1. Introduction

1.1. This is the Funding Strategy Statement ("FSS") for the London Borough of Merton Pension Fund ("the Fund") which is administered by London Borough of Merton ("the Administering Authority"). It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme (Administration) Regulations 2013 ("the Regulations").

1.2. The Fund Actuary, Barnett Waddingham LLP, has been consulted on the contents of this Statement.

1.3. It should be read in conjunction with the Fund's Investment Strategy Statement (ISS) and has been prepared with regard to the 2016 guidance issued by CIPFA.

2. Purpose of the Funding Strategy Statement

2.1. The purpose of the FSS is to explain the Fund's approach to meeting the pension scheme's liabilities and in particular:

- to establish a clear and transparent Fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to ensures that the regulatory requirements to set contributions so as to ensure the solvency and long-term cost efficiency of the fund are met;
- to take a prudent longer-term view of funding those liabilities; and
- to support the desirability of maintaining as nearly constant a primary contribution rate as possible, as defined in Regulation 62(5) of the LGPS Regulations 2013.

2.2. These objectives are desirable individually but may by their nature be mutually conflicting. This FSS seeks to set 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.

3. Aims of the Fund

3.1. The aims of the Fund are to:

- Manage employers' liabilities effectively and ensure that sufficient resource 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 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

4. Purpose of the Fund

4.1. The purpose of the Fund is to:

- Pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses, as defined in the LGPS Regulations 2013 and as required in the LGPS (Management and Investment of Funds) Regulations 2016;
- Meet the costs associated in administering the Fund;
- Receive monies in respect of contributions, transfer values and investment income; and
- Accumulate and invest money received, and facilitate the management of this.

5. Funding Objectives

5.1. 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.

5.2. The funding objectives are to:

- Set levels of employer contribution that will build up a fund of assets that will be sufficient to meet all future benefit payments from the Fund;
- Ensure the solvency and long-term cost efficiency of the Fund, while having regard to the desirability of maintaining as nearly constant employer contribution rates where practical;
- Set contributions to target a 100% funding level over an appropriate time period using appropriate actuarial assumptions;
- Ensure effective and efficient management of employers' liabilities;
- Allow the return from investments to be maximised within reasonable risk parameters; and
- Have regard to the likely outcomes of the review under Section 13(4)(c)

6. Key Parties

6.1. The key parties involved in the funding process and their responsibilities are as follows:

The Administering Authority

6.2. The Administering Authority for the Pension Fund is London Borough of Merton. The main responsibilities of the Administering Authority are to:

- Operate the Pension Fund;
- Collect and account for employee and employer contributions, investment income and other amounts due to the Fund;
- Invest the Fund's assets ensuring sufficient cash is available to meet liabilities as and when they become due;
- Pay the benefits due to Scheme members;
- 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 and funding and ensure that the FSS and ISS are updated as necessary;
- Prepare the Fund accounts;
- Effectively manage any potential conflict of interest arising from its dual role as both Fund administrator and Scheme employer; and
- Enable the Local Pension Board to review the actuarial valuation process as they see fit.

Individual Employers

6.3. In addition to the Administering Authority, a number of scheduled and admitted bodies participate in the Fund.

6.4. The responsibilities of each individual 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. Payments should be made monthly and no later than the 19th day of each month;
- Each payment should be accompanied by a statement of the total pensionable pay received by members during the period covered by the statement, the total employee contributions deducted from the pensionable pay and the total employer contributions in respect of the pensionable pay;
- Promptly notify the Administering Authority of any new Scheme members and any other membership changes promptly;
- Exercise any discretions permitted under the Regulations;
- Meet the costs of any augmentations or other additional costs, particularly in respect of early retirement strains, in accordance with agreed policies and procedures; and
- Pay any exit payments on ceasing participation in the Fund.

Fund Actuary

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

- Prepare the actuarial valuation, including the setting of employer contribution rates 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;
- Advise interested parties on funding strategy and completion of actuarial valuations in accordance with the FSS and the Regulations;
- Prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters;
- Prepare advice and valuations on the exiting of employers from the Fund;
- Provide advice to the Administering Authority on bonds or other forms of security against the financial effect on the Fund 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 his or her role in advising the Fund; and
- Advise on other actuarial matters affecting the financial position of the Fund.

7. Funding Strategy

7.1. 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.

7.2. The funding strategy seeks to achieve (via employee and employer contributions and investment income) two key objectives:

- Maintain the solvency of the Fund with an aim of targeting a funding level of 100%, as assessed by the Fund's appointed actuary, triennially, in accordance with the Regulations; and
- Maintaining the long-term cost efficiency of the Fund with a desire to retain stability of employer contributions.

7.3. The funding strategy recognises that the funding level will fluctuate with changing levels of employment, retirements and investment income, and the employer contribution has to be adjusted to a level sufficient to maintain the pension scheme's solvency and to achieve a funding level of 100% over the longer term.

7.4. The actuarial valuation involves a projection of future cash flows 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.

7.5. The last Actuarial Valuation was carried out as at 31 March 2016 with the assets of the Fund found to represent 94% of the accrued liabilities for the Fund.

8. Funding Method

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

8.2. The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund. The funding target may, however, depend on certain employer circumstances and in particular, whether an employer is an "open" employer – one which allows new recruits access to the Fund; or a "closed" employer 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 chosen funding target.

8.3. For open employers, the actuarial funding method that is adopted is known as the Projected Unit Funding Method which considers separately the benefits in respect of service completed before the valuation date ("past service") and benefits in respect of service expected to be completed after the valuation date ("future service"). This approach focuses on:

- 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 for pensions in payment. A funding level in excess of 100 per cent indicates a surplus of assets over liabilities; while a funding level of less than 100 per cent indicates a deficit; and
- The future service funding rate which is the level of contributions required from the individual employers which, in combination with employee contributions, is expected to support the cost of benefits accruing in future.

8.4. The key feature of this method is that, in assessing the future service cost, the contribution rate represents the cost of one year's benefit accrual.

8.5. For closed employers, the 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 the remaining expected working lifetime of active members.

9. Valuation Assumptions and Funding Model

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

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

- The statistical assumptions which are essentially estimates of the likelihood 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.

9.3. A summary of the key assumptions is included in the following table and can be found in the actuarial valuation report as at 31 March 2016. Further details regarding the derivation of these assumptions can be found in the Fund Actuary's initial results and assumptions advice to the Fund dated 13 September 2016.

Financial assumptions		Value at 31 March 2016 % p.a.
Discount rate		5.5%
Pay increases	Long-term	3.9%
	Short-term	CPI for period from 31 March 2016 to 31 March 2020
Consumer Price Inflation (CPI)		2.4%
Pension increases		2.4%
Post-retirement mortality		S2PA tables with a multiplier of 80% for males and 85% for females, projected into the future with the 2015 CMI Model with a long-term rate of improvement of 1.5% p.a.

Future Price Inflation

9.4. The base assumption in any valuation is the future level of price inflation over a period commensurate with the duration of the liabilities. This is derived by considering the average difference in yields over the appropriate period from conventional and index linked gilts during the six months straddling the valuation date, using the Bank of England Inflation Curves, to provide an estimate of future price inflation as measured by the Retail Price Index (or "RPI"). The resultant figure used in the 2016 valuation is 3.3% per annum.

Future Pay Inflation

9.5. 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 inflation. Historically, there has been a close link between price and pay inflation with pay increases in excess of price inflation. However in recent years the gap between pay increases and price inflation has been lower than historic levels. The assumption adopted in the 2016 Valuation is that pay increases will, on average over the longer term, exceed price inflation by 0.6% per annum. In addition, given the current economic climate and salary increase restrictions applied to public sector workers, it was also assumed that pay increases would be in line with CPI for the period to 31 March 2020.

Future Pension Increases

9.6. Pension increases are linked to changes in the level of the Consumer Price Index (or "CPI"). Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods and constituents that make up these indices. An adjustment of 0.9% per annum is therefore made to the RPI assumption to derive the CPI assumption.

Future Investment Returns/Discount Rate

9.7. 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.

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

9.9. For open employers, 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 underlying 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.

9.10. For closed employers, an adjustment may be made to the discount rate in relation to the remaining liabilities, once all active members are assumed to have retired if at that time (the projected "termination date"), the employer either wishes to leave the Fund, or the terms of their admission require it.

9.11. The Fund Actuary will incorporate such an adjustment after consultation with the Administering Authority.

9.12. The adjustment to the discount rate for closed employers is to set a higher funding target at the projected termination date, so that there are sufficient assets to fund the remaining liabilities on a "minimum risk" rather than on an ongoing basis. The aim is to minimise the risk of deficits arising after the termination date.

Asset Valuation

9.13. For the purposes 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.

Statistical Assumptions

9.14. The statistical assumptions incorporated into the valuation, such as future mortality rates, are based on national statistics. These are adjusted as appropriate to reflect the individual circumstances of the Fund and its individual employers.

10. Deficit Recovery/Surplus Amortisation Periods

10.1. 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 from the actuarial assumptions. Accordingly, the Fund will normally either be in surplus or in deficit.

10.2. Where the actuarial valuation discloses a significant surplus or deficit then the levels of required employers' contributions will include an adjustment to either amortise the surplus or fund the deficit over a period of years.

10.3. The deficit recovery period for each employer will depend upon the significance of the surplus or deficit relative to that employer's liabilities, the covenant of the individual employer and any limited period of participation in the Fund, and the implications in terms of stability of future levels of employers' contribution.

10.4. At the 2016 valuation, a maximum deficit recovery period of 12 years from 1 April 2017 is used for all employers. This will help protect against future adverse experience and help to reduce the interest cost paid by employers.

11. Pooling of Individual Employers

11.1. 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.

11.2. However, certain groups of individual employers are pooled for the purposes of determining contribution rates to recognise common characteristics or where the number of Scheme members is small.

11.3. Currently there are three pools within the Fund, namely the London Borough of Merton pool and two Academy pools; one which consists of academies that existed within the Fund at the 2013 valuation and one that is formed of Academies that joined the Fund after 31 March 2013.

11.4. The main purpose of pooling is to produce more stable employer contribution levels in the longer term whilst, recognising that ultimately there will be some level of cross-subsidy of pension cost amongst pooled employers.

12. New Admissions

12.1. On admission to the Fund, new employers are required to carry out an assessment of the level of risk to the Fund should their participation within the Fund cease due to certain circumstances, for example, insolvency, winding up or liquidation. This assessment will be to the satisfaction of the Administering Authority, having sought actuarial advice.

12.2. Depending on this assessment, the administering authority may require a new employer to enter into agreement to set up an indemnity or bond, in a form approved by the administering authority and in accordance with the Local Government Pension Scheme Regulations 2013, or those prevailing at the time of the admission.

13. Cessation Valuations

13.1. On the cessation of an employer's participation in the Scheme, the Fund Actuary will be asked to make a termination assessment. Any deficit in the Fund in respect of the employer will be due to the Fund as an exit payment, 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 Fund to another participating employer, and where any residual liabilities remain a termination assessment may still be due.

13.2. In assessing the deficit on termination, the Fund Actuary may adopt a discount rate based on gilt yields and adopt different assumptions to those used at the previous valuation in order to protect the other employers in the Fund from having to fund any future deficits which may arise from the liabilities that will remain in the Fund.

14. Early Retirement Costs

14.1. 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 calculation of these costs is carried out with reference to a calculation method approved by the Actuary to the Fund.

15. Links with the Investment Strategy Statement (ISS)

15.1. 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 underlying investment strategy as set out in the ISS.

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

16. Risks and Counter Measures

16.1. 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.

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

17. Financial Risks

17.1. 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.

17.2. The valuation results are most sensitive to the real discount rate. Broadly speaking an increase/decrease of 0.1% per annum in the real discount rate will decrease/increase the liabilities by around 2.0%, and decrease/increase the required employer contribution by around 0.5% of payroll.

17.3. The Fund Actuary can provide funding updates between valuations to check whether the funding strategy continues to meet the funding objectives.

18. Demographic Risks

18.1. 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 of one year to life expectancy of all members in the Fund will increase the value of liabilities by approximately 3%.

18.2. The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review.

18.3. The liabilities of the Fund can also increase by more than has been planned as a result of early retirements.

18.4. 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.

19. Regulatory Risks

19.1. 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 central government.

19.2. 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.

19.3. 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.

20. Governance

20.1. 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;
- An employer ceasing to exist without having fully funded their pension liabilities; and
- New employers being created out of existing employers.

20.2. 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.

20.3. 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.

21. Monitoring and Review

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

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