HYMANS ROBERTSON LLP

1 Introduction

This is the Funding Strategy Statement (FSS) of the London Borough of Barnet Pension Fund ("the Fund"), which is administered by the London Borough of Barnet, ("the Administering Authority").

It has been revised by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson, after consultation with the Fund's employers and investment adviser. This revised version replaces the previous FSS and is effective from 31 March 2008.

1.1 Regulatory framework

Scheme members' accrued benefits are guaranteed by statute. Members' contributions are fixed in the Regulations at a level which covers only part of the cost of accruing benefits. Employers currently pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers pay for their own liabilities.

The FSS forms part of a framework which includes:

- the Local Government Pension Scheme Regulations 1997 (regulations 76A and 77 are particularly relevant);
- the Rates and Adjustments Certificate, which can be found appended to the Fund actuary's triennial valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Statement of Investment Principles.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

1.2 Reviews of FSS

The FSS is reviewed in detail at least every three years ahead of triennial valuations being carried out, with the next full review due to be completed by 31 March 2011.

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact Peter Welsh in the first instance at peter.welsh@barnet.gov.uk.

2. Purpose

2.1 Purpose of FSS

The Office of the Deputy Prime Minister (ODPM) (now Communities and Local Government (CLG)) stated that the purpose of the FSS 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 framework to maintain **as nearly constant employer contribution rates as possible**; and*
- *to take a **prudent longer-term view** of funding those liabilities."*

These objectives are desirable individually, but may be mutually conflicting.

This statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered. The Fund:

- receives contributions, transfer payments and investment income;
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarised in the Annex.

2.3 Aims of the funding policy

The objectives of the Fund's funding policy include the following:

- to ensure the long-term solvency of the Fund as a whole and that of the share of the Fund allocated to the individual employers;
- to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- not to restrain unnecessarily the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to help employers recognise and manage pension liabilities as they accrue;
- to minimise the degree of short-term change in the level of employers' contributions where the Administering Authority considers it reasonable to do so;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations;

- to address the different characteristics of the disparate employers or groups of employees, to the extent that this is practical and cost effective; and

- to permit new employers to join the Fund on terms that do not adversely affect the interests of existing employers.

3. Solvency issues and target funding levels

3.1 Derivation of employer contributions

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the "*future service rate*"; plus

b) an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, "*past service adjustment*". If there is a surplus there may be a contribution reduction; if a deficit a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's actuary is required by the regulations to report the *Common Contribution Rate*[1], for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit under (b) is currently spread over a period of 20 years[2].

Individual adjustments are made to the *Common Contribution Rate* in respect of best value employers and other circumstances "peculiar" to an individual employer[3] except where employers have elected to pay pooled contribution rates. The sort of "peculiar" factors which are considered are discussed in section 3, paragraph 3.5.

In effect, the *Common Contribution Rate* is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific spreading and phasing periods.

For some employers it may be agreed to pool contributions, see section 3.7.5.

Any costs of non ill-health early retirements must be paid as lump sum payments at the time of the employer's decision in addition to the contributions described above (or by instalments shortly after the decision). The Administering Authority's current policy is to require payments over a maximum of 3 years after the early retirements.

Employers' contributions are expressed as minima, with employers able to pay regular contributions at a higher rate. Employers should discuss with the Administering Authority before making one-off capital payments.

3.2 Solvency and target funding levels

The Fund's actuary is required to report on the "solvency" of the whole fund at least every three years.

"Solvency" for ongoing employers is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund actuary's *ongoing funding basis*. This quantity is known as a funding level.

The ongoing funding basis is that used for each triennial valuation and the Fund actuary agrees the financial and demographic assumptions to be used for each such valuation with the Administering Authority.

[1] See Regulation 77(4).
[2] The actual deficit spread periods of individual employers are set in accordance with section 3.7.1.
[3] See Regulation 77(6)

The Fund operates the same target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. Please refer to paragraph 3.9 for the treatment of departing employers.

3.3 Ongoing funding basis

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds advised by the Fund Actuary. It is acknowledged that future life expectancy and in particular, the allowance for future improvements, is uncertain. Allowance has been made for improvements in line with the PMA/PFA92 series projections up to calendar year 2017 for pensioners and 2033 for non-pensioners, with age ratings applied to fit past LGPS experience. Employers are aware that their contributions are likely to increase in future if longevity exceeds the funding assumptions.

The approach taken is considered reasonable in light of the long term nature of the Fund. The demographic assumptions vary by type of member and so reflect the different profiles of employers.

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes allowance for anticipated returns from the Fund's assets in excess of gilts. There is, however, no guarantee that the assets will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

It is therefore normally appropriate to restrict the degree of change to employers' contributions at triennial valuation dates.

Given the very long-term nature of the liabilities, a long term view of prospective returns is taken. For the 2007 valuation, it is assumed that the Fund's investments will deliver an average additional return of 1.6% a year in excess of the return available from investing in index-linked government bonds at the time of the valuation. Based on the asset allocation of the Fund as at 31 March 2007, this is equivalent to taking credit for excess returns on equities of 2% p.a. over and above the redemption yield on index-linked government bonds on the valuation date.

The same financial assumptions are adopted for all ongoing employers. All employers have the same asset allocation.

3.4 Future service contribution rates

The future service element of the employer contribution rate is calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. For the 2007 valuation the future service rate has been calculated separately for all the employers although employers within a pool will pay the contribution rate applicable to the pool as a whole. The approach used to calculate each employer's future service contribution rate for any new employer joining the Fund will depend on whether or not new entrants are being admitted, in line with the approach described below.

Employers should note that it is only Admission Bodies that may have the power not to admit automatically all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

3.4.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* of valuation with a one year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise.

3.4.2 Employers that do not admit new entrants

Where an Admission Body has closed the scheme to new entrants this is expected to lead to the average age of employee members increasing over time. Hence, all other things being equal, the future service rate is expected to increase as the membership ages.

To give more long-term stability to such employers' contributions, the *Attained Age* funding method will be adopted for new admission bodies which are closed to new entrants. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both funding methods are described in the Actuary's report on the valuation.

Both future service rates will include expenses of administration to the extent that they are borne by the Fund and include an allowance for benefits payable on death in service and ill health retirement.

3.5 Adjustments for individual employers

Adjustments to individual employer contribution rates are applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

The combined effect of these adjustments for individual employers applied by the Fund actuary relate to:

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (e.g. mix of members by age, gender, part-time/full-time manual/non manual);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made;

over the period between the 2004 and 2007 valuations, and each subsequent triennial valuation.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers, unless the circumstances dictate otherwise.

The fund actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation including, but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of more or fewer withdrawals than assumed;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

3.6 Asset share calculations for individual employers

The Administering Authority does not account for each employer's assets separately. For the 2007 valuation onwards, the Fund's actuary is required to apportion the assets of the whole fund between the employers at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund. The asset apportionment is capable of verification but not to audit standard.

The Administering Authority recognises the limitations in the process, but having regard to the extra administration cost of building in new protections, it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

3.7 Stability of employer contributions

3.7.1 Deficit recovery periods

The Administering Authority instructs the Fund Actuary to adopt specific deficit recovery periods for all employers when calculating their contributions.

The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table below.

Type of Employer	*Maximum* Length of Deficit Recovery Period
Statutory bodies with tax raising powers	a period to be agreed with each employer not exceeding 20 years
Community Admission Bodies	a period equivalent to the expected future working lifetime of the remaining scheme members
Transferee Admission Bodies (contractors)	the period from the start of the revised contributions to the end of the employer's contract
All other types of employer	a period equivalent to the expected future working lifetime of the remaining scheme members

This *maximum* period is used in calculating each employer's *minimum* contributions. Employers may opt to pay higher regular contributions than these minimum rates.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2008 for the 2007 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.7.2 Surplus spreading periods

Any employers deemed to be in surplus may be permitted to reduce their contributions below the cost of accruing benefits, by spreading the surplus element over the maximum periods shown above for deficits in calculating their **minimum** contributions.

However, to help meet the stability requirement, employers may prefer not to take such reductions.

3.7.3 Phasing in of contribution rises

Best Value Admission Bodies are not eligible for phasing in of contribution rises. Other employers may opt to phase in contribution rises over a period of three years.

3.7.4 Phasing in of contribution reductions

Any contribution reductions will be phased in over up to six years for all employers except Best Value Admission Bodies who can take the reduction with immediate effect.

3.7.5 Pooled contributions

3.7.5.1 Smaller employers

The Administering Authority currently allows certain Further Education Colleges to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service.

3.7.5.2 Other contribution pools

Schools are also pooled with Barnet Council.

3.8 New employers joining

The Administering Authority may permit new employers to join the Fund, if they are considered not to adversely affect the interests of existing employers. The conditions that the Administering Authority currently requires include the following:

- Transferee Admission Bodies (TAB) are required to provide a bond to an amount considered appropriate by the Administering Authority/Awarding Authority after taking actuarial advice to protect the contract awarding authority against a funding shortfall in the event of the TAB's demise. TABs are allocated assets (taken from the previous employer) to provide a 100% funding level on the ongoing basis at the start of the contract.

- Community Admission Bodies (CAB) must provide a guarantor to protect existing employers against a funding shortfall in the event of their demise. New CABs or new Scheme Employers that are created out of an existing scheme employer would be expected to take on a share of the funding deficit of the existing employer.

- The past service of employees will be automatically transferred to the new employer except where an employee requests that their past service is not transferred.

3.9 Admission bodies ceasing

Admission Agreements for Best Value contractors are assumed to expire at the end of the contract.

Admission Agreements for other employers are generally assumed to be open-ended and to continue until the last pensioner dies. Contributions, expressed as capital payments, can continue to be levied after all the employees have retired. These Admission Agreements can, however, be terminated at any point.

If an Admission Body's admission agreement is terminated, the Administering Authority instructs the Fund actuary to carry out a special valuation under Regulation 78 to determine whether there is any deficit.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

(a) For Transferee Admission Bodies, the assumptions would usually be those used for an ongoing valuation to be consistent with those used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

(b) For Community Admission Bodies that elect to voluntarily terminate their participation, the Administering Authority must look to protect the interests of other ongoing employers and will require the actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. This could give rise to significant payments being required.

(c) For Admission Bodies with guarantors, it is possible that any deficit could be transferred to the guarantor, in which case it may be possible to simply transfer the former Admission Bodies' members and assets to the guarantor, without needing to crystallise any deficit.

Under (a) and (b), any shortfall would be levied on the departing Admission Body as a capital payment, unless otherwise agreed.

3.10 Early retirement costs

3.10.1 Non ill health retirements

The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health. Employers are required to pay additional contributions wherever an employee retires before attaining the age at which the valuation assumes that benefits are payable. The current costs of these are calculated by reference to formulae and factors provided by the actuary.

It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire.

The additional costs of premature retirement are calculated by reference to these ages.

4. Links to investment strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice.

4.1 Investment strategy

The investment strategy currently being pursued is described in the Fund's Statement of Investment Principles.

The investment strategy is set for the long-term, but is reviewed from time to time, normally every three years, to ensure that it remains appropriate to the Fund's liability profile. The Administering Authority has appointed three multi-asset managers. The Administering Authority has set control ranges, which define the maximum and minimum proportion of assets to be invested in key asset classes such as equities, bonds and property. As at 31 March 2007, the proportion held in equities and property was 79% of the total Fund assets.

The investment strategy of lowest risk – but not necessarily the most cost-effective in the long-term – would be one which provides cashflows which replicate the expected benefit cashflows (i.e. the liabilities). Equity investment would not be consistent with this.

The Fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from a liability matching strategy

The same investment strategy is currently followed for all employers. The Administering Authority does not currently have the facility to operate different investment strategies for different employers.

4.2 Consistency with funding basis

The funding basis adopts an asset outperformance assumption of 1.6% per annum over and above the redemption yield on index-linked gilts. Both the Fund's Actuary and its investment adviser consider that the funding basis does conform to the requirement to take a "prudent longer-term" approach to funding.

The Administering Authority is aware that in the short term – such as the three yearly assessments at formal valuations – the proportion of the Fund invested in equities brings the possibility of considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of the outperformance target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.3 Balance between risk and reward

Prior to implementing its current investment strategy, the Administering Authority considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes like equities.

4.4 Intervaluation monitoring of funding position

The Administering Authority monitors investment performance relative to the growth in the liabilities by means of quarterly inter-valuation monitoring reports measuring investment returns relative to the returns on a low risk portfolio of index-linked bonds. It reports back to employers by inter-valuation monitoring - Navigator.

5. Key risks & controls

5.1 Types of risk

The Administering Authority has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

5.2 Financial risks

Risk	**Summary of Control Mechanisms**
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term	*Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.* *Analyse progress at three yearly valuations for all employers.* *Inter-valuation roll-forward of liabilities between formal valuations will be provided on a quarterly basis.*
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	*Inter-valuation monitoring, as above.* *Some investment in bonds helps to mitigate this risk.*
Active investment manager under-performance relative to benchmark	*Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.* *Possible replacement of under-performing managers. More detailed annual performance reporting from WM.*
Pay and price inflation significantly more than anticipated	*The focus of the actuarial valuation process is on real returns on assets, net of pay and price increases.* *Inter-valuation monitoring, as above, gives early warning.* *Some investment in index-linked bonds also helps to mitigate this risk.* *Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.*

Risk	Summary of Control Mechanisms
Effect of possible increase in employer's contribution rates on service delivery and admission/scheduled bodies.	*Seek feedback from employers on scope to absorb short-term contribution rises.* *Mitigate impact through deficit spreading and phasing in of contribution risks.*

5.3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer	*Set mortality assumptions with some allowance for future increases in life expectancy.* *Sensitivity analysis in triennial valuation calculations helps employers understand the potential impact of life expectancy.* *Fund actuary monitors combined experience of around 50 LGPS funds to look for early warnings of lower pension amounts ceasing than assumed in funding.* *Administering Authority encourages employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.*
Higher than anticipated numbers of early retirements	*Employers are charged the extra capital cost of non ill health retirements following each individual decision.* *Employer ill health retirement experience is monitored.*

5.4 Regulatory

<table>
<tr><th>Risk</th><th>Summary of Control Mechanisms</th></tr>
<tr><td>Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees</td><td rowspan="2">The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.

It considers all consultation papers issued by the CLG and comments where appropriate.

The Administering Authority will consult employers where it considers that it is appropriate.</td></tr>
<tr><td>Changes to national pension requirements and/or HM Revenue & Customs rules e.g. effect of abolition of earnings cap for post 1989 entrants from April 2006</td></tr>
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5.5 Governance

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements). Administering Authority not advised of an employer closing to new entrants.	*The Administering Authority monitors membership movements on a quarterly basis, via a report from the administrator at quarterly meetings.* *The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 78) between triennial valuations*
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.	*In addition to the Administering Authority monitoring membership movements on an annual basis, it requires employers of Admission Bodies to inform it of forthcoming changes.* *It also operates a diary system to alert it to the forthcoming termination of Best Value Admission Agreements.*
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: • *Seeking a funding guarantee from another scheme employer, or external body, where-ever possible.* • *Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.* • *Vetting prospective employers before admission.* • *Where permitted and appropriate under the regulations, requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.*

Annex – responsibilities of 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 fund's actuary;
- prepare and maintain an FSS and a SIP, both after proper consultation with interested parties; and
- monitor all aspects of the fund'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 authorities promptly of all changes to membership or, as may be proposed, which 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; and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.
- provide interim valuations for budget planning;
- provide pension disclosure information for employer accounts (e.g. FRS17);
- provide advice on pension issues related to Human Resources policies; and
- advise on Government pension proposals.