Oxfordshire Pension Fund
www.oxfordshire.gov.uk/pensions

Consultation on the Funding Strategy Statement for the Oxfordshire Pension Fund – October 2022

Introduction

Under the Local Government Pension Scheme Regulations all Funds must publish a Funding Strategy Statement which sets out the Fund's approach to funding all future pension benefits. The approach needs to cover the management of risks associated with ensuring the timely payment of all pension benefits, ensuring the Fund is sustainable in the long term, and that risks are appropriately balanced between the individual scheme employers and between generations.

The Funding Strategy Statement sets out the parameters that must be followed by the Fund Actuary in carrying out the triennial Fund Valuations and setting employer contribution rates and allows existing and prospective scheme employers to understand the key financial issues at the different stages of their LGPS membership from admission through to cessation.

Over recent years, the Funding Strategy Statement has been subject to various amendments to reflect the growing complexity of the scheme and new regulatory requirements issued by Government. As such, the Statement had become unwieldy and difficult to navigate. As part of the approach to the 2022 Valuation, the opportunity has been taken to redraft the Statement with the aim of increasing transparency, and improving the accessibility and useability of the document, particularly for scheme employers. This consultation aims to understand whether the revised set of documents meets this aim, and to identify and key funding issues scheme employers wish to see addressed in the final document.

Key Changes in Documents

Document Structure

The biggest change in the approach to the Funding Strategy Statement is structural with the development of a shorter core Funding Strategy Statement which sets out the key policies and principles as required under the statutory guidance, and a series of satellite documents which cover specific policy areas in more detail. Six satellite documents have been produced covering:

- Approach to employer cessations
- Policy in respect of employer contribution reviews between formal Valuations
- Approach to pre-payments of contributions
- Policy regarding bulk transfers
- Academies
- Pass through agreements

The changes have been made to improve accessibility to the relevant information for scheme employers facing the relevant scenario.

It should be noted that going forward, whilst any changes the key policies and principles set out in the Core Funding Strategy Statement will be subject to statutory stakeholder consultation as part of the process for agreeing the amendments, the Pension Fund Committee will be free to determine changes to the detailed policy documents and the level of consultation with stakeholders required.

Q1. Do respondents agree that the structural changes to the documents have improved the accessibility, readability and useability of the documents?

Q2. Is there an appropriate split between the high level principles and policies set out in the core document which will require formal consultation to change, and the detailed arrangements set out in the satellite policy documents which can be amended at the discretion of the Pension Fund Committee?

Time Horizon to restore 100% Funding

Under the previous Funding Strategy Statement, the Pension fund Committee in consultation with the Fund Actuary were free to choose different time horizons by which scheme employers had to target being 100% funded. These decisions were based on the perceived level of risk associated with the scheme employer, with shorter horizons allocated to those scheme employers deemed to have a weaker financial covenant.

Under the latest core Statement, the time horizon for all scheme employers will be set at 20 years, and the differences in perceived risk will be managed through setting different levels of certainty that the scheme employer will be fully funded at the end of the 20-year period under the various economic scenarios built into the Valuation model. The weaker the financial covenant, the higher the level of certainty required, i.e. the employer will be fully funded over a greater number of the potential economic scenarios. The reasoning behind this change is to seek to have a clearer risk based approach consistently set throughout the Statement (also see approach to cessations below).

Q3. Do you support the use of a risk based approach utilising a standard time horizon and variable level of certainty as the basis for future contribution calculations? If not, please provide details of proposed alternative approach and reasoning for decision.

FE Sector

As part of the 2019 Valuation, a more prudent approach was followed for the FE Colleges based on concerns about their relative financial covenant (no tax raising powers, no guarantor in place to meet any deficit on cessation, lack of preferred creditor status on bankruptcy etc).

The Government are currently consulting on changes to the way FE colleges are classified, and the potential to introduce an undertaking for the Government to act as guarantor of last resort in respect of pension fund deficits. Such a change if approved would significantly impact the financial covenant of the FE colleges. The Funding Strategy Statement has therefore been drafted to include sufficient flexibility of approach depending on the outcome of the Government review.

Q4. Do you support the additional flexibility included in the Funding Strategy Statement in respect of the funding of FE Colleges?

Employer Cessations

The current approach to employer cessations has either been based on a low risk calculation using current gilt yield assumptions to discount future pension liabilities, or standard risk calculation using the current investment strategy to set the discount rate.

The former basis is likely to over-estimate the cessation payment required as the Fund does not adopt a practice of amending its asset allocation to set aside the appropriate level of government gilts for meet the employers future liabilities and so the Fund continues to earn what are normally the higher investment returns associated with their current investment strategy.

However the second basis increases the risk that whilst over the long term, the investments will deliver an average return in line with the standards assumed, returns may fall short within the period over which the scheme employers liabilities fall due.

The Funding Strategy Statement has therefore been amended to allow the cessation valuation to be carried out consistent with the on-going valuations and current investment allocations, but to permit the Pension Fund Committee in conjunction with the Fund Actuary to assign an appropriate level of certainty to the calculation that the amount received will be sufficient to meet all future liabilities. This approach will therefore be consistent with the tri-ennial valuations of the Fund, and reduce the significant discrepancies between the on-going funding levels and the cessation position.

Q5. Do you support the risk based approach to cessation valuations as an alternative to the current low risk, gilts only basis?

Areas not specifically covered in the Funding Strategy Statement

Alternative Investment Strategies

Previous consultations have included the option to introduce multiple investment strategies with scheme employers free to select the default investment strategy (consistent with the current strategic asset allocation) or to opt for an alternative strategy. As a minimum, it was expected that there would exist a lower risk strategy which led to less volatility in investment performance and therefore greater stability in future employer contribution rates (although likely to be at a level higher than current rates). For long term scheme employers with a strong financial covenant, the option of a higher risk, higher return investment strategy which would allow for lower employer contributions, was also discussed.

When previously raised, there was no interest in developing alternative investment strategies. In discussions with the Fund Actuary, it was determined that the increase in employer contribution rates required to support a lower risk investment strategy are unlikely to be affordable in the current economic circumstances and the Fund did not wish to increase the levels of risks associated with investment strategy targeting significantly higher returns. No changes have therefore been made to the current Funding Strategy Statement to allow for multiple investment strategies.

Q6. Do you support the decision to base the Funding Strategy Statement on a single investment strategy?

Cost of Ill-Health Retirements

The Fund Actuary has noted in discussions with the Fund Officers that some other Fund’s operate an insurance arrangement to support scheme employers against the risk of the potential high one-off costs associated with an ill-health retirement.

In Oxfordshire, we have operated pooling arrangements for the small scheduled and admitted bodies, and more recently for the smaller academy schools, with the pool acting as an insurance fund and spreading the costs of any ill-health retirement across the employers with the pool. We have therefore seen no significant advantage of running a separate insurance arrangement. This position has been clarified in the latest draft of the Funding Strategy Statement. Any employer outside the pools can make their own insurance arrangements outside the Fund if they wish.

Q7. Do you support the decision not to make explicit insurance arrangements for ill-health costs with the Funding Strategy Statement and leave it to the individual employers to make their own arrangements if they so wish (noting the indirect mitigations provided by pooler all smaller employers)?

McCloud

The additional prudence added into the 2019 Valuation results associated with the uncertainty about the impact of costs of the McCloud remedy has been removed from the draft 2022 results as the Fund Actuary has been able to provide a more accurate assessment of costs based on Government Guidance.

Q8. Do you support the removal of the requirement to explicitly disclose any additional costs associated with the McCloud remedy from the Funding Strategy Statement?

Climate Change

The Fund Actuary has carried out a number of scenario tests to look at the impact of climate change on both investment returns and scheme member longevity etc and determined that no explicit actions need to be taken within the Statement to address the risks of climate change.

Q9. Do you support the approach that the risks associated with climate change can be incorporated into the wider risks associated with the management of the Fund and as such no explicit approach needs to be set out with the Funding Strategy Statement?

Summary of Consultation Questions and Consultation Timetable and Process

The consultation period will run for 6 weeks and closes on Friday 18 November 2022. All responses received will be consolidated and reported to the Pension Fund Committee at their scheduled meeting on Friday 2 December 2022 where they will be asked to formally approve the Funding Strategy Statement which will support the 2022 Valuation.

Responses to should be sent direct to Sean Collins, the Service Manager with responsibility for the Pension Fund at sean.collins@oxfordshire.gov.uk or can be sent by post to him at:
Oxfordshire Pension Fund,
4640 Kingsgate
Cascade Way
Oxford Business Park South
Oxford OX4 2SU

Responses should address the specific questions addressed above and summarised below. Respondents are also invited to make any additional comments on the content of the Funding Strategy Statement and associated policies, or on areas currently excluded from the documents which they believe should be covered.

Summary of Consultation Questions

Q1. Do respondents agree that the structural changes to the documents have improved the accessibility, readability and useability of the documents?

Q2. Is there an appropriate split between the high level principles and policies set out in the core document which will require formal consultation to change, and the detailed arrangements set out in the satellite policy documents which can be amended at the discretion of the Pension Fund Committee?

Q3. Do you support the use of a risk based approach utilising a standard time horizon and variable level of certainty as the basis for future contribution calculations? If not, please provide details of proposed alternative approach and reasoning for decision.

Q4. Do you support the additional flexibility included in the Funding Strategy Statement in respect of the funding of FE Colleges?

Q5. Do you support the risk based approach to cessation valuations as an alternative to the current low risk, gilts only basis?

Q6. Do you support the decision to base the Funding Strategy Statement on a single investment strategy?

Q7. Do you support the decision not to make explicit insurance arrangements for ill-health costs with the Funding Strategy Statement and leave it to the individual employers to make their own arrangements if they so wish (noting the indirect mitigations provided by pooler all smaller employers)?

Q8. Do you support the removal of the requirement to explicitly disclose any additional costs associated with the McCloud remedy from the Funding Strategy Statement?

Q9. Do you support the approach that the risks associated with climate change can be incorporated into the wider risks associated with the management of the Fund and as such no explicit approach needs to be set out with the Funding Strategy Statement?

Q10. Do you have any further comments on the content of the draft Funding Strategy Statement and associated policies or on any areas you think should be added to the documents?

Responses should be sent to be received by Friday 18 November 2022 to
sean.collins@oxfordshire.gov.uk or

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