FUNDING STRATEGY STATEMENT

WANDSWORTH COUNCIL PENSION FUND
(incorporating former Richmond Council Pension Fund)

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Funding Strategy Statement – Scope

Following the Shared Staffing Arrangement between Richmond and Wandsworth Councils, which commenced on the 1st October 2016, all assets and liabilities of the Richmond Pension Fund transferred to the Wandsworth Pension Fund (the Fund) under SI 2016 No 1241 as part of new joint pension fund arrangements. References to the "Council" should be read as meaning Richmond and Wandsworth Councils as appropriate.

Funding Strategy Statement – Purpose

As required by Regulation 62 of the Local Government Pension Scheme Regulations 2013 (the Regulations), every local authority that administers a pension fund is required to obtain an actuarial valuation of the assets and liabilities as at 31st March 2016 and every third anniversary thereafter. The main purpose of the valuation is to determine the rate at which the participating employers should contribute in the future to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the Fund. Revised contribution rates, as certified by the actuary, must be implemented on 1st April of the following calendar year.

The employer contribution rate is the net sum of two elements:

- the primary contribution rate, as defined in Regulation 62(5) of the Regulations, which is the amount to be paid by the employer in respect of the cost of benefits accruing in future to active members of the Fund; and
- the secondary rate, as defined in Regulation 62(7) of the Regulations, which is an individual adjustment to the primary contribution rate for the employer which, in the actuary's opinion, is appropriate to take account of any circumstances peculiar to the employer.

1. Every valuation relies on a number of assumptions to calculate the funding level at the valuation date and the primary contribution rate. A degree of judgement is then required about the secondary rate to reflect any individual adjustments, for example for any surplus or shortfall. Regulation 58 of the Regulations require every local authority that administers a pension fund to prepare, maintain and publish a written statement setting out their funding strategy, addressing these assumptions and judgements. The Fund's actuary, when undertaking triennial valuations, must then have regard to this statement.
2. The purpose of this statement, therefore, is to establish the general strategy for ensuring appropriate assumptions and judgements in valuations of the Wandsworth Council Pension Fund. In particular, the purpose of this statement is to:

   a. Establish a clear and transparent Fund-specific strategy that will identify how employers' pension liabilities are best met going forward;

   b. Support the desirability of maintaining as nearly constant a primary contribution rate as possible;

   c. 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

   d. Take a prudent longer-term view of funding those liabilities.

3. In preparing the funding strategy statement, each authority must have regard to its own Investment Strategy Statement (ISS) and to guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). Each authority will also normally consult with all employers participating in the Fund and any other bodies it deems appropriate.

4. This statement must be revised and published again to reflect any material change in policy or in the ISS. CIPFA recommend that it should be reviewed formally at least every three years, in advance of the triennial valuation.

Pension Fund – Purpose, Aims and Scope

5. The purpose of the Pension Fund is to pay pensions, retirement and death lump sums, other scheme benefits, refunds of employees' contributions, transfers of pension rights to other pension schemes, and administration costs, from payments of employees' and employers' contributions, payments from other funds in respect of transferred pension rights, and investment income and realisations, in accordance with the Regulations.

6. The aims of the Fund are therefore, with a prudent long-term view, to:
   a. ensure that sufficient resources are available to meet all liabilities as they fall due;
   b. maximise the returns from investments within reasonable risk limits;
   c. have regard to the desirability of maintaining as nearly constant employer primary contribution rates as possible and at reasonable cost to all relevant parties (such as the taxpayers, scheduled, resolution and admission bodies), while achieving and maintaining fund solvency and long-term cost efficiency; and
   d. enable and assist participating employers to manage their liabilities effectively.
7. The scope of the Fund, in terms of employers and active membership, is almost entirely limited to eligible employees in Council-funded functions, and predominantly direct employees of the Councils. Wandsworth Council, as the administering authority, has for many years tended to resist the admission to the Fund of other employers, in view of the risk that their liabilities would ultimately fall on the Council. But all Wandsworth and Richmond schools have a degree of autonomy in their financial affairs that warrants special consultation and consideration about the impact of funding proposals. Academies may be viewed as separate employers as they have financial independence from the Councils.
8. The funding objectives are to:
   a. ensure that pension benefits can be met as and when they fall due over the lifetime of the Fund;
   b. ensure the solvency of the Fund;
   c. set levels of employer contribution to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions; and
   d. 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.

Responsibilities of Key Parties

9. Wandsworth Council as the Fund's administering authority should:

    a. collect employer and employee contributions from employers, investment income and other amounts due to the Fund as stipulated in the Regulations;

    b. ensure the investment of surplus monies is well-managed in accordance with the Regulations;

    c. pay the benefits due to Scheme members as stipulated in the Regulations;

    d. ensure that cash is available to meet liabilities as and when they fall due;

    e. manage the valuation process in consultation with the Fund's actuary;

    f. effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme employer;

    g. prepare and maintain a Funding Strategy Statement (FSS) and an Investment Strategy Statement (ISS); and

    h. monitor all aspects of the Fund's performance and funding, and amend the FSS or ISS when necessary.

10. Scheme employers (including schools), admission bodies and Wandsworth and Richmond Councils as employers should:

    a. deduct contributions from employees' pay correctly;

    b. pay all contributions, including their own as determined by the actuary, promptly by the due date;

    c. exercise discretions within the regulatory framework;

    d. make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain;

    e. notify the administering authority promptly of all changes to membership or, as may be proposed, which could affect future funding; and

    f. pay any exit payments due on ceasing participation in the Fund.

11. Active Scheme members are required to make contributions into the Fund as set by the Department of Communities and Local Government (DCLG).

12. The Fund's actuary should set employer contribution rates at levels to ensure Fund solvency and long-term cost efficiency, having regard to:

    a. the Fund's existing and prospective liabilities;

    b. circumstances peculiar to a particular employer or pool of employers;

    c. the desirability of maintaining as nearly a constant contribution rate as possible; and

    d. this Funding Strategy Statement.

    The actuary also prepares advice and calculations on other actuarial matters affecting the Fund, for example bulk transfers and individual benefit-related matters.

Fund Investment Policy

13. The investment objectives of the Fund according to the current SIP, i.e. "to maintain the solvency of the Fund at all times, and to deliver low and stable contribution rates over the long term", support the first three aims of the Fund as stated above.

14. The Fund's investment policy is "to appoint expert fund managers with clear performance benchmarks and place maximum accountability for performance against that benchmark with the investment manager". Managers are given discretion and are held accountable for stock selection decisions, within parameters, over periods typically ranging from one to five years. The overall framework for asset allocation is decided by the Council and reviewed periodically.

15. The practical effect of this policy is that the majority of the Fund's investments are currently held in equities. As the Fund is still attracting new members and can afford to take a long view, this degree of equity weighting is considered acceptable. It is also considered generally desirable in view of the higher return that may reasonably be expected in the long term from investments carrying higher risk. This expectation is supported by historical analysis showing that equities have out-performed bonds over most, but by no means all, periods. However; when determining asset allocation consideration is given to cash flow requirements to maximise the use of dividend and income payments to meet the shortfall between new contributions and current pension liabilities.

16. This investment policy, generally resulting in a heavy equity weighting, allows the actuary to include an asset out-performance assumption (AOA) (above the yield on bonds) within the average investment return assumed for fund valuations. The amount of this assumption will be decided for each valuation, having regard to market expectations at the time but with a significant allowance for prudence.

17. The Fund's heavy equity weighting means accepting more volatile valuation results, compared with funds invested largely in bonds. As the Councils are the major participating employer required to publish an annual balance-sheet, and as this balance-sheet is published for stewardship purposes and not to give assurance to lenders, the volatility in the pension reserve shown in the annual balance-sheet is not a concern. Volatility in triennial valuation results, however, tends to work against "the desirability of maintaining as nearly constant employer primary contribution rates as possible". Ways to mitigate this risk are discussed below. The additional risk is considered worth taking in pursuit of the aim to "maximise the returns from investments within reasonable risk limits", and hence to keep employer contribution rates as low as possible. A move entirely into bonds would markedly reduce volatility, but it would also compel the assumption of lower investment returns and thus require much greater employer contribution rates.

Funding Strategy

18. 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.

19. The most recent actuarial valuation of the Fund was carried out as at 31 March 2016. A summary of the methods and assumptions adopted is set out in the sections below.

20. The actuarial valuation involves a projection of future cash flows to and from the Fund.

21. 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.

Assumptions, Risks and Counter-Measures

22. There are many risks that could impact upon employer contribution rates. The key risks and the measures that could be taken to counter them are discussed below. Many of these are the subject of assumptions that have to be made in the course of each actuarial valuation. Although these assumptions refer to the long term, the risk for employers potentially crystallises at the next triennial valuation. If the assumptions made at one valuation do not appear to be sustainable three years later, and then have to be superseded by more adverse assumptions, there will be consequential increases in contribution rates. Conversely, substantial prudence at one valuation may be rewarded by a reduction in contribution rates three years later.

23. The main output of the valuation is the employer contribution rates to be paid over many years into the future. So called "marked to market" valuations have the potential to produce quite different valuation results and levels of required employer contributions depending on actual market conditions on the day of the valuation. Thus, to determine the value of liabilities, rather than adopt assumptions based on "spot" yields and market conditions on the actual valuation date, the Fund's actuary uses the average yields over the 6 month period spanning the valuation date. Similarly in the valuation of assets used for valuation purposes the Fund's actuary derives average market values of assets over the same 6 month period. This approach is akin to carrying out daily valuations over a 6 month period and then determining the average valuation result. The purpose of this averaging or smoothing process is to help stabilise levels of employer contributions as required by the Regulations.

Investment Performance/Discount Rate

24. As contributions are being invested now to provide for benefits payable in the future (and to make good any deficit), then part of the cost of providing the benefits can be met from investment returns. The higher the rate of return achieved by the assets, the lower the contributions that will be required in future to meet the cost of the benefits. Therefore, a key assumption in any valuation is the anticipated returns from assets in the future.

25. Investment managers may under-perform. Investment markets may perform worse than expected. Market yields may be lower. Some of these risks are controlled to some degree by the framework for investment management described in the ISS. The prudent long-term view and the desirability of maintaining as nearly constant employer contribution rates as possible, require the adoption of an AOA with a significant allowance for prudence in order to counter these risks. The allowance will be higher when investment market values are considered to be high.

26. The discount rate adopted for the 31 March 2016 valuation was 4.7% p.a.

Pay and Price Inflation

27. Pay growth enhances the future pension benefits of the active members of the Fund. To make the valuation assumption as robust as possible, the actuary has regard to the trend in national real earnings growth, to the experience of promotional increases in local government generally, and to any differences in the recent experience of the Fund. Employers are naturally mindful of the direct effect of pay rises on their budgets and local taxes; they should also be alert to the impact on their pension contributions if pay rises exceed the valuation assumptions, particularly for employees with long periods of service.

28. The long-term pay increase assumption adopted as at 31 March 2016 was CPI plus 1.5%, with a short-term assumption in line with CPI for the period to 31 March 2020. An allowance has also been made for promotional increases.

29. Annual increases in pensioner and deferred pensioner benefits and active members' benefits earned after 31 March 2014 are linked to Consumer Price Inflation (CPI). At each valuation, market expectations of future Retail Price Inflation (RPI) can be calculated from the difference between the yields on conventional and index-linked government bonds. Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods and so as at 31 March 2016, a deduction of 0.9% p.a. was made to the RPI assumption to derive the CPI assumption. The CPI assumption adopted as at 31 March 2016 was 2.4% p.a.

Longevity

30. Life expectancy is a key determinant in the valuation of prospective liabilities. The actuarial valuation reflects recent experience of pensioner mortality in the Pension Fund. Mortality investigations over the last few years have concluded that the population across the UK is living longer and that recent improvements in life expectancy have been at a faster rate than seen in the past. However, experience does vary across the country and from Fund to Fund.

31. For the 31 March 2016 valuation, longevity is assumed to increase in line with the Actuarial Profession's Continuous Mortality Investigation ("CMI") 2015 projected improvements with a long term rate of 1.5% p.a..

Early Retirement Costs

32. The Councils ensure due control of all early retirement costs by charging against the revenue account of the employing service a lump sum representing the present value of releasing benefits before the date on which they could have been taken by the employee without reduction. Costs of awarding additional pension at the time of retirement are treated similarly and are awarded subject to the Councils' Policy Statement on the use of discretions within the LGPS.

Regulatory Risks

33. Actuarial valuations do not anticipate potential changes to the local government pension scheme or to national pension requirements. But the potential for associated additional or

reduced liabilities emerging at subsequent valuations is one of the factors to be considered when deciding the prudent AOA and the appropriate deficit/surplus recovery period.

34. The Councils, as fund employers, take advantage of opportunities to respond to consultation on proposed changes, taking account of their likely impact on local authority budgets in particular.

Governance

35. The Fund aims to maintain good communication with all employers and meet all government requirements as set out in the Regulations.

Employer Contribution Rates

Funding Level

36. The funding level determined in the actuarial valuation is the result of comparing the assets held in the Fund with the existing and future liabilities already accrued in respect of the service of Scheme members up to the valuation date. The prudential target is to achieve/maintain 100% funding with assets and liabilities in balance.

37. When the funding level shows a significant surplus or shortfall, the employer contribution rate will normally include a secondary contribution, with a view to restoring balance within a reasonable recovery period.

Surplus and Shortfall Recovery Periods

38. The CIPFA guidance does not prescribe an optimum target period for securing full funding. It notes the need to avoid short-term horizons, provide stability in employer contributions, and to take advantage of the constitutional permanence of local government and the scheme's statutory status. Where this is thought prudentially appropriate and relevant to local circumstances, the guidance suggests, these considerations would allow longer-term recovery periods for shortfalls than those in the private sector.

39. A funding shortfall implies that employment costs for the workforce have previously been understated, so prudence implies that any shortfall should be recovered within the remaining working-life of the current workforce. The calculation of the average remaining working-life may allow for weighting by compound-interest factors at the rate used for the valuation. Adoption of this recovery period could be reinforced by the desirability of maintaining as nearly constant employer contribution rates as possible: for example, a high proportion of retirements over the subsequent three to nine years would force sharply increasing contribution rates in respect of the remaining workforce, if the valuation assumptions proved sustainable.

40. On the other hand, the desirability of stable contribution rates might support the adoption of a longer recovery period, to the extent that any shortfall were considered attributable to recent unusually adverse volatility in the investment markets that may prudently be expected to reverse before the next valuation.

41. Stable contribution rates are not the only mechanism available to the Councils for protecting local taxpayers from the impact of market volatility. Reserves for pension liabilities may be established as soon as market conditions suggest significant adverse impact at the next valuation, and these could be applied to offset the effect of the consequential increase in employer contributions. Other participating employers and schools are also empowered to establish provisions and reserves to have a similar effect within their own budgets. For these employers and for the Councils, the scope for such provisions and reserves depends upon the degree of other financial pressures at the time. In the event of the funding level showing a surplus, this should be spread over the actuarial life of the Fund with consideration of both prudence and the desirability of maintaining as nearly constant employer contribution rates as possible.

Stepped Contribution Changes

42. Phasing periods will be influenced by the credit worthiness of each employer and be explicitly expressed at each valuation.

Pooling or Individual Adjustment

43. Generally, the Councils expect to have a common contribution rate for all employers, other than admission bodies and academies. However, there are risks that any deficit is not repaid at any point at which the employer ceases to exist, in which case the liability would fall on the Councils and be reflected in council tax. In respect of new employers, the maximum deficit recovery periods for each employer is restricted according to the period over which the Pension Fund can be assured that an adequate funding stream in respect of that employer would be available. Consequential decisions on pooling of employers together to share liabilities and funding terms are then made to reflect any commonality between employers. The Councils reserve the right, however, to require additional contributions when employers take decisions that incur substantially disproportionate liabilities for the Fund.

Version	Nature of Change	Implemented
V1	Initial Creation	April 2005
V2	Reflecting the 2007 Valuation	April 2008
V3	Reflecting the 2010 Valuation and a move to risk based outcome modelling	April 2011
V4	Reflecting the 2013 Valuation and a move to economic rate discount model	April 2014
V5	Reflecting the 2016 Valuation and the transfer of assets and liabilities from the Richmond Council Pension Fund	April 2017
V6	Reflecting changes proposed by the Fund’s Actuary	November 2017