate – Scheduled bodies	4.8% p.a.
Discount rate – Admitted bodies	3.3% p.a.

#### Admitted bodies

A more prudent discount rate is adopted for admitted bodies in the Fund, resulting in a higher level of contributions being required from these bodies. This is in recognition of the fact that such employers may typically be expected to participate in the Fund for a limited period of time and so the aim is to increase the likelihood of sufficient assets being available to fund their employees' past service benefits by the time they cease participation in the Fund. In this way, the risk of deficits arising after the termination date and thus needing to be met by other employers in the Fund is reduced. Some admitted bodies may also be deemed to have a weaker covenant than other employers and so a higher contribution requirement reflects the increased risk that these employers present to the Fund.

#### **Asset valuation**

For the purpose of the valuation, the asset value used is the market value of the accumulated fund at the valuation date, adjusted to reflect average market conditions during the six months straddling the valuation date. This is referred to as the smoothed asset value and is calculated in a consistent way to the valuation of the liabilities.

The Fund's assets are allocated to employers at an individual level by allowing for actual Fund returns achieved on the assets and cashflows paid into and out of the Fund in respect of each employer (e.g. contributions received and benefits paid).

#### **Demographic assumptions**

The demographic assumptions incorporated into the valuation are based on Fund-specific experience and national statistics, adjusted as appropriate to reflect the individual circumstances of the Fund and/or individual employers.

City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019 10 of 22 PUBLIC



Further details of the assumptions adopted are included in the Fund's 2019 valuation report.

#### McCloud/Sargeant judgements

The McCloud/Sargeant judgements were in relation to two employment tribunal cases which were brought against the government in relation to possible age and gender discrimination in the implementation of transitional protection following the introduction of the reformed 2015 public service pension schemes from 1 April 2015. These judgements were not directly in relation to the LGPS, however, do have implications for the LGPS.

In December 2018, the Court of Appeal ruled that the transitional protection offered to some members as part of the reforms amounted to unlawful discrimination. On 27 June 2019 the Supreme Court denied the government's request for an appeal in the case. A remedy is still to be either imposed by the Employment Tribunal or negotiated and applied to all public service schemes, so it is not yet clear how this judgement may affect LGPS members' past or future service benefits. It has, however, been noted by government in its 15 July 2019 statement that it expects to have to amend all public service schemes, including the LGPS.

Further details of this can be found below in the Regulatory risks section.

At the time of drafting this FSS, it is still unclear how this will affect current and future LGPS benefits. As part of the Fund's 2019 valuation, in order to mitigate the risk of member benefits being uplifted and becoming more expensive, the potential impact of McCloud was covered by the prudence allowance in the discount rate assumption. As the remedy is still to be agreed the cost cannot be calculated with certainty, however, the Fund Actuary expects it is likely to be less than, the impact of reducing the discount rate assumption by 0.05%.

#### Guaranteed Minimum Pension (GMP) indexation and equalisation

As part of the restructuring of the state pension provision, the government needs to consider how public service pension payments should be increased in future for members who accrued a Guaranteed Minimum Pension (GMP) from their public service pension scheme and expect to reach State Pension Age (SPA) post-December 2018. In addition, a resulting potential inequality in the payment of public service pensions between men and women needs to be addressed. Information on the current method of indexation and equalisation of public service pension schemes can be found here.

On 22 January 2018, the government published the outcome to its *Indexation and equalisation of GMP in public* service pension schemes consultation, concluding that the requirement for public service pension schemes to fully protect the GMP element of individuals' public service pension would be extended to those individuals reaching SPA before 6 April 2021. HMT published a Ministerial Direction on 4 December 2018 to implement this outcome, with effect from 6 April 2016. Details of this outcome and the Ministerial Direction can be found here.

The 2019 valuation assumption for GMP is that the Fund will pay limited increases for members that have reached SPA by 6 April 2016, with the government providing the remainder of the inflationary increase. For members that reach SPA after this date, it is assumed that the Fund will be required to pay the entire inflationary increase.

## Deficit recovery/surplus amortisation periods

Whilst one of the funding objectives is to build up sufficient assets to meet the cost of benefits as they accrue, it is recognised that at any particular point in time, the value of the accumulated assets will be different to the value of accrued liabilities, depending on how the actual experience of the Fund differs to the actuarial assumptions. This theory applies down to an individual employer level; each employer in the Fund has their own share of deficit or surplus attributable to their section of the Fund.

Version 1 City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019 11 of 22 PUBLIC



Where the valuation for an employer discloses a deficit then the level of required employer contributions includes an adjustment to fund the deficit over a maximum period of 19 years. The adjustment will usually be set as a fixed monetary amount.

Where the valuation for an employer discloses a surplus then the level of required employer contribution may include an adjustment to amortise a proportion of the surplus.

The deficit recovery period or amortisation period that is adopted, and the proportion of any deficit/surplus that is recovered/amortised, for any particular employer will depend on:

- The significance of the surplus or deficit relative to that employer's liabilities;
- The covenant of the individual employer (including any security in place) and any limited period of participation in the Fund;
- The remaining contract length of an employer in the Fund (if applicable); and
- The implications in terms of stability of future levels of employers' contribution.

### Pooling of individual employers

The policy of the Fund is that each individual employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly, contribution rates are set for individual employers to reflect their own particular circumstances. Pooling of individual employers may be considered in exceptional circumstances if deemed appropriate by the administering authority and Fund Actuary.



## New employers joining the Fund

When a new employer joins the Fund, the Fund Actuary is required to set the contribution rates payable by the new employer and allocate a share of Fund assets to the new employer as appropriate. The most common types of new employers joining the Fund are admission bodies and new academies. These are considered in more detail below.

#### **Admission bodies**

New admission bodies in the Fund are commonly a result of a transfer of staff from an existing employer in the Fund to another body (for example as part of a transfer of services from a council or academy to an external provider under Schedule 2 Part 3 of the Regulations). Typically these transfers will be for a limited period (the contract length), over which the new admission body employer is required to pay contributions into the Fund in respect of the transferred members.

#### Funding at start of contract

Generally, when a new admission body joins the Fund, they will become responsible for all the pensions risk associated with the benefits accrued by transferring members and the benefits to be accrued over the contract length. This is known as a full risk transfer. In these cases, it may be appropriate that the new admission body is allocated a share of Fund assets equal to the value of the benefits transferred, i.e. the new admission body starts off on a fully funded basis. This is calculated on the relevant funding basis and the opening position may be different when calculated on an alternative basis (e.g. on an accounting basis).

However, there may be special arrangements made as part of the contract such that a full risk transfer approach is not adopted. In these cases, the initial assets allocated to the new admission body will reflect the level of risk transferred and may therefore not be on a fully funded basis or may not reflect the full value of the benefits attributable to the transferring members.

#### Contribution rate

The contribution rate may be set on an open or a closed basis. Where the funding at the start of the contract is on a fully funded basis then the contribution rate will represent the primary rate only; where there is a deficit allocated to the new admission body then the contribution rate will also incorporate a secondary rate with the aim of recovering the deficit over an appropriate recovery period.

Depending on the details of the arrangement, for example if any risk sharing arrangements are in place, then additional adjustments may be made to determine the contribution rate payable by the new admission body. The approach in these cases will be bespoke to the individual arrangement.

#### Security

To mitigate the risk to the Fund that a new admission body will not be able to meet its obligations to the Fund in the future, the new admission body may be required to put in place a bond in accordance with Schedule 2 Part 3 of the Regulations, if required by the letting authority and administering authority.

If, for any reason, it is not desirable for a new admission body to enter into a bond, the new admission body may provide an alternative form of security which is satisfactory to the administering authority.



#### **New academies**

When a school converts to academy status, the new academy (or the sponsoring multi-academy trust) becomes a Scheme employer in its own right.

#### **Funding at start**

On conversion to academy status, the new academy will be allocated assets based on the active cover of the relevant local authority at the conversion date. The active cover approach is based on the funding level of the local authority's active liabilities, after fully funding the local authority's deferred and pensioner liabilities.

#### Contribution rate

The total contribution rate for new academies will be chosen to meet both the costs of benefits accruing to the existing active members in the future, and to try to restore the funding level to 100% over the Fund's maximum deficit recovery period.



## **Cessation valuations**

When a Scheme employer exits the Fund and becomes an exiting employer, as required under the Regulations, the Fund Actuary will be asked to carry out an actuarial valuation in order to determine the liabilities in respect of the benefits held by the exiting employer's current and former employees. The Fund Actuary is also required to determine the exit payment due from the exiting employer to the Fund or the exit credit payable from the Fund to the exiting employer.

Any deficit in the Fund in respect of the exiting employer will be due to the Fund as a single lump sum payment, unless it is agreed by the administering authority and the other parties involved that an alternative approach is permissible. For example:

- It may be agreed with the administering authority that the exit payment can be spread over some agreed period;
- the assets and liabilities relating to the employer may transfer within the Fund to another participating employer; or
- the employer's exit may be deferred subject to agreement with the administering authority, for example if it intends to offer Scheme membership to a new employee within the following three years.

Similarly, any surplus in the Fund in respect of the exiting employer may be treated differently to a payment of an exit credit, subject to the agreement between the relevant parties and any legal documentation.

In assessing the value of the liabilities attributable to the exiting employer, the Fund Actuary may adopt differing approaches depending on the employer and the specific details surrounding the employer's cessation scenario.

For example, if there is no guarantor in the Fund willing to accept responsibility for the residual liabilities of the exiting employer, then those liabilities are likely to be assessed on a "minimum risk" basis leading to a higher exit payment being required from (or lower exit credit being paid to) the employer, in order to extinguish their liabilities to the Fund and to reduce the risk of these liabilities needing to be met by other participating employers in future.

If it is agreed that another employer in the Fund will accept responsibility for the residual liabilities, then the assumptions adopted will be consistent with the current ongoing funding position, but additional prudence will be included in order to take potential uncertainties and risk into account e.g. due to market changes, additional liabilities arising from regulatory or legislative change and political/economic uncertainties. The additional level of prudence will be set by considering the distribution of funding levels under a large number of economic scenarios, with the aim being to gain a reasonable level of confidence that the Fund will be able to meet its benefit obligations to the relevant members in future.

## **Regulatory factors**

At the date of drafting this FSS, the government is currently consulting on potential changes to the Regulations, some which may affect the regulations surrounding an employer's exit from the Fund. This is set out in the *Local government pension scheme: changes to the local valuation cycle and the management of employer risk* consultation document.

Further details of this can be found in the Regulatory risks section below.



## **Bulk transfers**

Bulk transfers of staff into or out of the Fund can take place from other LGPS Funds or non-LGPS Funds. In either case, the Fund Actuary for both Funds will be required to negotiate the terms for the bulk transfer – specifically the terms by which the value of assets to be paid from one Fund to the other is calculated.

The agreement will be specific to the situation surrounding each bulk transfer but in general the Fund will look to receive the bulk transfer on no less than a fully funded transfer (i.e. the assets paid from the ceding Fund are sufficient to cover the value of the liabilities on the agreed basis).

A bulk transfer may be required by an issued Direction Order. This is generally in relation to an employer merger, where all the assets and liabilities attributable to the transferring employer in its original Fund are transferred to the receiving Fund.



## Links with the Investment Strategy Statement (ISS)

The main link between the Funding Strategy Statement (FSS) and the ISS relates to the discount rate that underlies the funding strategy as set out in the FSS, and the expected rate of investment return which is expected to be achieved by the long-term investment strategy as set out in the ISS.

As explained above, the ongoing discount rate that is adopted in the actuarial valuation is derived by considering the expected return from the long-term investment strategy. This ensures consistency between the funding strategy and investment strategy.



## Risks and counter measures

Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of employer contributions, it is recognised that there are risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.

The major risks to the funding strategy are financial, although there are other external factors including demographic risks, regulatory risks and governance risks.

#### Financial risks

The main financial risk is that the actual investment strategy fails to produce the expected rate of investment return (in real terms) that underlies the funding strategy. This could be due to a number of factors, including market returns being less than expected and/or the fund managers who are employed to implement the chosen investment strategy failing to achieve their performance targets.

The valuation results are most sensitive to the real discount rate (i.e. the difference between the discount rate assumption and the price inflation assumption). Broadly speaking an increase/decrease of 0.1% p.a. in the real discount rate will decrease/increase the valuation of the liabilities by around 2%, and decrease/increase the required employer contribution by around 0.7% of payroll p.a.

However, the Investment and Pension Fund Committee regularly monitors the investment returns achieved by the fund managers and receives advice from the independent advisers and officers on investment strategy.

The Committee may also seek advice from the Fund Actuary on valuation related matters.

In addition, the Fund Actuary provides funding updates between valuations to check whether the funding strategy continues to meet the funding objectives.

## **Demographic risks**

Allowance is made in the funding strategy via the actuarial assumptions for a continuing improvement in life expectancy. However, the main demographic risk to the funding strategy is that it might underestimate the continuing improvement in longevity. For example, an increase in the long-term rate of mortality improvement of 0.25% p.a. will increase the liabilities by around 1%.

The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review. For the past two funding valuations, the Fund has commissioned a bespoke longevity analysis by Barnett Waddingham's specialist longevity team in order to assess the mortality experience of the Fund and help set an appropriate mortality assumption for funding purposes.

The liabilities of the Fund can also increase by more than has been planned as a result of the additional financial costs of early retirements and ill-health retirements. However, the administering authority monitors the incidence of early retirements; and procedures are in place that require individual employers to pay additional amounts into the Fund to meet any additional costs arising from early retirements.

The administering authority is currently implementing an ill-health self-insurance pool within the Fund whereby a portion of all employers' contributions into the Fund are allocated to a segregated ill-health section of the Fund. When an ill-health retirement occurs, a funding strain (i.e. the difference between the value of the benefits payable to the ill-health member and the value that was assumed as part of the actuarial valuation) is generated in the employer's section of the Fund. As part of the self-insurance policy, assets equal to the funding strain are

City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019 18 of 22 PUBLIC



transferred from the segregated ill-health assets section of the Fund to the employer's section of the Fund to cover the funding strain.

### Maturity risk

The maturity of a Fund (or of an employer in the Fund) is an assessment of how close on average the members are to retirement (or already retired). The more mature the Fund or employer, the greater proportion of its membership that is near or in retirement. For a mature Fund or employer, the time available to generate investment returns is shorter and therefore the level of maturity needs to be considered as part of setting funding and investment strategies.

The cashflow profile of the Fund needs to be considered alongside the level of maturity: as a Fund matures, the ratio of active to pensioner members falls, meaning the ratio of contributions being paid into the Fund to the benefits being paid out of the Fund also falls. This therefore increases the risk of the Fund having to sell assets in order to meets its benefit payments. The Fund may carry out cash flow modelling to assess if, when and in what circumstances the Fund will become cash flow negative and options to address this.

The government has published a consultation (Local government pension scheme: changes to the local valuation cycle and management of employer risk) which may affect the Fund's exposure to maturity risk. More information on this can be found in the Regulatory risks section below.

### Regulatory risks

The benefits provided by the Scheme and employee contribution levels are set out in Regulations determined by central government. The tax status of the invested assets is also determined by the government.

The funding strategy is therefore exposed to the risks of changes in the Regulations governing the Scheme and changes to the tax regime which may affect the cost to individual employers participating in the Scheme.

However, the administering authority participates in any consultation process of any proposed changes in Regulations and seeks advice from the Fund Actuary on the financial implications of any proposed changes.

There are a number of general risks to the Fund and the LGPS, including:

- If the LGPS was to be discontinued in its current form it is not known what would happen to members' benefits.
- The potential effects of GMP equalisation between males and females, if implemented, are not yet
- More generally, as a statutory scheme the benefits provided by the LGPS or the structure of the scheme could be changed by the government.
- The State Pension Age is due to be reviewed by the government in the next few years.

At the time of preparing this FSS, specific regulatory risks of particular interest to the LGPS are in relation to the McCloud/Sargeant judgements, the cost cap mechanism and the timing of future funding valuations consultation. These are discussed in the sections below.

#### McCloud/Sargeant judgements and cost cap

The 2016 national Scheme valuation was used to determine the results of HM Treasury's (HMT) employer cost cap mechanism for the first time. The HMT cost cap mechanism was brought in after Lord Hutton's review of public service pensions with the aim of providing protection to taxpayers and employees against unexpected

Version 1 City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019 19 of 22 PUBLIC



changes (expected to be increases) in pension costs. The cost control mechanism only considers "member costs". These are the costs relating to changes in assumptions made to carry out valuations relating to the profile of the Scheme members; e.g. costs relating to how long members are expected to live for and draw their pension. Therefore, assumptions such as future expected levels of investment returns and levels of inflation are not included in the calculation, so have no impact on the cost management outcome.

The 2016 HMT cost cap valuation revealed a fall in these costs and therefore a requirement to enhance Scheme benefits from 1 April 2019. However, as a funded Scheme, the LGPS also had a cost cap mechanism controlled by the Scheme Advisory Board (SAB) in place and HMT allowed SAB to put together a package of proposed benefit changes in order for the LGPS to no longer breach the HMT cost cap. These benefit changes were due to be consulted on with all stakeholders and implemented from 1 April 2019.

However, on 20 December 2018 there was a judgement made by the Court of Appeal which resulted in the government announcing their decision to pause the cost cap process across all public service schemes. This was in relation to two employment tribunal cases 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. Transitional protection enabled some members to remain in their pre-2015 schemes after 1 April 2015 until retirement or the end of a pre-determined tapered protection period. The claimants challenged the transitional protection arrangements on the grounds of direct age discrimination, equal pay and indirect gender and race discrimination.

The first case (McCloud) relating to the Judicial Pension Scheme was ruled in favour of the claimants, while the second case (Sargeant) in relation to the Fire scheme was ruled against the claimants. Both rulings were appealed and as the two cases were closely linked, the Court of Appeal decided to combine the two cases. In December 2018, the Court of Appeal ruled that the transitional protection offered to some members as part of the reforms amounts to unlawful discrimination. On 27 June 2019 the Supreme Court denied the government's request for an appeal in the case. A remedy is still to be either imposed by the Employment Tribunal or negotiated and applied to all public service schemes, so it is not yet clear how this judgement may affect LGPS members' past or future service benefits. It has, however, been noted by government in its 15 July 2019 statement that it expects to have to amend all public service schemes, including the LGPS.

At the time of drafting this FSS, it is not yet known what the effect on the current and future LGPS benefits will be.

# Consultation: Local government pension scheme: changes to the local valuation cycle and management of employer risk

On 8 May 2019, the government published a consultation seeking views on policy proposals to amend the rules of the LGPS in England and Wales. The consultation covered:

- amendments to the local fund valuations from the current three year (triennial) to a four year (quadrennial) cycle;
- a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle;
- proposals for flexibility on exit payments;
- proposals for further policy changes to exit credits; and
- proposals for changes to the employers required to offer LGPS membership.

The consultation is currently ongoing: the consultation was closed to responses on 31 July 2019 and an outcome is now awaited. This FSS will be revisited once the outcome is known and reviewed where appropriate.



#### Timing of future actuarial valuations

LGPS valuations currently take place on a triennial basis which results in employer contributions being reviewed every three years. In September 2018 it was announced by the Chief Secretary to HMT, Elizabeth Truss, that the national Scheme valuation would take place on a quadrennial basis (i.e. every four years) along with the other public sector pension schemes. This results of the national Scheme valuation are used to test the cost control cap mechanism and HMT believed that all public sector scheme should have the cost cap test happen at the same time with the next quadrennial valuation in 2020 and then 2024.

#### Managing employer exits from the Fund

The consultation covers:

- Proposals for flexibility on exit payments. This includes:
  - Formally introducing into the Regulations the ability for the administering authority to allow an exiting employer to spread the required exit payment over a fixed period.
  - Allowing employers with no active employers to defer payment of an exit payment in return for an ongoing commitment to meeting their existing liabilities (deferred employer status).
- Proposals for further policy changes to exit credits. The proposed change would require the exiting
  employer's exposure to risk to be taken into account in calculating any exit credit due (for example a
  pass through employer who is not responsible for any pensions risk would likely not be due an exit
  credit if the amendments are made to the Regulations).

#### Changes to employers required to offer LGPS membership

At the time of drafting this FSS, under the current Regulations further education corporations, sixth form college corporations and higher education corporations in England and Wales are required to offer membership of the LGPS to their non-teaching staff.

With consideration of the nature of the LGPS and the changes in nature of the further education and higher education sectors, the government has proposed to remove the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer new employees access to the LGPS. This could impact on the level of maturity and the cashflow profile for these employers. As described earlier this may increase the risk of contribution income being insufficient to meet benefit outgo, if not in the short term then in the long term as the payroll in respect of these types of employers decreases with fewer active members participating in the Fund.

This also brings an increased risk to the Fund in relation to these employers becoming exiting employers in the Fund. Should they decide not to admit new members to the Fund, the active membership attributable to the employers will gradually reduce to zero, triggering an exit under the Regulations and a potential significant exit payment. This has the associated risk of the employer not being able to meet the exit payment and thus the exit payment falling to the other employers in the Fund.

There are very few employers of this type currently participating in the Fund and so the risks are considered relatively low at present.

Version 1 City of Westminster Pension Fund | Funding Strategy Statement | 11 November 2019
PUBLIC 21 of 22



## **Employer risks**

Many different employers participate in the Fund. Accordingly, it is recognised that a number of employer-specific events could impact on the funding strategy including:

- Structural changes in an individual employer's membership;
- An individual employer deciding to close the Scheme to new employees; and
- An employer ceasing to exist without having fully funded their pension liabilities.

However, the administering authority monitors the position of employers participating in the Fund, particularly those which may be susceptible to the events outlined, and takes advice from the Fund Actuary when required. In particular, the Fund regularly commissions an employer risk review from the Fund Actuary to help identify the employers in the Fund that might be considered as high risk. In the case of admitted bodies, the Fund has a policy of requiring some form of security from the employer, in the form of a guarantee or a bond, in case of employer default where the risk falls to the Fund. Where the risk of default falls on the liabilities of an original letting authority, the Fund provides advice to the letting authority to enable them to make a decision on whether a guarantee, some other form of security or a bond should be required.

In addition, the administering authority keeps in close touch with all individual employers participating in the Fund to ensure that, as administering authority, it has the most up to date information available on individual employer situations. It also keeps individual employers briefed on funding and related issues.

#### Governance risks

Accurate data is necessary to ensure that members ultimately receive their correct benefits. The administering authority is responsible for keeping data up to date and results of the actuarial valuation depend on accurate data. If incorrect data is valued then there is a risk that the contributions paid are not adequate to cover the cost of the benefits accrued.

## Monitoring and review

This FSS is reviewed formally, in consultation with the key parties, at least every three years to tie in with the triennial actuarial valuation process.

The most recent valuation was carried out as at 31 March 2019, certifying the contribution rates payable by each employer in the Fund for the period from 1 April 2020 to 31 March 2023.

The timing of the next funding valuation is due to be confirmed as part of the government's *Local government* pension scheme: changes to the local valuation cycle and management of employer risk consultation which closed on 31 July 2019. At the time of drafting this FSS, it is anticipated that the next funding valuation will be due as at 31 March 2022 but the period for which contributions will be certified remains unconfirmed.

The administering authority also monitors the financial position of the Fund between actuarial valuations and may review the FSS more frequently if necessary.

PUBLIC