

# Funding Strategy Statement

London Borough of Southwark Pension Fund

DATE

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# Purpose of the Fund and the FSS

## Introduction

This is the Funding Strategy Statement (FSS) of the London Borough of Southwark Pension Fund (the Fund).

It has been prepared by London Borough of Southwark (the Administering Authority) in collaboration with the Fund Actuary, Aon Solutions UK Limited, and after consultation with officers, the Pensions Advisory Panel and the Fund's employers and is effective from the date of issue of this statement.

The FSS has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (the Regulations) and the guidance jointly produced by the Scheme Advisory Board (SAB), the Chartered Institute of Public Finance and Accountancy (CIPFA) and Ministry of Housing, Communities and Local Government (MHCLG). In addition, the Administering Authority has had regard to the Investment Strategy Statement, the supplementary statutory guidance issued by MHCLG: "Guidance on preparing and maintaining policies on review of employer contributions, employer exit payments and deferred debt agreements", and has also considered the Scheme Advisory Board's "Guide to Employer Flexibilities".

A summary of the roles and responsibilities of the key parties is included as Appendix 5 to this document.

A glossary of terms is included as Appendix 6 to this document.

If you have any queries on the contents of this FSS or require a paper copy of the document, please contact:

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## Aims and objectives of the FSS

The purpose of the Fund is to collect and invest 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 Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the Investment Regulations).

The Administering Authority has a fiduciary duty to act in the best interests of the pension fund members and the participating employers. This means the Administering Authority will act in line with relevant legal requirements and make delegated decisions rationally and reasonably taking into account all affected parties.

The main purpose of the FSS is to document the processes by which the Administering Authority:

- Establishes a clear and transparent funding strategy, specific to the Fund, to meet employer's pension liabilities going forward.
- Aims to meet the regulatory requirement in relation to the desirability of maintaining as nearly constant a primary contribution rate as possible.

- Ensures the regulatory requirement to set contributions so as to ensure the solvency and long-term cost efficiency of the Fund are met.
- Takes a prudent longer-term view of funding the Fund's liabilities.

noting that whilst the funding strategy applicable to individual employers or categories of employers must be reflected in the FSS its focus should at all times be on those actions which are in the best long-term interests of the Fund.

Benefits payable under the Fund are set out in the Regulations. 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 aims of the Fund in relation to the funding strategy include:

### **Solvency and long-term cost efficiency**

Securing solvency and long-term cost efficiency is a regulatory requirement.

The Fund's solvency should be assessed in light of the risk profile of the Fund and the risk appetite of the Administering Authority and employers.

We set out detail of how the Fund meets these requirements in the section "Key Funding Principles".

The Fund's compliance with these requirements is assessed and reported following each Actuarial Valuation through the Government Actuary's Department independent review of the Actuarial Valuation outcomes and approach under Section 13 of the Public Service Pensions Act.

### **Management of liabilities and payment of benefits**

The Administering Authority recognises the need to ensure that sufficient funds are available to meet all benefits (including pensions, transfer values, costs, charges and other expenses) as they fall due for payment. It is the Administering Authority's policy that such expenditure is met, in the first instance, from incoming employer and employee contributions to avoid the expense of disinvesting assets. The Administering Authority monitors the position on a monthly basis to ensure that all cash requirements can be met.

### **Management of employer liabilities and stability of employer contributions**

The Administering Authority seeks to ensure that all employers' liabilities are managed effectively. In a funding context, this is achieved by:

- seeking regular actuarial advice
- ensuring that employers are properly informed and consulted
- regular monitoring of the funding position and the outlook for employers' contributions
- appropriate segregation of employers for funding purposes

The Administering Authority aims to manage employers' liabilities effectively through regular review of contributions at triennial Actuarial Valuations and additional contributions for early retirement. At such reviews, regard will be had to the desirability of maintaining stability of employer contributions, subject to the Administering Authority not taking undue risks, and at reasonable cost to the taxpayers and employers.

### **Link to investment strategy**

The Fund seeks to maximise the returns from investments within reasonable risk parameters.

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 and is set out in the Investment Strategy Statement.

The Administering Authority recognises the desirability of maximising investment income within reasonable risk parameters. Investment returns higher than those available on Government

stocks are sought through investment in other asset classes such as stocks and property. The Administering Authority ensures that risk parameters are reasonable by:

- Complying with any restrictions set out in the Investment Regulations.
- Restricting investment to asset classes generally recognised as appropriate for UK pension funds.
- Analysing the potential volatility and absolute return risks, and funding risk represented by those asset classes in collaboration with Investment Advisors and Fund Managers, the Fund Actuary and the London Collective Investment Vehicle (CIV) and ensuring that they remain consistent with the risk and return profiles anticipated in the funding strategy.
- Limiting concentration of risk by developing a diversified investment strategy.
- Monitoring the mis-matching risk that the investments do not move in line with the Fund's liabilities.

### **Risk profile of the Fund**

The Administering Authority takes a risk-based approach to valuing the liabilities, which considers the liability and asset risk when setting the funding assumptions and employer contribution rates.

The Administering Authority considers employer risk by monitoring employer covenant and allowing for different types of employers when setting funding targets.

This is explained in more detail in the Key Funding Principles section of this FSS.

### **Integrated funding framework**

The FSS together with the Fund's investment strategy and approach to employer covenant monitoring ensure an integrated approach to funding strategy and risk management supporting the Fund in meeting the Regulatory funding requirements.

The Fund's governance framework and decision-making processes is set out in the Governance Compliance Statement, which is found as an appendix of the Fund's Annual Report (<https://www.southwarkpensions.co.uk/finance-and-investment/finance-investment-documents/>) With the assistance of the Pensions Advisory Panel, the Strategic Director of Resources (the Chief Finance Officer or CFO) is responsible for setting the funding strategy as set out in the FSS. Other responsibilities relating to the implementation of the strategy, including ensuring the Actuarial Valuation is completed within the required timescales and in line with the Regulations, are delegated to the Fund officers.

## **Monitoring and review of the FSS**

The Administering Authority undertook its latest substantive review of this FSS in February 2026.

The Administering Authority plans to formally review this FSS as part of each triennial Actuarial Valuation of the Fund unless circumstances arise which require earlier action.

The Administering Authority will also consider a review of the FSS if it determines that circumstances have changed such that this is appropriate, taking into account the implications for the funding strategy and for meeting the liabilities of employers. Circumstances which might lead to such a review include:

- material changes to the scheme benefit structure or regulations
- on the advice of the Fund Actuary
- significant changes to investment strategy or if there has been significant market volatility which impacts the FSS or goes beyond the expectations outlined in the existing FSS

- significant changes to the Fund membership and/or Fund maturity profile
- significant or notable changes to the number, type, or individual circumstances of any employers to such an extent that they impact on the funding strategy (e.g. exit/restructuring/failure which could materially impact cashflow and/or maturity profile and/or covenant)
- material change in the affordability of contributions and/or employer(s) financial covenant strength which has an impact on the FSS
- recommendations from MHCLG/Government Actuary's Department

If such a review of the FSS were to take place, the Administering Authority will consider:

- the implications for the funding strategy for meeting liabilities of individual employers, and
- any amendments required to the ISS or other Fund documents as a result.

### **Employer engagement**

The Administering Authority will consult with employers when proposing to update the FSS. Employers will be given at least 14 days to respond to the consultation.

When the FSS is updated, the Administering Authority will also communicate with any individual (or groups of) employers specifically impacted by any changes and in particular will reference any impact on employers on entry or exit from the Fund or in response to change in risk.

The Administering Authority will respond to any employers who provide feedback or comments on FSS consultations, including informing them how/whether their comments have been incorporated into the revised FSS.

## Key Funding Principles

### Funding target

In order to satisfy the regulatory requirement to secure the solvency and long-term cost efficiency of the Fund, employer contributions are set so as to make provision for the cost of benefit accrual, with an appropriate adjustment for any surplus or deficit. The regulations require that an Actuarial Valuation exercise is carried out every 3 years, in order to set employer contributions.

The funding target is the amount of assets which the Fund needs to hold at the valuation date to pay the liabilities at that date as indicated by the chosen valuation method and assumptions and the valuation data. The Fund is deemed to be fully funded when the assets held are equal to 100% of the funding target / liabilities. When assets held are greater than this amount the Fund is deemed to be in surplus, and when assets held are less than this amount the Fund is deemed to be in deficit. The funding level is the assets divided by the funding target / liabilities.

The Fund needs to balance investment returns achieved on the Fund's assets and setting Employer contributions at an appropriate level. Employers' contributions will be set to ensure that 100% of the funding target / liabilities can be met over the long-term using appropriate actuarial assumptions. When setting the assumptions consideration will be given to the returns on the Fund's assets, and the characteristics and circumstances of the employers, including the maturity and potential period to exit if applicable. In setting contributions, the Administering Authority will also have regard to the desirability of maintaining as nearly constant a primary rate as possible.

The Administering Authority believes that its funding strategy will ensure the solvency of the Fund because employers collectively have the financial capacity to increase employer contributions should future circumstances require, in order to continue to target a funding level of 100% (where the assets are equal to the funding target / liabilities).

### Risk based funding target

The Fund uses a risk-based funding strategy to calculate the funding target / liabilities for the majority of employers, where the Actuarial Valuation is carried out on the basis of the assessed likelihood of meeting the funding objectives. In practice, three key decisions are required for the risk-based approach:

- what the **solvency target** should be (the funding objective - where the Administering Authority wants the Fund to get to),
- the **trajectory period** (how quickly the Administering Authority wants the Fund to get there), and
- the **probability of funding success** (how likely the Administering Authority wants it to be now that the Fund will achieve the Solvency Target by the end of the Trajectory Period).

These three decisions, supported by risk modelling carried out by the Fund Actuary, define the discount rate (investment return assumption) to be adopted and, by extension, the appropriate employer contributions payable. Together they measure the riskiness of the funding strategy.

Information about the assumptions used in the calculation of the funding target / liabilities are set out in the section "Main actuarial assumptions".

### Solvency target

The Fund is deemed to be solvent when the assets held are equal to or greater than the value of the Fund's liabilities assessed using appropriate actuarial methods and assumptions.

### Trajectory period

The Trajectory Period in relation to an employer is the period between the Actuarial Valuation date and the date on which solvency is targeted to be achieved. The Fund adopts a trajectory period of 25 years as a suitable long-term period.

### **Probability of funding success**

The Administering Authority deems funding success to have been achieved if the Fund, at the end of the trajectory period, has achieved the solvency target. The probability of funding success is the assessed chance of this happening based on asset-liability modelling carried out by the Fund Actuary.

The Administering Authority will not permit contributions to be set following an Actuarial Valuation that have an unacceptably low chance of achieving the solvency target at the end of the relevant trajectory period.

### **Other funding targets**

Details of how funding targets for other employers are derived is set out below in the “Main actuarial assumptions” section.

### **Subsumed liabilities**

If another employer in the Fund agrees to provide a source of future funding in respect of any emerging deficit in respect of the liabilities of an employer exiting the fund, the liabilities are known as subsumed liabilities (in that responsibility for them is subsumed by the accepting employer).

Subsumed liabilities will be assessed using actuarial assumptions used for the funding target of the accepting employer.

### **Orphan liabilities**

Liabilities of former employers in the fund who did not have a subsumption commitment from another employer in the fund are known as orphan liabilities. Details of how orphan liabilities are funded is set out below in the “Main actuarial assumptions” section. There were no orphan liabilities in the Fund at the 2025 valuation.

## **Managing risk**

The Administering Authority has an active risk management programme in place. The Administering Authority will ensure that funding risks are included within their overarching risk management framework and strategy, linking to their risk register and risk management policy as appropriate and includes defining a role for the Local Pension Board within this framework. The measures that the Administering Authority has in place to control key risks are summarised in Appendix 1 under the following headings:

- economic
- investment
- demographic
- climate risk
- liquidity/maturity
- regulatory/compliance
- employer data quality
- governance
- orphan liabilities
- employer covenant

## **Main actuarial assumptions**

### **Financial assumptions**

The key financial assumptions are the discount rate and the pension increase/revaluation assumption.

## **Pension and pay increase assumption**

The Scheme provides increases in line with increases in the Consumer Prices Index on the majority of pensions paid. The pension increase assumption is generally set by reference to the Fund Actuary's best estimate of Consumer Prices Index inflation over the long term. The pay increase assumption can then be derived from the CPI assumption, with the pay increase assumption being set as CPI plus 1.5% at the 2025 Actuarial Valuation.

## **Discount rate**

The discount rate, or future investment return assumption, depends on the Funding Target used. The Funding Target used is determined by the type of employer in the Fund, the way any exit valuations will be carried out, and the employer risk/covenant. This is achieved by using different principles to derive the Solvency and Funding Targets for different employers in the Fund, as set out below.

- **Scheduled Bodies and certain other employers of sound covenant**, and those employers with a subsumption guarantee from such an employer: The assumption is based on indefinite investment in a broad range of assets, with reference to the Fund's strategic asset allocation as set out in the ISS. The assumption recognises the need for prudence and is set such that there is an 86% Probability of Funding Success. The Funding Target for such employers is called the Scheduled and Subsumption Body Funding Target. All employers were subject to this funding target in the 2025 valuation.
- **Admission Bodies**, and certain other employers whose participation is limited: For Admission Bodies and other employers whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit, the discount rate would be set as for secure scheduled bodies for the period before contributing members are assumed to leave service. For the period after leaving service (or the period contributing members are assumed to have left service), investment in a portfolio of UK Government bonds will normally be assumed and the investment return assumption will be based on the expected yields on those bonds. The Funding Target for such employers is called the (Ongoing) Orphan Funding Target. There were no employers subject to this funding target in the 2025 valuation.
- **Already orphaned liabilities**: For liabilities in respect of former employers in the Fund, for which no individual employer is responsible for funding, the discount rate/investment return assumption will be based on the expected yields on UK Government bonds. The Funding Target for such liabilities is called the Low-Risk Funding Target. There were no former employers' liabilities which are "orphan" and therefore subject to this funding target in the 2025 valuation.

## **Demographic assumptions**

Demographic assumptions relate to membership movements or decisions leading to benefit payments or ending of benefit payments, for example rates of mortality, ill health, turnover of staff, marital statistics and promotional increases in pay. How long members and their dependants are assumed to live after retirement (post-retirement mortality) is the key demographic assumption.

The demographic assumptions are reviewed by the Fund Actuary and updated once every three years in agreement with the Administering Authority. The demographic assumptions are intended to be best estimate and are designed to be applicable to the long-term future and should, therefore, not be too influenced by recent events. In addition, it is usually not practical, desirable or cost effective to set demographic assumptions at an employer specific level.

The post-retirement mortality assumption is set with reference to the Fund's own data on deaths, national mortality statistics, and the experience of other pension funds, including using members' postcodes to allocate them to different socioeconomic groups.

Where practical, the other demographic assumptions are also informed by the actual experience of the Fund's membership. Where this is not practical, other demographic assumptions are set by reference to national statistics and/or a larger sample of pension schemes with similar socio-economic profiles as LGPS members.

Further information is set out in the Actuarial Valuation report:

<https://www.southwarkpensions.co.uk/media/o43hrk0o/actuarial-valuation-report.pdf>.

## Asset shares notionally allocated to employers

In order to establish contribution rates for individual employers or groups of employers the Fund Actuary notionally subdivides the Fund assets between the employers/groups, as if each employer/group had its own notional asset share within the Fund.

This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, nor ownership of any particular assets or groups of assets by any individual employer or group.

The notional asset share allocated to each employer will be rolled forward allowing for all cashflows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income allocated as set out below.

In general no allowance is made for the timing of contributions and cashflows for each year are assumed to be made halfway through the year with investment returns assumed to be uniformly earned over that year. However, where significant one-off employer contributions have been paid, allowance is made for the timing of such contributions.

Further adjustments are made for:

- A notional deduction to meet the expenses paid from the Fund in line with the assumption used at the previous Actuarial Valuation.
- Allowance for any known material internal transfers in the Fund, as cashflows will not exist for these transfers. The Fund Actuary will assume an estimated cashflow equal to the value of the cash equivalent transfer value based on appropriate factors set by the Government Actuary's Department, unless some other approach has been agreed.
- Allowance for lump sum death in service and other benefits shared across all employers in the Fund.
- An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund which will take into account any gains or losses related to the orphan liabilities.

In exceptional circumstances, information available will not allow for such cashflow calculations. In such circumstances another method will be agreed to calculate the notional asset share.

## Attribution of investment income

Where the Administering Authority has agreed with an employer that it will have a tailored asset portfolio notionally allocated to it, the assets notionally allocated to that employer will be credited with a rate of return appropriate to the agreed notional asset portfolio.

Where the employer has not been allocated a tailored notional portfolio of assets, the assets notionally allocated to that employer will be credited with the rate of return earned by the Fund assets as a whole, adjusted for any return credited to those employers for whom a tailored notional asset portfolio exists.

For already orphaned liabilities, to the extent that the Administering Authority decides not to match these liabilities with asset holdings of UK Government bonds of appropriate term then

any excess or deficient returns will be added to or deducted from the investment return to be attributed to the other employers' notional assets.

## Grouping or pooling and risk sharing arrangements

Historically, all employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service – in other words, the cost of such benefits is shared across all the employers in the Fund. With effect from the 31 March 2025, the Administering Authority agreed to extend this risk sharing arrangement to include the pension benefits payable in ill health and dependants' pension benefits on death in service for all employers in the Fund. Such benefits can cause funding strains which could be significant for some of the smaller employers without insurance or sharing of risks. The Fund, in view of its size, does not see it as cost effective or necessary to insure these benefits externally and this is seen as a pragmatic and low-cost approach to spreading the risk.

In some circumstances it may be desirable to group or pool a number of similar employers within the Fund together for funding purposes (i.e. to calculate employer contribution rates). Reasons might include:

- reduction of volatility of contribution rates for small employers, facilitating situations where employers have a common source of funding or accommodating employers who wish to share the risks related to their participation in the Fund, or
- small outsourcings where the outsourcing employer wishes the service provider / contractor to be given either the same contribution rate as the outsourcing body or the fixed contribution rate agreed contractually, or
- employers have been grouped for practical or commercial reasons.

The Administering Authority recognises that grouping/pooling of employers can give rise to cross subsidies from one employer to another over time. The Administering Authority's policy is to consider the position carefully at each Actuarial Valuation and to notify each employer that is grouped that this is the case, and that grouping/pooling of employers will only occur with the consent of the employers involved. If the employer objects to this grouping, it will be set its own contribution rate. For employers with more than 50 contributing members, the Administering Authority would look for evidence of homogeneity between employers before considering grouping. For employers whose participation is for a fixed period grouping is unlikely to be permitted, unless the grouping is with the letting authority for the purpose of risk sharing arrangements.

As at the date of writing this Statement, there are a number of employers grouped with the London Borough of Southwark for funding purposes, and each Multi-Academy Trust is treated as a group in relation to the individual academies within the Trust.

## Pass-through and Risk sharing

The pensions risk of a number of admission bodies is underwritten by London Borough of Southwark, and in return the employer's contribution is fixed at the rate set at the employer's initial entry to the Fund. This fixed rate may be subject to certain provisos in the Admission Agreement.

Such employers will be required to sign an agreement with Southwark Council which will set out the contributions to be paid. Where an employer has this "pass-through" arrangement in place with the London Borough of Southwark, no exit credit or payment will be made, and all assets and liabilities will be subsumed by the London Borough of Southwark upon exit.

## Guarantors

### Guarantees from employers participating in the Fund

Some employers may participate in the Fund by virtue of the existence of a Guarantor. The Administering Authority maintains a list of employers and their associated Guarantors. The

Administering Authority, unless notified otherwise, sees the duty of a Guarantor to include the following:

- If an employer exits the Fund and defaults on any of its financial obligations to the Fund, the Guarantor is expected to provide finance to the Fund such that the Fund receives the amount certified by the Fund Actuary as due, including any interest payable.
- If the Guarantor is an employer in the Fund and is judged to be of suitable covenant by the Administering Authority, the Guarantor may subsume the residual liabilities into its own pool of Fund liabilities. In other words, it agrees to be a source of future funding in respect of those liabilities.

During the period of participation of the employer a Guarantor can at any time agree to the future subsumption of any residual liabilities of an employer. The effect of that action may be to change the funding target for the employer, which could lead to reduced contribution requirements.

### **Guarantees from relevant public bodies and others**

Some employers in the Fund have guarantees from external public bodies.

In particular, academies and colleges have a guarantee from the Department for Education. This guarantee means that the Fund treats these employers for funding purposes in a similar way to the secure (tax raising) scheduled bodies.

Other guarantees from external bodies will be assessed individually by the Administering Authority, with advice from the Fund Actuary and having received specialist covenant advice if appropriate, to determine the impact on the funding approach for the relevant employers.

## **Link to Investment Strategy Statement**

Funding and investment strategy are closely linked. Investment strategy is set by the Administering Authority after taking investment advice.

The Administering Authority has produced this FSS having taken an overall view of the level of risk inherent in the investment policy set out in the Investment Strategy Statement (ISS) published under Regulation 7 of the Investment Regulations and the funding policy set out in this FSS.

Funding is defined as the making of advance provision to meet the cost of accruing benefit promises. Members' contributions are set by the Regulations at a rate which covers only part of the cost of accruing benefits. Investment income meets a further part of the cost. Employers pay the balance of the cost of delivering the benefits to the members. Decisions regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made, and if investment returns or income are lower than expected, then higher employer contributions may be needed.

The investment strategy should therefore take account of the liability profile and funding position. The discount rate is calculated based on the strategic asset allocation, and so it is important to consider the consequent changes in funding position and solvency objective when setting investment strategy.

Equally, the funding strategy allows for the investment strategy when setting the discount rate (which is based on expected investment returns on the Fund's long-term investment strategy).

The Investment Strategy Statement currently states:

*"In setting the investment strategy the Fund seeks to balance twin objectives: first, to achieve sufficient long-term returns for the Fund to be affordable and second, to keep the employers' contribution rate as stable as possible.*

*The Fund will seek to operate a long term, sustainable strategy; one which does not rely upon the pursuit of short-term returns or adherence to asset management trends but utilises a well-structured asset and fund manager investment allocation to target long term socially responsible investment performance. The Fund’s uncomplicated investment structure provides significant flexibility and adaptability if required.*

*To achieve the twin objectives, the Fund needs to invest in a diverse range of assets which provide higher returns relative to the growth of pension liabilities whilst taking account of the volatility inherent in investment markets.”*

The 2025 Actuarial Valuation was based on the following high-level strategic asset allocation:

Main asset classes	Strategic allocation (used for 2025 valuation)
Global Equities	32.5%
Emerging Market Equities	5.0%
Private Equity	2.5%
UK Index Linked Gilts	22.5%
Property	20.5%
Multi Asset Credit	10.0%
Infrastructure	7.0%

The Administering Authority will continue to monitor the suitability of the investment policy in light of the Fund’s developing liabilities and finances. The Administering Authority will continue to review the FSS and the ISS to ensure that the overall risk profile remains appropriate. Such reviews may use asset liability modelling or other analysis techniques.

See the Investment Strategy Statement

(<https://www.southwarkpensions.co.uk/media/hj3fvluu/investment-strategy-statement-1.pdf> ) for more information

Should an employer request it, the Administering Authority may examine ways of providing individual employers, at their own risk and cost, with an investment strategy that may be more tailored to their individual liabilities. The implementation of a bespoke investment policy for an individual employer, or group of employers, will be at the Administering Authority’s discretion.

## Setting employer contributions

As part of each Actuarial Valuation, separate employer contribution rates are assessed by the Fund Actuary for each participating employer or group of employers. The Administering Authority also monitors the position and may amend contributions between Actuarial Valuations as permitted by Regulations 64(4) and 64A. Further details of the Administering Authority’s policy in relation to reviewing contributions are set out in Appendix 3.

Employer contribution rates are set using the same Funding Target assumptions as for the liabilities.

Employer contributions are made up of primary and secondary contributions, which together make up the total contributions for each employer. The employer contributions are specified in the rates and adjustments certificate included with each Actuarial Valuation, and/or in any updates to the certificate between Actuarial Valuations.

The Actuarial Valuation report also shows a weighted average contribution rate based on the whole Fund payroll, both the average percentage rates payable and a total amount in respect of

cash adjustments. The purpose of this is to show a single rate of contributions expected to be received by the Fund over each of the three years that can be readily compared with other funds and reconciled with actual receipts.

## Primary contributions

For open employers (i.e. those who still admit new members) the Projected Unit method is used in the Actuarial Valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the primary contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period, over and above members' own contributions.

For employers who no longer admit new members (closed employers), the Attained Age valuation method is normally used. This means that the primary contribution rate is derived as the average cost of benefits accruing to members (over and above their own contributions) over the period until they die, leave the Fund or retire.

## Secondary contributions

Where an employer has a surplus or a deficit, a positive or negative adjustment to the primary contribution rate is needed to arrive at the total contributions each employer is required to pay (this requirement is modified where a "surplus buffer", as described in the section on Removal of surplus, is in operation). This adjustment is called the secondary contribution. The secondary rate may be expressed as a lump sum payment or as a percentage of payroll.

## Recovery Periods

The recovery period is the time period over which the secondary contribution is payable.

The recovery period applicable for each employer is set by the Fund Actuary in consultation with the Administering Authority, and having regard to representations from the employer where appropriate, taking into consideration the following:

- The aim to keep employer contribution rates stable
- The need to maintain solvency, which is consistent with a desire to set deficit recovery periods as short as possible
- The covenant of the employer, and any guarantee or subsumption agreement from another employer in the Fund
- The expected period of participation in the Fund of the employer
- Representations received from the employer and any Scheme Employer or guarantor
- The risk associated with adopting a recovery period for recovery of deficit (rather than requiring immediate payment), which increases as longer deficit recovery periods are chosen. The risk is that, by adopting this approach, relatively little action is taken to restore full funding between Actuarial Valuations.

In particular:

- The Administering Authority has agreed with the Fund Actuary a maximum deficit recovery period of 30 years for employers which are assessed by the Administering Authority as being a long-term secure employer. At the 2022 Actuarial Valuation, the default deficit recovery period was 20 years.
- Where there is a deficit for employers over successive valuations, the aim will be to set the recovery period in successive valuations so that the existing deficit continues to target the same date of recovery, whilst new emerging deficits are recovered as set out in this section, and balancing this with the desire for stability in employer contribution.

- The default surplus spreading period is 20 years, unless the employer has a fixed term of participation in the Fund in which case the remaining period of participation will be used.
- The Administering Authority and Fund Actuary would be unlikely to agree to a Recovery Period longer than the remaining term of participation.
- For employers that are closed to new entrants and do not have a fixed term of participation, the recovery period will generally be set to be the future working lifetime of the remaining active members.
- For any employers that have entered into a deferred debt agreement, the recovery period will generally be set equal to the remaining period of the deferred debt agreement.
- When considering recovery periods for employers, the Administering Authority may apply an underpin to ensure that the overall contribution does not reduce from the previous Actuarial Valuation whilst that employer continues to be in deficit.

### **Removal of surplus**

Consistent with a desire to keep employer contribution rates as stable as possible, and the requirement to maintain solvency for the Fund, the surplus allowed for in the calculation of the secondary contribution shall generally only apply to surplus in respect of an employer funding level above a certain threshold or “surplus buffer”, which was 110% at the 2025 valuation. The Administering Authority will review this threshold level every three years in conjunction with the actuarial valuation and may amend the threshold or disapply this element of the strategy if it considers it appropriate to do so, having regard to the overall desirability of stability of contributions, and balancing fairness to participating employers and funding risks.

The period over which any surplus is removed will generally be set in line with the Recovery Periods section above.

### **Phasing in of contribution rates**

Consistent with a desire to keep employer contribution rates as stable as possible, the Administering Authority will consider, at each Actuarial Valuation, whether new contribution rates should be payable immediately, or reached by a series of steps over future years (this could be an increase or decrease in employer contribution rates).

The Administering Authority will discuss with the Fund Actuary the risks inherent in such an approach and will examine the financial impact and risks associated with each employer. The Administering Authority’s policy is that for employers increasing their contributions, generally no more than three equal annual steps (i.e. the valuation period) will be permitted. Further steps or unequal steps may be permitted at the Administering Authority’s discretion, but the total number of steps is unlikely to exceed six steps. Where contributions are being stepped down, no limit will be set to phasing in contribution rates.

### **Grouped/Pooled employers**

The assets and liabilities for employers will allow for any assets and liabilities the employer has agreed to subsume relating to employers who have exited or have been taken over / merged as a result of reorganisation. This will include employers who have exited and had a subsumption guarantee from another employer, and academies and schools who join a MAT.

Where employers are grouped or pooled for funding purposes, employer contributions will be set allowing for the grouping/pooling.

As at the date of writing this Statement, there are a number of employers grouped with the London Borough of Southwark for funding purposes, and each Multi-Academy Trust is treated as a group in relation to the individual academies within the Trust.

### **Pass-through/risk shared employers**

Where a pass-through or other risk sharing arrangement is in place, employers should refer to the wording of their specific arrangement.

## Advance payment of contributions

The Administering Authority may, after considering the advice of the Fund Actuary, permit particular employers to pay contributions early as a lump sum that would otherwise be payable over the following year (or a longer period not exceeding three years). Pre-payments can be made annually or triennially in advance and will attract a discount on employer contributions as agreed with the Administering Authority on the advice of the Fund Actuary. Any employer wishing to enter into a pre-payment arrangement must engage with the Administering Authority prior to the triennial Actuarial Valuation report and rates and adjustments certificate being finalised.

## Additional contributions

Employers will have to pay additional contributions to the Fund when granting additional member benefits:

- Awards of additional pension
- Retirement before normal retirement age on unreduced benefits (e.g. on redundancy), commonly called "strain costs"

## Conflicts of interest

In relation to funding, the following measures are in place:

- Maintenance of a log of interests and declarations of Pensions Advisory Panel members in key meetings
- The Pensions Advisory Panel assisting the Strategic Director of Resources (the Chief Finance Officer or CFO) in agreeing high-level principles of funding strategy, and actuarial assumptions which apply to all employers, rather than making recommendations to the Strategic Director of Resources on individual employer rates. The Fund Actuary will calculate resulting employer rates based on those high-level decisions around risk appetite and objectives
- The actuarial team advising the Fund does not provide actuarial advice to participating employers, with agreed conflict of interest protocols
- The Fund Actuary is subject to professional standards which requires them to only certify contribution rates which are sufficiently prudent and in line with the Regulatory requirements
- There is central oversight of the valuation process and whether it meets the requirements of solvency and long-term cost efficiency from the Government Actuary's Department review under Section 13 of the Public Service Pensions Act.

## Monitoring employer covenant

The Administering Authority monitors employer risk/covenant.

- For tax raising bodies, covenant is taken to be high
- For employers with a guarantee or subsumption commitment from another employer in the Fund, the covenant of the guarantor is considered.
- For other employers, a risk assessment would be carried out as set out below. At time of writing, there are no such employers in the Fund who require this level of assessment.

## Employer risk assessment

The Administering Authority assesses employer risk on an ongoing basis. This consists of looking at various metrics such as the type of employer, funding sources, any guarantees, and the expected length of participation.

For some employers, a more detailed risk or covenant assessment may be considered appropriate. In such cases, the Administering Authority will request advice from a covenant specialist.

## Link to Administration Strategy

Employers must comply with the Fund's administration strategy (<https://www.southwarkpensions.co.uk/media/xgoh2vzl/southwark-administration-strategy-2021.pdf>), and have regard to other relevant policies published on the Fund's website.

In particular, employers should note that it is important to provide accurate and timely data to the Administering Authority, so that the funding strategy can be implemented correctly.

The Administering Authority expects all employers in the Fund to take into consideration the effect of their behaviours on the Fund, for example when considering:

- Discretions policies
- Outsourcing decisions
- Salary increases

All employers need to inform the Fund of any changes to the organisation that will impact on their participation in the Fund. This includes change of name or constitution, mergers with other organisations, or other decisions which will or may materially affect the employer's Fund membership.

Employers considering outsourcing any services should have regard to and adhere to the requirements of the Best Value Authorities Staff Transfer (Pensions) Direction 2007. They should also advise the Administering Authority at the earliest opportunity and before any transfer of staff so that the necessary paperwork and calculations can be completed.

## Employer events

### Joining the Fund

Some employers are entitled to join the Fund under Schedule 2 of the LGPS 2013 Regulations. Other employers may apply to the Administering Authority for admission, and if admitted they will become an Admission Body in the Fund.

#### Initial notional asset transfer

When a new employer starts in the Fund, and members transfer from another employer in the Fund, a notional transfer of assets is needed from the original employer to the new employer. Information on how this is calculated is set out in Appendix 2.

### Employer contributions

#### Initial contribution rate

When a new employer joins the Fund, the Fund Actuary determines the initial employer contribution rate payable from the new employer's commencement date. Information on how this is calculated is set out in Appendix 2.

#### Review of contributions

The Regulations require a triennial Actuarial Valuation of the Fund. As part of each Actuarial Valuation separate employer contribution rates are assessed by the Fund Actuary for each participating employer or group of employers and may be increased or reduced.

The Administering Authority also monitors the position and may amend contributions between triennial Actuarial Valuations as permitted by Regulations 64(4) and 64A. The Fund's policy on contribution reviews is set out in Appendix 3.

### Bonds and other securitisation

Schedule 2 Part 3 Paragraph 6 of the Regulations creates a requirement for a new admission body to carry out to the satisfaction of the Administering Authority (and the Scheme Employer in the case of a body admitted under Schedule 2 Part 3 Paragraph 1(d)(i) of the Regulations) an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.

The Administering Authority's policy on managing risks associated with new Admissions, including requirements for bonds and other securitisation, is included in Appendix 2.

### Exit of an employer from the Fund

Where an employer exits the Fund, an exit valuation will be carried out by the Fund Actuary in accordance with Regulation 64.

The Funding Target used for the exit valuation will depend on the circumstances on exit and/or the type of employer exiting the Fund.

The exit valuation may reveal either a surplus or a deficit, and how these are dealt with is set out in Appendix 4.

### Deferred Employers

In certain circumstances it may be agreed to enter into a deferred debt agreement rather than require an immediate exit payment. In that case, the employer would remain a participating body as a deferred employer.

Further details of the Administering Authority's policy for deferred debt agreements are set out in Appendix 4.

## Suspension notices

Regulation 64(2A) permits the suspension of the requirement to carry out an exit valuation for a period of up to 3 years where the Administering Authority believes that the employer is likely to have one or more active members contributing to the Fund within the period specified in the suspension notice.

Further details of the Administering Authority's policy for suspension notices are set out in Appendix 4.

## Partial terminations

A partial termination occurs where an employer exits the Fund in respect of non-active members only.

Further details of the Administering Authority's policy for partial terminations are set out in Appendix 4.

## Bulk transfers

A bulk transfer occurs when more than 2 or more members transfer to another registered pension scheme under Regulation 98, or where 10 or more members transfer to or from another LGPS fund under Regulation 103(3).

The steps that are normally involved in a bulk transfer are as follows:

- The actuaries of the two funds/schemes agree the membership and data of the members transferring.
- The actuary of the original fund/scheme proposes a basis for a transfer payment, usually set out in an "actuary's letter". Where this is under Regulation 98, this will also cover the service credits to be granted.
- The actuaries of the two funds/schemes, together with the funds and the relevant employers, negotiate and agree the final basis for the transfer payment, and a final actuary's letter is produced and signed.
- Example calculations are carried out and agreed between the actuaries.
- A payment date is agreed, and final payment is made.

In general, where a bulk transfer out of the Fund is occurring:

- Where all membership of an employer is transferring, the proposal for the asset transfer will be the total asset share of the employer.
- Where all of the active members of an employer are transferring, but non-actives are remaining in the Fund, the proposal for the asset transfer will be the total asset share of the employer less the value of the liabilities in respect of the non-active membership valued using the funding target for orphan liabilities.
- Where part of the active membership of an employer is transferring, but the employer will remain a participating employer in the Fund, the proposal for the asset transfer will be determined by applying the funding level of the employer to the transferring liabilities, where the liabilities are calculated on the ongoing basis appropriate to that employer at the transfer date.

## Appendix 1: Key Risks

The Administering Authority has an active risk management programme in place. The Administering Authority will monitor the risks to the Fund and will take appropriate action to limit the impact of these before, and after they emerge, wherever possible. The risks most likely to impact on the funding strategy and measures that the Administering Authority has in place to control those risks are summarised below.

### Economic risk

Economic risks can affect both assets and liabilities.

The main risks affecting the liabilities include interest rates and price inflation. The Administering Authority will ensure that the Fund Actuary investigates these matters at each Actuarial Valuation or, if appropriate, more frequently, and reports on developments. The Administering Authority will agree with the Fund Actuary any changes necessary to the assumptions used to calculate the liabilities to allow for observed or anticipated changes.

Interest rates, inflation, and wider macro-economic risks can also affect the assets held. In addition, the assets may not be affected in the same way as the liabilities. Investment risk is covered in more detail below.

If significant funding changes become apparent between Actuarial Valuations, the Administering Authority will notify all participating employers of the anticipated impact on costs that will emerge at the next Actuarial Valuation and consider whether any bonds in place for Admission Bodies require review.

### Investment risk

This covers items such as the performance of financial markets and the Fund's investment managers, asset reallocation in volatile markets, leading to the risk of investments not performing (income) or increasing in value (growth) as forecast. Examples of specific risks would be:

- assets not delivering the required return (for whatever reason, including manager underperformance)
- systemic risk with the possibility of interlinked and simultaneous financial market volatility
- insufficient funds to meet liabilities as they fall due
- inadequate, inappropriate or incomplete investment and actuarial advice is taken and acted upon
- counterparty failure

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income - yield curve, credit risks, duration risks and market risks
- alternative assets – liquidity risks, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risk
- macroeconomic risks

The Administering Authority invests a substantial proportion of the Fund in assets which are expected to offer higher long-term rates of return on average but can be more volatile. This short-term volatility in returns can result in volatility in funding positions and employer contributions.

The Fund mitigates these risks through diversification, investing in a wide variety of markets and assets, as set out in the ISS.

Producing low volatility in employer contributions would require material investment in "matching" assets for the liabilities, i.e. investing in very secure assets that behave in a similar

way to the liabilities as economic conditions alter (e.g. long-dated index-linked gilt investments). However, a matched strategy could increase employer contributions from their current levels.

The Fund Actuary sets the discount rate by taking into account expected returns and volatility of each asset class in the long-term investment strategy. This can help mitigate the risk in that movements in asset values typically impact expected returns on those asset classes, and liabilities should move in a similar way to the assets, helping to manage the impact on the funding position.

The Administering Authority or the Asset Pool reviews each investment manager's performance regularly. The Administering Authority also regularly considers the asset allocation of the Fund by carrying out an annual asset allocation review. The Administering Authority also regularly reviews the effect of market movements on the Fund's overall funding position.

## Demographic risk

The main demographic risks that may affect the liabilities include life expectancy, changing retirement patterns and other demographic risks. The Administering Authority will ensure that the Fund Actuary investigates these matters at each Actuarial Valuation or, if appropriate, more frequently, and reports on developments. The Administering Authority will agree with the Fund Actuary any changes necessary to the assumptions used to calculate the liabilities to allow for observed or anticipated changes.

If significant liability changes become apparent between Actuarial Valuations, the Administering Authority will notify all participating employers of the anticipated impact on costs that will emerge at the next Actuarial Valuation and consider whether any bonds in place for Admission Bodies require review.

Where it appears likely to the Administering Authority that for an employer the amount of the liabilities arising or likely to arise has changed significantly since the last Actuarial Valuation, the Administering Authority may consider revising an employer's contributions as permitted by Regulation 64A in line with the Administering Authority's policy.

## Climate risk

The systemic risks posed by climate change and the policies implemented to tackle them will fundamentally change economic, political and social systems and the global financial system. They will impact every asset class, sector, industry and market in varying ways and at different times, creating both risks and opportunities for investors. The Administering Authority keeps the effect of climate change on future investment returns under review and will commission advice from the Fund Actuary on the potential effect on funding as required.

The impact on financial markets and life expectancy / morbidity will also impact the value placed on the liabilities, which can also significantly change the funding level and any surplus or deficit, and the resulting employer contributions. At the 2022 Actuarial Valuation the Fund Actuary carried out scenario analysis to assess the resilience of the funding strategy to climate change risk over an agreed period. This demonstrated potential funding level outcomes under different scenarios based largely on the speed of government transition to environmental policies and regulation to manage global warming, and the resulting impact on carbon prices, global temperature increases and financial markets. This analysis has helped support funding strategy and risk management considerations for the 2025 valuation and investment strategy.

At the 2025 Actuarial Valuation and subsequent Investment Strategy review, Aon's Fund Actuary and Investment Consultants used Aon's Capital Market Assumptions to formulate their actuarial and investment advice to the Fund. The Capital Market Assumptions incorporate client related factors into financial market assumptions and are used to try to ensure the financial health of the Fund in a number of different economic and climate scenarios.

In addition, the Fund has made a number of investments in assets which have a primary objective to provide a financial return, but which are also designed to have a positive impact on climate and the energy transition. The Fund regularly reports its carbon emissions and engages with its investment managers to lower these in line with the Paris Agreement.

## Liquidity and maturity risk

Changes to the LGPS may impact upon the maturity profile of the Fund and have potential cash flow implications. The increased emphasis on outsourcing and other alternative models for service delivery may result in the following:

- active members leaving the Fund
- transfer of responsibility between different public sector bodies
- scheme changes which might lead to increased opt-outs
- spending cuts and their implications

All of these may result in workforce reductions that would reduce membership, reduce contributions and prematurely increase retirements in ways that may not have been taken into account in previous forecasts.

The Fund recognises that permitting the Solvency Target to be achieved over a period (the recovery period) rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements.

The Administering Authority's policy is to require regular communication between itself and employers and to ensure reviews of maturity at overall Fund and employer level where material issues are identified.

The Fund's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of recovery period to no longer than 30 years.

For closed employers, the Recovery Period will only be permitted to exceed the future working lifetime of the active members as calculated by the Fund Actuary in exceptional circumstances. This limits the exposure of the Fund to potential adverse consequences which can arise due to increasing volatility of contribution requirements for the closed employer as membership declines.

## Regulatory/compliance risk

The risks relate to changes to general and LGPS specific regulations, national pension requirements or HM Revenue and Customs' rules.

The Administering Authority will keep abreast of all proposed changes. If any change potentially affects the costs of the Fund, the Administering Authority will ask the Fund Actuary to assess the possible impact on costs of the change. Where significant, the Administering Authority will notify Employers of the possible impact and the timing of any change.

There are a number of uncertainties associated with the benefit structure at the time this FSS was last updated, in particular:

- The outcome of the cost management process as at 31 March 2024.
- The Goodwin case in which an Employment Tribunal ruled (in relation to the Teachers' Pension Scheme) that the less favourable provisions for survivor's benefits of a female member in an opposite sex marriage compared to a female in a same sex marriage or civil partnership amounts to direct discrimination on grounds of sexual orientation. At the time of writing this statement, draft Regulations (The Local Government Pension Scheme (Miscellaneous Amendments) Regulations 2025) are under consultation and include changes to reflect the ruling.

- The impact of the McCloud underpin to 2014-2022 pensions for those who joined the LGPS before 1 April 2012, particularly where full data is not yet available.
- The court judgement in Virgin Media v NTL Pensions Trustees may have some implications for the LGPS.

In determining how these uncertainties should be allowed for in employer contributions the Administering Authority will have regard to guidance issued by the SAB, taking account of the Fund Actuary's advice.

For the purposes of the 2025 Actuarial Valuation, an approximate employer specific allowance will be made in respect of the McCloud remedy based upon a high-level analysis of the employer's fund membership.

An approximate allowance will also be made for the purposes of the 2025 Actuarial Valuation to allow for the potential additional liabilities arising from the Goodwin case.

## Employer data quality risk

Actuarial calculations such as triennial Actuarial Valuations, employer contribution rates, and exit valuations, rely on accurate data being supplied.

Where data quality is low, there is a risk that these calculations are not as accurate, which could lead to employer contributions and/or exit payments being set too high or too low.

The Fund Actuary carries out data validation to assess the quality of the data in advance of each triennial Actuarial Valuation. Where required, the Fund Actuary and the Administering Authority will agree an approach for data that is not of the highest quality. For example, this may take the form of estimating missing data items from other available items of data.

## Governance risk

This covers the risk of unexpected structural changes in Fund membership (for example the closure of an employer to new entrants or the large-scale withdrawal or retirement of groups of staff), and the related risk of the Administering Authority not being made aware of such changes in a timely manner.

The policy is to require regular communication between the Administering Authority and employers and to ensure regular reviews of such items as bond arrangements, financial standing of non-tax raising employers and funding levels.

## Orphan liability risk

This risk arises from the risk of employers leaving the Fund and leaving orphaned liabilities. In addition, there is also a risk that deficits might arise in respect of already orphaned liabilities.

In the cases of such employers who will ultimately exit and leave orphan liabilities, funding targets will be set to target the assumed exit position, to reduce the risk of deficits arising on exit.

The Administering Authority will seek to minimise the risk to other employers in the Fund that any deficit arises on the orphan liabilities such that this creates a cost for those other employers to make good the deficit. To give effect to this, the Administering Authority will seek funding from the outgoing employer sufficient to enable it to match the liabilities with low-risk investments, generally UK Government fixed interest and index linked bonds.

## Employer covenant risk

These risks arise from the ever-changing mix of employers, from short-term and ceasing employers, and the potential for a shortfall in payments and/or orphaned liabilities where employers are unable to meet their obligations to the Fund.

The Fund has a Funding Strategy Statement which contains sufficient detail on how funding risks are managed in respect of the main categories of employer and other pension fund stakeholders.

The Administering Authority monitors employer payments and expects employers to engage with the Fund where their circumstances have changed, noting that contributions can be reviewed between triennial Actuarial Valuations if the conditions in Regulations 64A and the terms of the Administering Authority's policy as set out in Appendix 2 are met.

The Administering Authority will maintain a knowledge base on employers, their basis of participation and their legal status (e.g., charities, companies limited by guarantee, group/subsidiary arrangements) and will use this information to inform the FSS.

The Administering Authority monitors employer covenant as set out earlier in the FSS.

## Appendix 2: Employer Funding Policy

This Policy explains the policies and procedures of the Fund in the treatment of employers including on commencement or admission and participation of employers in the Fund.

It should be noted that this statement is not exhaustive and circumstances specific to individual employers may be taken into consideration where appropriate.

Where the information relates to a particular type of employer, this will be explained. If no type of employer is indicated the information relates to all employers in the Fund.

The Administering Authority's aim is to minimise risk to the Fund by ensuring that the employers participating in the Fund are managed in a way that ensures they are able to adequately fund the liabilities attributable to them and, in particular, to pay any deficit due when exiting the Fund.

The Administering Authority has an obligation to pursue all liabilities owed so that any shortfall from an individual employer does not fall back on other employers.

### Commencement process for Admission Bodies

An employer who wishes to join the fund may apply to the Administering Authority for admission. If admitted, that employer becomes an Admission Body and specified categories of its employees can participate as members of the Fund.

The Administering Authority is responsible for deciding whether an application from an employer to become an Admission Body within the Fund should be declined or accepted.

### Bond, Indemnity or Guarantee

It is important to minimise the risk that a new Admission Body might create for the Fund and the other employers in the Fund. This risk will be taken into account by the Administering Authority in considering the application for admission, who may put in place conditions on any approval of admission to the Fund to minimise this risk, such as a satisfactory guarantee, indemnity or bond and a satisfactory risk assessment.

An indemnity / bond is a way of insuring against the potential cost of the Admission Body failing by reason of insolvency, winding up or liquidation and hence being unable to meet its obligations to the Fund.

In order to reduce the risk of the liabilities not being funded at the point of exit, the Regulations require that a risk assessment be carried out, taking account of actuarial advice, on the level of risk arising on premature termination on insolvency, winding up or liquidation. This assessment is carried out by the Admission Body to the satisfaction of the Administering Authority. In an outsourcing situation, the risk assessment must also be to the satisfaction of the Scheme Employer (i.e. the employer that the outsourcing is coming from). Usually, the actuarial advice is provided to the Administering Authority by the Fund Actuary and the cost for this is recharged to the Admission Body or, where appropriate, to the scheme employer.

Where the level of risk identified by the assessment is such as to require it the Admission Body shall enter into an indemnity or bond with an appropriate party. Where it is not desirable for an Admission Body to enter into an indemnity or bond, the body is required to secure a guarantee in a form satisfactory to the Administering Authority from an organisation who either funds, owns or controls the functions of the Admission Body.

The Administering Authority's approach to indemnities and bonds is as follows:

- In the case of Admission Bodies admitted under paragraph 1(d) of Part 3 of Schedule 2 of the LGPS Regulations and other Admission Bodies with a Guarantor, and so long as the Administering Authority judges the relevant Scheme Employer or Guarantor to be of sufficiently sound covenant, any bond exists purely to protect the relevant Scheme Employer on default of the admission body. As such, it is entirely the responsibility of the

relevant Scheme Employer or Guarantor to arrange any risk assessments and decide the level of required bond. The Administering Authority will be pleased to supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer, but this should not be construed as advice to the relevant Scheme Employer on this matter.

- In the case of Admission Bodies admitted under paragraph 1(e) of Part 3 of Schedule 2 of the LGPS Regulations, or under paragraph 1(d) where the Administering Authority does not judge the Relevant Scheme Employer to be of sufficiently strong covenant, and other Admission Bodies with no Guarantor or where the Administering Authority does not judge the Guarantor to be of sufficiently strong covenant, the Administering Authority must be involved in the assessment of the required level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed the level of bond cover. The Administering Authority will supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer form a view on what level of bond would be satisfactory. The Administering Authority will also on request supply this to the Admission Body or Guarantor. This should not be construed as advice to the Scheme Employer, Guarantor or Admission Body.
- Given the existing funding guarantee from the Department of Education, the Administering Authority may decide that a bond is not required for Academy outsourcing admission bodies under a pass-through arrangement (for more information on Academy outsourcings please see below).
- The Administering Authority notes that levels of required bond cover can fluctuate and will review, or recommends the Scheme Employer reviews, the required cover regularly, ideally annually.

Where the liabilities on exit from the fund cannot be fully met by a guarantor or insurer, the Regulations provide that:

- the Scheme Employer will be liable in an outsourcing situation; and
- in all other cases the liabilities will fall on all the other employing authorities within the Fund.

## Pass-through and risk sharing

### London Borough of Southwark group

The pensions risk of a number of admission bodies is underwritten by London Borough of Southwark, and in return the employer's contribution is fixed at the rate set at the employer's initial entry to the Fund. This fixed rate may be subject to certain provisos in the Admission Agreement or separate risk sharing agreement.

Such employers will be required to sign an agreement with London Borough of Southwark which will set out the contributions to be paid. Where an employer has this "pass-through" arrangement in place with the London Borough of Southwark, no exit credit or payment will be made, and all assets and liabilities will be subsumed by the London Borough of Southwark upon exit.

The full list of active employers that, at the time of writing, have a risk sharing (or "pass-through") arrangement with the London Borough of Southwark is below:

- AiP - Ivydale School
- Aspens Services LTD - St Joseph's RC
- Aspens Services LTD - Newlands Academy
- Brandon Trust
- Browning Tenant Management
- Energy Kidz
- KGB Cleaning (Southwest) - Bacons College
- Lunchtime Company (Lunchtime-Charles Dickens)

- Nourish Contract Catering (New)
- PFI VEOLIA ES
- South London Gallery - SLG
- Southwark Law Centre
- Westgate Cleaning – Bird in Bush

## Academy outsourcings

The Department for Education (DfE) published its policy on providing a guarantee in academy outsourcing arrangements on 17 May 2023. This extended the existing DfE funding guarantee for academies' pension fund liabilities to also automatically cover academy outsourcings, i.e. where an academy enters into a contract with a third-party provider to provide services such as catering or cleaning, where the academy remains responsible for the funding of the pensions liabilities and assets in respect of the outsourcing. This covers:

- Academy Trust LGPS eligible staff who are transferred to a contractor on outsourcing, including when those staff are transferred in subsequent generation outsourcings
- Local authority school LGPS eligible staff who transferred to a contractor before academy conversion, and then the contract passed to the academy on conversion
- Local authority LGPS eligible staff who provide services to the academy under a contract, and the staff are transferred to a third-party provider under a new contract.

Given this policy and Guarantee, employers admitted to the Fund as a result of academy outsourcings will be pooled under a "pass-through" arrangement with the scheme employer (i.e. the outsourcing academy/Multi Academy Trust) for the purposes of funding and setting employer contribution rates.

There will be no notional allocation of assets from the scheme employer to the admission body on commencement of the contract.

On admission the contractor will pay the primary contribution rate payable by the scheme employer i.e. Academy/MAT.

Academy outsourcings will have contributions recalculated at each triennial valuation (and any other time as appropriate) based on the combined funding position and/or primary contribution rate for the scheme employer (i.e. the Academy or Multi Academy Trust). There will be no separate calculation of funding position or employer contributions for these admission bodies.

On exit of the employer, assets and liabilities of the admission body will be subsumed by the Academy/Multi Academy Trust. As a result, no exit deficit or credit would be due, and no exit valuation would be needed (although the Fund Actuary will provide a formal confirmation of the position to satisfy the regulatory requirements). At the time of writing, there are no employers who fall into this category.

## Actuarial calculations

### Funding Target

The Funding Target relates to what is expected to happen to the liabilities in respect of the employees of the employer on exit of that employer. See the "Key Funding" section of this document for more information on Funding Targets.

The Funding Target used for any particular employer will determine the level of assets transferred to the employer in respect of transferring members, and the level of contributions required to be paid by the employer.

### Initial notional asset transfer

When a new employer starts in the Fund, and/or when members transfer from another employer in the Fund, a notional transfer of assets is needed from the original employer to the new employer.

When a new Admission Body starts in the Fund, they will usually start as fully funded. This means that any past service surplus or deficit for the members who are transferring to the new employer remains with the original employer and does not transfer to the new employer.

Another option for the initial notional asset transfer is to allow for the funding level of the original employer, and therefore to transfer any past service surplus or deficit in respect of the transferring membership to the new employer. This approach would normally apply to new Scheduled Bodies.

Where a school is converting to an academy and an asset transfer is required from the London Borough of Southwark as the Local Authority, the following standard approach is taken:

- Liabilities will be allocated to the academy/MAT in relation to its current employees only, with the London Borough of Southwark retaining liability for former employees.
- A share of fund approach is adopted by the Fund Actuary in notionally re-allocating assets from the London Borough of Southwark to the academy / MAT subject to ensuring the liabilities for the former employees are fully funded, and subject to a maximum transfer of assets equal to the transferring liabilities.

Where an employer has a “pass-through” arrangement with the London Borough of Southwark (or an academy/ Multi Academy Trust), no initial asset transfer occurs as the London Borough of Southwark (or the academy/ Multi Academy Trust) retains responsibility for funding the past service pension liabilities in respect of the transferring members.

## **Initial employer contribution rate**

When a new employer joins the Fund, the Fund Actuary determines the initial employer contribution rate payable from commencement.

When setting the employer contribution rate the following elements will be taken into consideration:

- Any past service or inherited liabilities.
- Whether the new employer is open or closed to new entrants.
- For Admission Bodies, whether the admission agreement is fixed term or not, and the period of any fixed term contract period.
- Other relevant circumstances.

## **London Borough of Southwark pass-through employers**

Admitted Bodies subject to the pass-through arrangement with London Borough of Southwark will be set a fixed contribution rate, equal to the primary rate advised by the Fund Actuary based on the market conditions and membership on commencement.

This rate will be fixed for the contract duration and will not vary at subsequent triennial valuations, in order to provide certainty on pensions costs to contractors bidding for outsourcing contracts (i.e. to avoid pensions risk being built into the contract price).

## **Academy outsourcing pass-through employers**

On admission the contractor will pay the primary contribution rate payable by the Scheme employer i.e. Academy/MAT. This is consistent with the pass-through arrangement i.e. the contractor does not take on any responsibility for historic Scheme Employer deficit/surpluses or future deficit/surplus arising.

## **Varying the employer contribution rate**

The Regulations require a triennial Actuarial Valuation of the fund. As part of each Actuarial Valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers and may be increased or reduced.

The Administering Authority also monitors the position and may amend contributions between valuations as permitted by Regulations 64(4) and 64A. The Administering Authority will consider reviewing employer contributions between formal valuations in certain circumstances. The policy on contribution rate reviews is set out in Appendix 3.

## Employer exit from the Fund

An employer can cease participation in the following circumstances:

- An employer ceases to be a Scheme employer (including ceasing to be an Admission Body participating in the Fund) or has no active members contributing to the Fund and does not enter into a Deferred Debt Agreement.
- A Deferred Debt Agreement ends (where an employer has agreed to enter a Deferred Debt Agreement).

The Administering Authority's policy on exit valuations, exit payments and exit credits, and the policy on Deferred Debt Agreements is found in Appendix 4.

Regulation 64(2A) permits the suspension of an employer's liability to make an exit payment for up to 3 years where the Administering Authority believes that the employer is likely to have one or more active members contributing to the Fund within the period specified in the suspension notice.

A partial termination occurs where an employer exits the Fund in respect of non-active members only.

The Administering Authority's policy on suspension notices and partial terminations is found in Appendix 4.

## Appendix 3: Employer contribution reviews

### When will contributions be reviewed?

The Regulations require a triennial Actuarial Valuation of the fund. As part of each Actuarial Valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers and may be increased or reduced.

The Administering Authority will consider reviewing employer contributions between triennial Actuarial Valuations, as permitted by Regulations 64(4) and 64A, in the following circumstances:

- it appears to the administering authority that it is likely that the Scheme employer will become an exiting employer.
- it appears likely to the Administering Authority that the amount of the liabilities arising or likely to arise has changed significantly since the last Actuarial Valuation.
- it appears likely to the Administering Authority that there has been a significant change in the ability of the Scheme employer or employers to meet the obligations of employers in the Scheme.
- a Scheme employer or employers have requested a review of Scheme employer contributions and have undertaken to meet the costs of that review.

For the avoidance of doubt, the Administering Authority will not consider a review of contributions under Regulation 64A purely on the grounds of a change in market conditions affecting the value of assets and/or liabilities.

In determining whether or not a review should take place under Regulation 64A, the Administering Authority will consider the following factors (noting that this is not an exhaustive list):

- the circumstances leading to the change in liabilities arising or likely to arise, for example whether this is the result of a decision by the employer, such as the restructuring of a Multi-Academy Trust, a significant outsourcing or transfer of staff, closure to new entrants, material redundancies or significant pay awards, or other factors such as ill-health retirements, voluntary withdrawals or the loss of a significant contract.
- the materiality of any change in the employer's membership or liabilities, taking account of the Fund Actuary's view of how this might affect its funding position, primary or secondary contribution rate.
- whether, having taken advice from the Fund Actuary, the Administering Authority believes a change in ongoing funding target or deficit recovery period would be justified, e.g. on provision or removal of any security, subsumption commitment, bond, guarantee, risk-sharing arrangement, or other form of indemnity in relation to the employer's liabilities in the Fund
- the materiality of any change in the employer's financial strength or longer-term financial outlook, based on information supplied by the employer and supported by a financial risk assessment or more detailed covenant review carried out by the Fund Actuary or other covenant adviser to the Fund.
- the general level of engagement from the employer and its adherence to its legal obligations as set out in the Pension Administration Strategy, including the nature and frequency of any breaches such as failure to pay contributions on time and data quality issues due to failure to provide new starter or leaver forms.
- whether the employer was both in surplus at the previous valuation date and paying contributions in excess of the primary rate certified in the resulting Rates and Adjustments Certificate. If this is the case the administering authority would then also take into account

the Fund Actuary's view on whether the employer is still in a surplus position at the date of the review.

- Whether the employer has requested a review in the previous 12 months. The Administering Authority is unlikely to agree to more than one review per year.

In determining whether or not a review for an admission body should take place under Regulation 64(4), the Administering Authority will consider the following factors (noting that this is not an exhaustive list):

- A material change in circumstances, such as the exit date becoming known, material membership movements or material financial information coming to light may cause the Administering Authority to informally review the situation and subsequently formally request an interim valuation.
- For an employer whose participation is due to cease within the next 3 years, the Administering Authority will monitor developments and may see fit to request an interim valuation at any time.
- For Admission Bodies admitted under paragraph 1(d) of Part 3, Schedule 2 of the Regulations falling into the above category, the Administering Authority sees it as the responsibility of the relevant Scheme Employer to instruct it if an interim valuation is required. Such an exercise would be at the expense of the relevant Scheme Employer unless otherwise agreed.

Notwithstanding the above guidelines, the Administering Authority reserves the right to request an interim valuation of any employer at any time if Regulation 64(4) or 64A applies. In determining whether or not a review should take place, the Administering Authority will generally focus on the materiality of any potential changes in the context of the employer concerned, its financial position and current contribution levels. The Administering Authority does not consider that a review is not justified just because an employer is small in the context of the Fund as a whole, noting that failure to act could make discussions at the next Actuarial Valuation more difficult and compound the risk to the Fund. However, in determining the extent and speed of any changes to the employer's contributions the Administering Authority will consider the effect on the overall funding position of the Fund, i.e. other Fund employers.

Where contributions are being reviewed for an employer with links to another Fund employer, particularly where this is a formal organisational or contractual link, e.g. there is a tripartite admission agreement, an ownership relationship or a formal guarantee, subsumption commitment or risk sharing arrangement is in place, the Administering Authority will consider the potential risk/impact of the contribution review on those other employer(s), taking advice from the Fund Actuary as required.

## Employer engagement

The Administering Authority will involve the employer in the process in the following ways:

- In most cases the employer will be aware of the proposed review of their contributions since this will be triggered by an employer's action and employers should be aware of the need to engage with the Fund in relation to any activity which could materially affect their liabilities or ability to meet those liabilities. In other cases, information will be required from the employer, e.g. in relation to its financial position and business plans which could be the catalyst for informing the employer that a review is being proposed.
- the Administering Authority will advise the employer that a review is being carried out and share the outcome of the review and any risk or covenant assessment as appropriate.
- the Administering Authority will inform the employer of the indicative timetable for completion of the review. In general, the results of the review will be available no more than 3 months after all data and information has been received by the Administering Authority,

and the employer will be informed where there are circumstances that means this timescale will vary.

- The Administering Authority will consult with the employer on the timing of any contribution changes and there will be a minimum of 4 weeks' notice given of any contribution increases.

## Requesting a review

Before requesting a review, employers should consider the regulatory requirements and the Fund's policy as set out above and satisfy themselves that there has been a relevant change in the expected amount of liabilities or their ability to meet those liabilities.

The employer should contact the Administering Authority and complete the necessary information requirements for submission to the Administering Authority in support of their application.

The Administering Authority will consider the employer's request and may ask for further information or supporting documentation/evidence as required. If the Administering Authority, having taken actuarial advice as required, is of the opinion that a review is justified, it will advise the employer and provide an indicative cost.

All employers are expected to engage with the Administering Authority and adhere to the notifiable events framework as well as providing financial and other information on a regular basis. This will be necessary to support the effective monitoring of the employer's circumstances and any change in covenant. Notifiable events are set out in the Pensions Administration Strategy.

## Determining the contribution rate

When determining whether employer contributions should be adjusted as the result of the review, the Administering Authority will consider: the materiality of the changes, representations from the employer, the proximity to the next triennial Actuarial Valuation, the outcome of any discussions with the employer and any related/linked employer in the Fund and any other factors.

- Where, following representations from the employer, the Administering Authority is considering not increasing the employer's contributions following a review, despite there being good reason to do so from a funding and actuarial perspective, e.g. if it would precipitate the failure of the employer or otherwise seriously impair the employer's ability to deliver its organisational objectives or it is expected that the employer's financial position will improve significantly in the near-term, the Administering Authority will consult with any related/linked employers seeking their view on such an approach
- Contribution reviews under Regulation 64A are unlikely to be carried out during the 12 month period from the Actuarial Valuation date although if there were any material changes to the expected amount of liabilities arising or the ability of the employer to meet those liabilities during that period, this should be taken into account when finalising the Rates and Adjustments Certificate flowing from the Actuarial Valuation.
- Employers should be aware that all costs incurred by the Fund associated with a contribution review request, whether or not this results in contributions being amended, will be recharged to the employer.

## Appeals

Any appeal against the Administering Authority's decision regarding employer contribution reviews must be made in writing to the Administering Authority within 6 months of being notified of the decision. An appeal will require the employer to evidence one of the following:

- deviation from the published policy or process by the Administering Authority, or

- any further information (or interpretation of information provided) which could influence the outcome, noting new evidence will be considered at the discretion of the Administering Authority.

## Appendix 4: Employer exits

### Exit of an employer

Where an employer becomes an exiting employer, an exit valuation will be carried out in accordance with Regulation 64 of the Regulations. That valuation will take account of any activity as a consequence of exit regarding any existing contributing members (for example any bulk transfer payments due, and any asset transfer associated with the transfer of active members to another employer in the Fund) and the status of any liabilities that will remain in the Fund.

Where an employer has a risk sharing (i.e. pass-through) arrangement in place with the London Borough of Southwark (or an academy/multi academy trust), generally no exit payment will be required, or exit credit paid. The Fund Actuary will provide the Administering Authority with an exit valuation confirming that no exit deficit or surplus is due to be paid at the exit date and a revised rates and adjustments certificate showing the nil exit payment due from the exiting employer, as required under Regulation 64(2) of the LGPS Regulations.

The assumptions adopted to value the departing employer's liabilities for the exit valuation (including on termination of any Deferred Debt Agreement) will depend upon the circumstances. In particular, the exit valuation will distinguish between residual liabilities which will become:

- 'orphan' liabilities, i.e. no other individual employer in the Fund will have future responsibility for funding the residual liabilities; and
- liabilities which will be 'subsumed' by other employers, i.e. another employer takes on responsibility for funding the residual liabilities of the former employer after exit.

For those liabilities that will become orphan liabilities the exit valuation will be carried out on the Low-Risk Funding Target.

For subsumed liabilities the exit valuation will be carried out on the ongoing Funding Target appropriate to the subsuming employer, updated for financial conditions at the exit date.

The exit valuation will assess the assets held as at the exit date in the Fund in respect of the exiting employer, as compared to the liabilities of the Fund in respect of benefits attributable to the exiting employer's current and former employees. The exit valuation will normally conclude that there is either:

- a deficit, in that the liabilities have a higher value than the assets; or
- a surplus, in that the assets have a higher value than the liabilities.

When calculating the liabilities in the Fund in respect of the exiting employer, an increase will be applied to these liabilities to allow for the potential increase in benefits due to the McCloud judgement and any other benefit uncertainties, as advised by the Fund Actuary.

### Exit payments

Where the exit valuation shows a deficit, an exit payment will usually be required from the exiting employer.

The Administering Authority may, with the consent of the scheme employer in question, allow another employer in the Fund to subsume the assets and liabilities of the exiting employer. This may include the Administering Authority agreeing to the other scheme employer accepting ongoing liability for any deficit in substitution of the requirement for an exit payment from the exiting employer.

The Administering Authority's policy is that generally any deficit that exists at exit of an employer will be payable immediately as a single payment. In certain cases, the Administering Authority may be prepared to agree phased payment over a period of time as permitted under Regulation

64B, at the request of an employer. The Administering Authority will consult with the employer to consider its request and determine whether or not spreading the exit payment is appropriate and the terms which should apply.

In determining whether or not to permit an exit payment to be spread, the Administering Authority will consider factors including, but not limited to:

- The ability of the employer to make a single capital payment. Where the Administering Authority considers that the employer is financially able to make a single capital payment it will not normally be appropriate for the exit payment to be spread
- Whether any security is in place, including a charge over assets, bond, guarantee or other indemnity.
- Whether the overall recovery to the Fund is likely to be higher if spreading the exit payment is permitted.
- Any actuarial, covenant or legal advice the Administering Authority deems necessary.
- The views of any guarantor, and whether the guarantee will continue in force during the spreading period.
- The written representations of the employer in relation to any factors which, in their view, would influence such a decision.

The employer will be required to provide details of its financial position, business plans and financial forecasts and such other information as required by the Administering Authority in order for it to make a decision on whether or not to permit the exit payment to be spread. This information must be provided within 2 months of request.

In determining the appropriate length of time for an exit payment to be spread, the Administering Authority will consider the affordability of the instalments using different spreading periods for the employer. The default spreading period will be three years, but longer periods (up to ten years) will be considered where the Administering Authority is satisfied that this doesn't pose undue risk to the Fund in relation to the employer's ability to continue to make payments over the period.

Whilst the default position would be for an employer to request spreading of any exit payment in advance of the exit date, it is acknowledged that a final decision by the employer (and the Administering Authority) on whether this will be financially beneficial/appropriate may not be possible until the employer has exited. At its sole discretion the Administering Authority may therefore consider a request for spreading debt on or after the date of exit.

Where it has been agreed to spread an exit payment the Administering Authority will advise the employer in writing of the arrangement, including the spreading period; the annual payments due; interest rates applicable; other costs payable and the responsibilities of the employer during the spreading period. Where a request to spread an exit payment has been denied the Administering Authority will advise the employer in writing and provide a brief explanation of the rationale for the decision.

Employers will be asked to pay actuarial; legal and covenant advice costs associated with the spreading agreement as well as calculation of the exit deficit (these costs will not be spread).

The Administering Authority will generally review spreading agreements as part of its preparation for each triennial Actuarial Valuation and will take actuarial, covenant, legal and other advice as considered necessary.

Employers will be expected to engage with the Administering Authority during the spreading period and adhere to the notifiable events framework. Notifiable events are set out in the Pensions Administration Strategy. If the Administering Authority has reason to believe the employer's circumstances have changed such that a review of the spreading period (and hence the payment amounts) is appropriate, it will consult with the employer, and a revised payment schedule may be implemented.

Any review will not consider changes to the original exit amount nor interest rate applicable.

An employer will be able to discharge its obligations under the spreading arrangement by paying off all future instalments at its discretion. The Administering Authority will seek actuarial advice in relation to whether there should be a discount for early payment given interest will have been added over the expected spreading period. The cost of any such advice will be recharged to the employer.

## Deferred debt arrangements

In certain circumstances it may be agreed to enter into a deferred debt agreement rather than require an immediate exit payment.

Regulation 64(7A) permits the Administering Authority to enter into a written agreement with an exiting Scheme employer for that employer to defer their obligation to make an exit payment and continue to make contributions at the secondary rate (a 'Deferred Debt Agreement' or DDA). In that case, the employer would remain a participating body as a deferred employer.

DDAs will generally only be entered into at the request of an employer. The Administering Authority will then consult with the employer to consider the request and determine whether or not a DDA is appropriate and the terms which should apply (including the precise details of the DDA). As part of its application for a DDA, the Administering Authority will require information from the employer to enable the Administering Authority to take a view on the employer's strength of covenant.

Information will also be required on an ongoing basis to enable the employer's financial strength/covenant to be monitored. Employers should be aware that all costs incurred by the Fund associated with a request for a DDA, whether or not this results in an agreement being entered into, and its ongoing monitoring, will be recharged to the employer.

### Factors for consideration in whether to enter into a DDA

In determining whether or not to enter into a DDA with an employer the Administering Authority will take into account the following factors, including but not limited to:

- The materiality of the employer and any exit deficit in terms of the Fund as a whole.
- The risk to the Fund of entering into a DDA, in terms of the likelihood of the employer failing before the DDA has ended, based on information supplied by the employer and generally supported by a financial risk assessment or more detailed covenant review carried out by the Fund Actuary or other covenant adviser.
- The rationale for the employer requesting a DDA, particularly if the Administering Authority believes it would be able to make an immediate payment to cover the exit deficit.
- Whether an up-front payment will be made towards the deficit, and/or any security is, or can be put, in place, including a charge over assets, bond, guarantee or other indemnity, to reduce the risk to other employers.
- The written representations of the employer in relation to any factors which, in their view, would influence such a decision.

Where the employer's covenant is expected to materially weaken over time the Administering Authority is very unlikely to consider entering into a DDA with that employer. Further, where an employer can demonstrably meet the exit payment in a single instalment, the Administering Authority would be unlikely to enter into a DDA. The Administering Authority is unlikely to enter into a DDA unless it is clear that this wouldn't increase risk to the Fund, e.g. if the employer was fully taxpayer-backed and sufficient assurance was in place that all contributions due, including any residual deficit at the end of the DDA, would be met in full.

### Matters to be reflected in the agreement

The matters which the Administering Authority will reflect in the DDA, include:

- An undertaking by the employer to meet all requirements on Scheme employers, including payment of the secondary rate of contributions, but excluding the requirement to pay the primary rate of contributions.
- A provision for the DDA to remain in force for a specified period, which may be varied by agreement of the Administering Authority and the deferred employer.
- A provision that the DDA will terminate on the first date on which one of the following events occurs:
  - the deferred employer enrolls new active members.
  - the period specified, or as varied, elapses.
  - the take-over, amalgamation, insolvency, winding up or liquidation of the deferred employer.
  - the Administering Authority serves a notice on the deferred employer that it is reasonably satisfied that the deferred employer's ability to meet the contributions payable under the deferred debt arrangement has weakened materially or is likely to weaken materially in the next 12 months; or
  - the Fund Actuary assesses that the deferred employer has paid sufficient secondary contributions to cover the exit payment that would have been due if the employer had become an exiting employer on the calculation date.
- The responsibilities of the deferred employer.
- Conditions triggering the implementation of a recovery plan, i.e. when the secondary contributions payable and/or the period of the DDA may be varied.
- The circumstances triggering a cessation of the arrangement leading to an exit payment (or credit) becoming payable, in addition to those set out in Regulation 64(7E) and above.
- Any other matter the Administering Authority considers relevant.

## Management and monitoring the DDA

The Administering Authority will monitor the funding position and risk/covenant associated with deferred employers on a regular basis. This will be at least triennially and most likely annually, but the frequency will depend on factors such as the size of the employer and any deficit and the materiality of movements in market conditions or the employer's membership.

The Administering Authority has a template agreement for DDAs, which it will require employers (and any guarantors) to sign up to. It is expected that the consultation process with the employer will include discussions on the precise details of the DDA, although the purpose of developing a template agreement is to make the process easier, quicker and cheaper and therefore it is not envisaged that there will be material changes to the Administering Authority's template.

The circumstances in which the Administering Authority may consider seeking to agree a variation to the length of the agreement under regulation 64(7D) include:

- Where the exit deficit has reduced (increased) such that it is reasonable to reduce (extend) the length of the recovery period and associated period of the DDA assuming that, in the case of the latter, this does not materially increase the risk to the other employers/Fund.
- Where the deferred employer's business plans, staffing levels, finances or projected finances have changed significantly, but, in the case of a deterioration, the Administering Authority, having taken legal, actuarial, covenant or other advice as appropriate, does not consider that there is sufficient evidence that the deferred employer's ability to meet the contributions payable under the DDA has weakened materially, or is likely to weaken materially in the next 12 months.

- Where the level of security available to the Fund has changed in relation to the DDA, as determined by the Administering Authority, taking legal, actuarial or other advice as appropriate.

Advisory fees incurred by the Fund associated with consideration of a DDA for an exiting employer, whether or not this results in a DDA being entered into, will be recharged to the employer. This will include actuarial, legal, covenant and other advice and the costs of monitoring the arrangement as well as the initial set up. Estimated costs can be provided on request.

Employers are expected to make a request to consider a DDA before they would otherwise have exited the Fund under Regulation 64(1) and that a DDA should be entered into within 3 months of that date. The employer should continue to make secondary contributions at the prevailing rate whilst the DDA is being considered unless the Administering Authority, having taken actuarial and other advice as appropriate, determines that increased contributions should be payable. In exceptional circumstances, e.g. where there has been a justifiable delay due to circumstances outside of the employer's control, and at the sole discretion of the Administering Authority, a DDA may be entered into more than 3 months after the date the employer would have otherwise exited the Fund under Regulation 64(1).

## Funding target used in DDA

For deferred employers where a deferred debt agreement is in place the funding target will take into account any likely change in the notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date the deferred debt agreement is expected to end and any other factors considered to be relevant by the Administering Authority on the advice of the Actuary, which may include, without limitation:

- the agreed period of the deferred debt agreement.
- the type/group of the employer.
- the business plans of the employer.
- an assessment of the financial covenant of the employer.
- any contingent security available to the Fund or offered by the employer such as a guarantor or bond arrangements, charge over assets, etc.

Deferred employers will be expected to engage with the Administering Authority during the period of the DDA and adhere to the notifiable events framework as set out in the Pensions Administration Strategy as well as providing financial and other information on a regular basis. This will be necessary to support the effective monitoring of the arrangement and will be a requirement of the DDA.

## Exit credits

Where the exit valuation discloses a surplus in the Fund in respect of the exiting employer, an exit credit may be due to the employer.

As soon as is practicable after the production of the applicable exit valuation, the Administering Authority will notify the exiting employer and, where the exiting employer has been admitted to the Fund as an admission body, any guarantor, Scheme Employer or subsuming employer where applicable, of:

- The fact that the exit valuation shows a surplus.
- That the Administering Authority intends to make a determination of whether this surplus should be passed in whole or in part to the exiting employer
- To request that each party, within 4 weeks, provides their written representations to the Administering Authority in relation to any factors which, in their view, would influence such a

decision and make the payment of a surplus to the exiting employer more or less appropriate.

The representations of the parties mentioned above may (but need not) detail any risk sharing arrangement agreed between the parties as regards the participation of the exiting employer in the Fund.

The Administering Authority will make a determination of the amount of the exit credit (if any) payable to the exiting employer.

In reaching this decision the Administering Authority will have regard to the following factors:

- the extent to which there is a surplus.
- the proportion of the excess of assets which has arisen because of the value of the exiting employer's contributions.
- the representations received from the parties under paragraph 8.
- where part or all of the surplus relates to an increase in the value of the assets of the Fund as at exit date due to better-than-expected investment growth or returns, the extent to which that increase in asset value can be regarded as a stable and long-term value increase.
- (where the Administering Authority is aware of the same) whether or not the exiting employer has been exposed to the full financial risk of participation in the Fund and the existence of any risk-sharing arrangements in place with third parties.
- whether the Administering Authority, with the consent of the scheme employer in question, has allowed another employer in the Fund to subsume the assets and liabilities of the exiting employer. This may include the surplus shown on exit.
- the date on which the admission and/or commercial arrangements between the exiting employer and scheme employer came into effect, and whether therefore the parties had the opportunity to deal with the chance of an exit credit in their contractual arrangements; and
- any other relevant factors.

No single factor will be conclusive, and the Administering Authority will consider all the circumstances in the round in coming to its decision on the correct level of an exit payment. In order to help the parties in formulating their representations, the Administering Authority sets out below the factors it may consider, and some guidance as to the usual implication of those factors:

Factor	The Administering Authority's view on how this may influence the determination
The extent to which there is a surplus	Will not of itself influence the determination in favour or against the exit credit, but the Administering Authority may decide to truncate the determination process where the surplus is so small as to make the full process administratively disproportionate.
The proportion of the excess of assets which has arisen because of the value of the exiting employer's contributions	In general, the Administering Authority considers that where the surplus exceeds the total employer contributions received over the course of the admission, this would weigh against the payment of the full surplus as an exit credit.
The representations received from the parties	Dependent on their content.
Where part or all of the surplus relates to an increase in the value of the assets of the Fund as at exit date due to better-than-expected investment growth or returns, the extent to which	In general, the Administering Authority considers that where the exit took place at a time when the value of assets held by the Fund were unexpectedly high, and subsequently declined, or appear to the Administering Authority reasonably likely to decline in

Factor	The Administering Authority's view on how this may influence the determination
that increase in asset value can be regarded as a stable and long-term value increase;	the short or medium term, then this will weigh against the payment an exit credit (either in full or in part dependent on the circumstances). Where the Authority relies on this factor in making a determination, it will provide the parties with details of why it considers that is the case.
Whether or not the exiting employer has been exposed to the full financial risk of participation in the Fund and the existence of any risk-sharing arrangements in place with third parties	In general, the Administering Authority considers that where the exiting employer has not been exposed to the usual financial risks associated with admission by reason of its commercial arrangements with third parties (for example the scheme employer), this would weigh against the payment of an exit credit (either in full or in part dependent on the circumstances of the arrangement in question)
Whether the Administering Authority, with the consent of the scheme employer in question, has allowed another employer in the Fund to subsume the assets and liabilities of the exiting employer. This may include the surplus shown on exit.	Where there is an arrangement with another scheme employer to subsume all assets, liabilities, and any surplus or deficit on exit, then this would weigh against the payment of an exit credit.
The date on which the admission and/or commercial arrangements between the exiting employer and scheme employer came into effect, and whether therefore the parties had the opportunity to deal with the chance of an exit credit in their contractual arrangements	In general, the Administering Authority considers that where the arrangements pre-date the introduction into the Regulations of the concept of exit credits, this will weigh against the payment of an exit credit (either in full or in part dependent on the circumstances), and where the arrangements post-date the concept of exit credits, this will weigh in favour of the payment of an exit credit (either in full or in part dependent on the circumstances)
Any other relevant factors.	Dependent on the factor in question

In making a determination, the Administering Authority will take such legal and actuarial advice as it considers appropriate.

The Administering Authority will notify the exiting employer, and any guarantor or Scheme Employer if applicable, of the amount of any surplus which it has determined should be returned to the exiting employer, if any (the "exit credit").

The Administering Authority will, unless otherwise agreed with the exiting employer, pay any exit credit to the exiting employer within 6 months of the later of the exit date and the date when the employer has provided all the necessary information required by the Administering Authority to enable the Fund Actuary to calculate the final assets and liabilities on exit.

## Suspension notices

Regulation 64(2A) permits the suspension of the requirement to carry out an exit valuation for a period of up to 3 years where the Administering Authority believes that the employer is likely to have one or more active members contributing to the Fund within the period specified in the suspension notice.

The Administering Authority considers that it is appropriate to exercise that discretion in relation to any employer where there is a reasonable expectation that a member will join in the near future (e.g., before the next triennial Actuarial Valuation). In that case, the Fund will advise the employer of the exit amount calculated by the Actuary and serve a written suspension notice on the employer.

Whilst under a suspension notice, the employer must continue to pay any certified secondary contributions as if it were an ongoing employer. The Fund Actuary will recalculate contributions due at the next Actuarial Valuation. If there are no new members by the time the suspension notice expires the employer will be treated as an exiting employer as at the date the suspension notice expires.

## Partial terminations

A partial termination occurs where an employer exits the Fund in respect of non-active members only.

In general, the Administering Authority does not permit partial terminations.

Any requests from employers will be considered on a case-by-case basis.

## Appeals

Any appeal against the Administering Authority's decision regarding exit credits must be made in writing to the Administering Authority within 6 months of being notified of the decision. An appeal will require the employer to evidence one of the following:

- deviation from the published policy or process by the Administering Authority, or
- any further information (or interpretation of information provided) which could influence the outcome, noting new evidence will be considered at the discretion of the Administering Authority.

## Appendix 5: Roles and responsibilities

The efficient and effective management of the Fund can only be achieved if all parties are aware of and exercise their statutory duties and responsibilities conscientiously and diligently.

The primary parties to the FSS are the Administering Authority, the Fund Actuary and the Employers.

The **Administering Authority (the Fund)** is required to:

- operate a pension fund
- collect employer and employee contributions, investment income and other amounts due to the pension fund as stipulated in LGPS Regulations
- have an escalation policy in situations where employers fail to meet their obligations
- pay from the pension fund the relevant entitlements as stipulated in LGPS Regulations
- invest surplus monies in accordance with the relevant regulations
- ensure that cash is available to meet liabilities as and when they fall due
- ensure benefits paid to members are accurate and undertake timely and appropriate action to rectify any inaccurate benefit payments
- take measures as set out in the regulations to safeguard the Fund against the consequences of employer default
- manage the Actuarial Valuation process in consultation with the Fund's Actuary
- prepare and maintain an FSS and ISS, after proper consultation with interested parties
- monitor all aspects of the Fund's performance and funding, and amend the FSS/ISS accordingly
- establish a policy around exit payments and payment of exit credits/debits in relation to employer exits, and around revising employer contributions between Actuarial Valuations
- effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and scheme employer
- enable the Local Pension Board to review the Actuarial Valuation and FSS review process as set out in their terms of reference
- support and monitor a Local Pension Board (LPB) as required by the Public Service Pensions Act 2013, the Regulations and the Pensions Regulator's relevant Code of Practice
- exercise discretions within the regulatory framework, taking into account the cost of decisions.
- ensure consistent use of policies relating to revising employer contributions between formal valuations, entering into deferred debt agreements and spreading exit payments, and ensure the process of applying those policies is clear and transparent to all fund employers

The individual **employer** is required to:

- ensure staff who are eligible are contractually enrolled and deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations),
- provide the Fund with accurate data and understand that the quality of the data provided to the Fund will directly impact on the assessment of their liabilities and their contributions. In particular, any deficiencies in their data may result in the employer paying higher contributions than otherwise would be the case if their data was of high quality,

- pay all ongoing contributions, including employer contributions determined by the Fund Actuary and set out in the Rates and Adjustments Certificate, promptly by the due date,
- develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework,
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain,
- notify the Administering Authority promptly of all changes to active membership that affect future funding,
- notify the Administering Authority promptly of possible or intended changes that could affect the basis of participation in the Fund which affect future funding,
- note and if desired respond to any consultation regarding the Funding Strategy Statement, the Investment Strategy Statement or other policies,
- pay any exit payments on ceasing participation in the Fund in a timely manner,
- be aware that responsibility for compensatory added years, which the Administering Authority pays on behalf of the employer as a paying agent, lies with the employer which awards and is recharged for the cost of compensatory added years,
- when considering outsourcing any services have regard to and adhere to the requirements of the Best Value Authorities Staff Transfer (Pensions) Direction 2007. Employers should also advise the Administering Authority at the earliest opportunity and before any transfer of staff so that the necessary paperwork and calculations can be completed.

The **Fund Actuary** should:

- prepare Actuarial Valuations including the setting of employers' contribution rates at a level to ensure Fund solvency and long-term cost efficiency based on the assumptions agreed with the Administering Authority and having regard to the FSS and the LGPS Regulations
- provide advice so the Fund can agree the necessary assumptions for the Actuarial Valuation
- prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters such as pension strain costs, ill health retirement costs, compensatory added years costs, etc
- provide advice and exit valuations to the fund so that it can make decisions on the exit of employers from the fund, and assist the Administering Authority in relation to any decision by the Administering Authority to put in place a Deferred Debt Agreement under Regulation 64(7B) or spread an exit payment under Regulation 64B
- provide advice to the Fund on bonds or other forms of security against the financial effect on the Fund of employer default
- assist the fund in assessing whether employer contributions need to be revised between Actuarial Valuations as permitted or required by the LGPS Regulations
- ensure that the fund is aware of any professional guidance or other professional requirements that may be relevant in the role of advising the Fund
- identify to the Fund and manage any potential conflicts of interest that may arise in the delivery the contractual arrangements to the Fund and other clients.

## Appendix 6: Glossary

### **Actuarial Valuation**

An assessment by the Fund Actuary of the Funding Level of the Fund and recommended employer contributions. The assessment of the Funding Level is based on calculating the Past Service Liabilities and comparing this to the value of the assets held in the Fund. Actuarial Valuations take place every three years (triennial).

### **Administering Authority**

London Borough of Southwark is the Administering Authority to the Fund.

### **Admission Agreement / Admission Body**

A written agreement which provides for a body to participate in the Fund as a scheme employer. An admission body is an employer admitted to the Fund under an admission agreement.

### **Assumptions**

Assumptions about the future need to be made by the Fund Actuary in order to calculate how much money the Fund needs at the Valuation Date to pay for the benefits that have been earned up to the Valuation Date. These assumptions are estimates of future experience for example, pay growth, longevity of pensioners, inflation, and investment returns.

### **Code of Practice**

The Pensions Regulator's General Code of Practice.

### **Deficit**

If the assets are lower than the liabilities, then a deficit exists. The deficit is the difference between the Past Service Liabilities and the assets.

### **Employer Covenant**

The extent of the employer's legal obligation and financial ability to support its liabilities in the Fund now and in the future.

### **Fund**

The London Borough of Southwark Pension Fund.

### **Fund Actuary**

An actuary appointed by the Administering Authority to provide advice to the Fund, including carrying out Actuarial Valuations.

### **Funding Level**

The funding level is the value of assets divided by the value of the liabilities.

### **Fund Valuation Date**

The effective date of the triennial fund Actuarial Valuation.

### **Guarantee / guarantor**

A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor may mean that the fund can consider the employer's covenant to be as strong as its guarantor's.

### **LGPS Regulations**

The statutory regulations setting out the contributions payable to, and the benefits payable from, the Local Government Pension Scheme and how the Funds are to be administered. These

include the Local Government Pension Scheme Regulations 2013 and various transitional regulations.

### **Local Pension Board**

The board established to assist the administering authority as the Scheme Manager for each fund.

### **Long-term cost efficiency**

The notes to the Public Service Pensions Act 2013 state that long-term cost efficiency implies that the rate must not be set at a level that gives rise to additional costs. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the time.

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long-term cost efficiency if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, GAD may have regard to the following considerations:

- the implied average deficit recovery period
- the investment return required to achieve full funding over different periods, e.g. the recovery period
- if there is no deficit, the extent to which contributions payable are likely to lead to a deficit arising in the future
- the extent to which the required investment return above is less than the administering authority's view of the expected future return being targeted by a fund's investment strategy, taking into account changes in maturity/strategy as appropriate.

### **Non-statutory guidance**

Guidance which although it confers no statutory obligation on the parties named, they should nevertheless have regard to its contents.

### **Notifiable events**

Events which the employer should make the administering authority aware of.

### **Past service liabilities**

This is the cost or present value of the benefits to which members are entitled based on benefits built up to/in payment at the date of calculation, assessed using the agreed assumptions. It generally allows for projected future increases to pay or pension as appropriate through to retirement or date of leaving service.

### **Pension Advisory Panel**

An administering authority may delegate its pension management function to a committee, sub-committee or an officer. The London Borough of Southwark has delegated this function to the Strategic Director of Resources (the Chief Finance Officer or CFO). The Pensions Advisory Panel (PAP) has a primary objective to assist the Strategic Director of Resources in the management of the pensions function.

### **Pensions Administration Strategy**

A statement of the duties and responsibilities of scheme employers and administering authorities to ensure the effective management of the scheme.

### **Primary rate of the employers' contribution**

The primary rate for each employer is that employer's future service contribution rate, which is the contribution rate required to meet the cost of the future accrual of benefits, expressed as a percentage of pensionable pay, ignoring any past service surplus or deficit but allowing for any employer-specific circumstances, such as the membership profile of that employer, the funding strategy adopted for that employer (including any risk-sharing arrangements operated by the administering authority), the actuarial method chosen and/or the employer's covenant.

The primary rate for the whole Fund is the weighted average (by payroll) of the individual employers' primary rates.

### **Rates and adjustments certificate**

A certificate required at each actuarial valuation by the Regulations, setting out the primary and secondary contributions payable by employers for the 3 years from the 1 April that falls in the calendar year following the Fund Valuation Date.

### **Secondary rate of the employers' contribution**

The secondary rate is an adjustment to the primary rate to arrive at the rate each employer is required to pay. It may be expressed as a percentage adjustment to the primary rate, and/or a cash adjustment in each of the three years beginning with 1 April in the year following that in which the Fund Valuation Date falls. The secondary rate is specified in the Rates and Adjustments Certificate. For any employer, the rate they are required to pay is the sum of the primary and secondary rates.

The actuary should also disclose the secondary rates for the whole scheme in each of the three years beginning with 1 April in the year following that in which the Actuarial Valuation date falls. These should be calculated as a weighted average based on the whole scheme payroll in respect of percentage rates and as a total amount in respect of cash adjustments. The purpose of this is to show a single rate of contributions expected to be received by the Fund over each of the three years that can be readily compared with other funds and reconciled with actual receipts.

### **Solvency**

The notes to the Public Service Pensions Act 2013 state that solvency means that the rate of employer contributions should be set at "such level as to ensure that the scheme's liabilities can be met as they arise". It is not regarded that this means that the pension fund should be 100% funded at all times. Rather, and for the purposes of Section 13 of the Public Service Pensions Act 2013, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

- the rate of employer contributions is set to target a Funding Level for the Fund of 100% over an appropriate time period and using appropriate actuarial assumptions; and either
- employers collectively have the financial capacity to increase employer contributions, and/or the Fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or
- there is an appropriate plan in place should there be, or if there is expected in future to be, no or a limited number of Fund employers, or a material reduction in the capacity of Fund employers to increase contributions as might be needed.

If the conditions above are met, then it is expected that the Fund will be able to pay scheme benefits as they fall due.

### **Surplus**

If the assets are higher than the Past Service Liabilities, then a surplus exists. The surplus is the difference between the assets and the Past Service Liabilities.