London Borough of Bromley Pension Fund (LBBPF)
Funding Strategy Statement (FSS)

This Statement has been prepared by London Borough of Bromley (the Administering Authority) to set out the funding strategy for the London Borough of Bromley Pension Fund (the LBBPF), in accordance with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) and the guidance paper issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel. While these regulations have technically been revoked and replaced by the LGPS Regulations 2013, in practice the provisions within those Regulations are still saved for those members to whom they apply.

1. INTRODUCTION

The Local Government Pension Scheme (Administration) Regulations 2008 (as amended) ("the Administration Regulations") provide the statutory framework from which the Administering Authority is required to prepare a FSS. The key requirements for preparing the FSS can be summarised as follows:

- In consultation with the external actuary, the Administering Authority will prepare and publish a funding strategy.
- In preparing the FSS, the Administering Authority must have regard to :-
  - the guidance issued by CIPFA for this purpose; and
  - the Statement of Investment Principles (SIP) for the LBBPF published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

Benefits payable under the LBBPF are guaranteed by statute and thereby the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.

The Scheme is a defined benefit arrangement with principally final salary related benefits from contributing members up to 1 April 2014 and Career Averaged Revalued Earnings ("CARE") benefits earned thereafter. There is also the introduction of a "50:50 Scheme Option", where members can elect to accrue 50% of the full scheme benefits and pay 50% of the normal member contribution.

The benefits provided by the LBBPF are specified in the governing legislation (the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) ("the BMC Regulations") and the Administration Regulations referred to above. New legislation contained in the Local Government Pension Scheme Regulations 2013 ("the 2013 Regulations") governs the LBBPF from 1 April 2014. The required levels of employee contributions from 1 April 2014 are also specified in the 2013 Regulations.

Employer contributions are determined in accordance with the Administration Regulations which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate. Contributions to the LBBPF should be set so as to “secure its solvency”, whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

2. PURPOSE OF THE FSS IN POLICY TERMS

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

The purpose of this Funding Strategy Statement is:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory requirement to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

The intention is for this strategy to be both cohesive and comprehensive for the LBBPF as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the Administering Authority to implement and maintain.

3. AIMS AND PURPOSE OF THE LBBPF

The aims of the Fund are to:

- enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies
- manage employers’ liabilities effectively
- ensure that sufficient resources are available to meet all liabilities as they fall due, and
- maximise the returns from investments within reasonable risk parameters.

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income,
- and pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses as defined in the Local Government Pension Scheme (Administration) Regulations 2008 (as amended), the Local Government Pension

Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended), the 2013 Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

4. RESPONSIBILITIES OF THE KEY PARTIES

The Administering Authority should:

- collect employer and employee contributions
- invest surplus monies in accordance with the Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- manage the valuation process in consultation with the LBBPF's actuary
- prepare and maintain an FSS and a SIP, and
- monitor all aspects of the LBBPF's performance and funding and amend FSS/SIP.

The Individual Employer should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- exercise discretions within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain, and
- notify the Administering Authority promptly of all changes to membership 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
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters,
- advise on funding strategy, the preparation of the FSS, and the inter-relationship between the FSS and the SIP.

5. SOLVENCY ISSUES AND TARGET FUNDING LEVELS

Funding Objective

To meet the requirements of the Administration Regulations the Administering Authority's long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the "**funding target**") assessed on an

ongoing past service basis including allowance for projected final pay. In the long term, the employer rate would ultimately revert to the Future Service Rate.

Determination of the Funding Target and Recovery Period

The principal method and assumptions to be used in the calculation of the funding target are set out in Appendix 1.

Underlying these assumptions are the following two tenets:

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

This allows us to take a longer term view when assessing the contribution requirements for certain employers. As part of this valuation when looking to potentially stabilise contribution requirements we will consider whether we can build into the funding plan the following:-

- allowance for interest rates and bond yields having reverted since the valuation date to higher levels

In considering this the Administering Authority, based on the advice of the Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful.

As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the distinct employers (employer groups) in the Scheme. In attributing the overall investment performance obtained on the assets of the Scheme to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole.

The Administering Authority has adopted the following objectives for setting the individual employer contribution rates arising from the 2013 actuarial valuation:

- A default recovery period of 15 years will apply. Employers will, however, have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan below).

- In the current circumstances, as a general rule, the Fund does not believe it appropriate for contribution reductions to apply compared to the 2010 funding plan where substantial deficits remain.

- For any employers assessed to be in surplus at the valuation date, their individual contribution requirements will be adjusted to such an extent that any surplus is used (ie run-off) over a 15 year period. The current level of contributions will be phased down as appropriate.

- The employer contributions will generally be expressed as a percentage of pensionable payroll.

- On the cessation of an employer's participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer will be due to the Scheme as a termination contribution, unless it is agreed by the Administering Authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Scheme to another participating employer.

In determining the above objectives the Administering Authority has had regard to:

- relevant guidance issued by the CIPFA Pensions Panel
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose, and
- the Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.

Deficit Recovery Plan

If the assets of the scheme relating to an employer are less than the funding target at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall.

Additional contributions will be expressed as a level percentage of pensionable payroll, subject to review based on the results of each actuarial valuation.

In determining the actual recovery period to apply for any particular employer or employer group, the Administering Authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of the employer;
- the assessment of the financial covenant of the employer; and the security of future income streams
- any contingent security available to the Fund or offered by the employer such as guarantor or bond arrangements, charge over assets, etc.
- length of expected period of participation in the Fund.

The assumptions used in these Recovery Plan calculations are set out in Appendix 1.

The Normal Cost of the Scheme (Future Service Contribution Rate)

In addition to any contributions required to rectify a shortfall of assets below the funding target, contributions will be required to meet the cost of future accrual of benefits for members after the valuation date (the "normal cost"). The method and assumptions for assessing these contributions are also set out in Appendix 1.

6. LINK TO INVESTMENT POLICY SET OUT IN THE STATEMENT OF INVESTMENT PRINCIPLES

The results of the 2013 valuation show the liabilities at 31 March 2013 to be 82% covered by the current assets, with the funding deficit of 18% being covered by future deficit contributions.

In assessing the value of the LBBPF's liabilities in the valuation, allowance has been made for asset out-performance as described in Appendix 1, taking into account the investment strategy adopted by the LBBPF, as set out in the SIP.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which closely matches the liabilities and represents the minimum risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts. Investment of the LBBPF's assets in line with the least risk portfolio would minimise fluctuations in the LBBPF's ongoing funding level between successive actuarial valuations.

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

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

Global Equities (70% allocation in agreed Investment Strategy)

	Value @ 31 March 2014	% of total
	£m	%
Baillie Gifford	217.6	
MFS International	120.0	
Blackrock	122.1	
	459.7	73.1%

Fixed Income (20% allocation in agreed Investment Strategy)

	Value @ 31 March 2014	% of total
	£m	%
Baillie Gifford	45.2	
Fidelity	58.2	
	103.4	16.4%

Diversified Growth (10% allocation in agreed Investment Strategy)

	Value @ 31 March 2014	% of total
	£m	%
Baillie Gifford	26.8	
Standard Life	27.0	
	53.8	8.6%

Other (cash, current assets/liabilities)

	Value @ 31 March 2014	% of total
	£m	%
Cash held by Fund managers	8.6	
Current net assets	3.5	
	12.1	1.9%

Grand Total

	Value @ 31 March 2014	% of total
	£m	%
Total assets held by Fund managers	625.5	
Current net assets	3.5	
	629.0	100.0%

7. IDENTIFICATION OF RISKS AND COUNTER MEASURES

The funding of defined benefits is by its nature uncertain. Funding of the LBBPF is based on both financial and demographic assumptions. These assumptions are specified in Appendix 1 and in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the actuary that the greatest risk to the LBBPF's funding is the investment risk inherent in the predominantly equity (or return seeking) based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the overall out performance assumed in the long term.

What are the Risks?

Financial

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- Effect of possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies

Demographic

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)

Insurance of certain benefits

The contributions for any employer may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund.

Regulatory

- Further changes to Regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees
- Changes to national pension requirements and/or HMRC rules

Governance

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

8. MONITORING AND REVIEW

The Administering Authority has taken advice from the actuary in preparing this Statement.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of then current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- if there have been significant changes to the LBBPF membership, or LGPS benefits
- if there have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy e.g. closure to new entrants
- if there have been any significant special contributions paid into the LBBPF

APPENDIX 1

ACTUARIAL VALUATION AS AT 31 MARCH 2013

Method and assumptions used in calculating the funding target and recovery plan

Method

The actuarial method to be used in the calculation of the funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted (the Attained Age method), which makes advance allowance for the anticipated future ageing and decline of the current closed membership group.

Financial assumptions

Investment return (discount rate)

A yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") 1.75% per annum.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date.

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities, but subject to the following two adjustments:

- an allowance for supply/demand distortions in the bond market is incorporated, and
- due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index, the overall reduction to RPI inflation at the valuation date is 1.0% per annum.

Salary increases

The assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase, assumption allowance has been made for expected short term pay restraint of 1% per annum for 3 years.

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the RPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

Demographic assumptions

Mortality

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity. The mortality tables used are set out below, with a loading reflecting wider LGPS experience. Existing ill health retirees are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 3 years older. Current members who retire on the grounds of ill health are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 4 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 1.5% per annum.

Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up.

Other Demographics

All other assumptions are as per the last valuation.

Expenses

Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by adding 0.7% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

The costs of any discretion exercised by an employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation.

Method and assumptions used in calculating the cost of future accrual

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target except that the financial assumptions adopted will be as described below.

The financial assumptions for assessing the future service contribution rate should take account of the following points:

- contributions will be invested in market conditions applying at future dates, which are unknown at the effective date of the valuation, and which are not directly linked to market conditions at the valuation date; and
- the future service liabilities for which these contributions will be paid have a longer average duration than the past service liabilities.

The financial assumptions in relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real return (i.e. return in excess of price inflation) of 3.0% per annum, with a long term average assumption for consumer price inflation of 2.6% per annum. These two assumptions give rise to an overall discount rate of 5.6% p.a (i.e. 3.0% plus 2.6%).

Adopting this approach the future service rate is not subject to variation solely due to different market conditions applying at each successive valuation, which reflects the requirement in the Regulations for stability in the “Common Rate” of contributions. In market conditions at the effective date of the 2013 valuation this approach gives rise to a slightly more optimistic stance (i.e. allows for a higher AOA) in relation to the cost of accrual of future benefits compared to the market related basis used for the assessment of the funding target.

At each valuation the cost of the benefits accrued since the previous valuation will become a past service liability. At that time any mismatch against gilt yields and the asset out-performance assumptions used for the funding target is fully taken into account in assessing the funding position.

Summary of key whole Fund assumptions used for calculating funding target and cost of future accrual (the "normal cost") for the 2013 actuarial valuation

Long-term gilt yields	
Fixed interest	3.20% p.a.
Index linked	-0.40% p.a.
Past service Funding Target financial assumptions	
Investment return/Discount Rate	4.95% p.a.
CPI price inflation	2.60% p.a.
Long Term Salary increases	4.10% p.a.
Pension increases/indexation of CARE benefits	2.60% p.a.
Future service accrual financial assumptions	
Investment return	5.60% p.a.
CPI price inflation	2.60% p.a.
Long Term Salary increases	4.10% p.a.
Pension increases/indexation of CARE benefits	2.60% p.a.

Demographic assumptions

The post retirement mortality tables adopted for this valuation are as follows:

Life expectancy at 65 in 2013		Base table	Adjustment	Improvement model	Long term rate
CURRENT ANNUITANTS	Normal health	S1PxA	97% / 97%	CMI_2012	1.5%
	Ill health	S1PxA	Normal health + 3 years	CMI_2012	1.5%
	Dependants	S1PMA/S1DFA	159% / 109%	CMI_2012	1.5%
	Future Dependants	S1PMA/S1DFA	110% / 98%	CMI_2012	1.5%
CURRENT ACTIVES / DEFERREDS	Actives normal health	S1PxA	97% / 91%	CMI_2012	1.5%
	Actives ill health	S1PxA	Normal health + 4 years	CMI_2012	1.5%
	Deferreds	S1PxA	118% / 105%	CMI_2012	1.5%
	Future dependants	S1PMA/S1DFA	107% / 99%	CMI_2012	1.5%

Notes:

CMI = Continuous Mortality Investigation, which publishes mortality projections for the Institute and faculty of Actuaries.

S1P = the set of base tables used by the CMI.

Other demographic assumptions are as for the 2010 valuation.