City of
BRADFORD
METROPOLITAN DISTRICT COUNCIL

Report of the Director, West Yorkshire Pension Fund, to the meeting of West Yorkshire Pension Fund Pension Board to be held on 23 June 2020

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Subject: Funding Strategy Statement Consultation

Summary statement:

This report updates the Local Pension Board on the recent consultation on the Funding Strategy to incorporate the Fund's approach to the refund of exit credits and to allow new employer admissions to be on a pass through basis.

Recommendation

It is recommended that the Local Pension Board make any comments on the amendments they would wish the Joint Advisory Group to consider.

Appendix: Draft Funding Strategy statement

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Portfolio

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Overview & Scrutiny Area

1. SUMMARY

1.1 The current Funding Strategy Statement (FSS) requires updating for two reasons.

- To incorporate changes made by the Local Government Pension Scheme (LGPS) Regulations relating to exit credits.
- To change how new employer admissions are administered, to reduce administration and advisory fees, and to provide a further option for employers via the introduction of a pass through ("pooling") approach with effect from 1 April 2020
- The Joint Advisory Group will consider the draft amendments to the FSS and responses to the consulation at its meeting in July.

2. CHANGES TO THE FSS

2.1 Exit Credits

On 14 May 2018 the Government unexpectedly introduced the requirement for funds to pay out an exit credit to employers leaving the LGPS with a surplus (i.e. where the value of assets notionally allocated to the employer exceeds the value of its liabilities on exit). It soon became apparent that this wasn't working as intended and could lead to payments to contractors who had been protected against pension deficits and contribution increases under contractual arrangements that simply did not envisage surpluses being paid out. The Government consulted on possible amendments to rectify the position, and in February 2020 issued a response to that consultation, together with new Regulations which came into force on 20 March 2020. The Government response document was clear that "*Administering Authorities should adopt a fair and reasonable exit credits policy which should be set out in their Funding Strategy Statement*." and stated that "*The policy should aim to protect the interests of the members and employers as a whole and look wider than the interests of the single employer in question.*" It also encouraged administering authorities to take legal and actuarial advice.

We have considered the regulatory changes, sought advice, and developed an approach which we believe achieves the Government's objectives and very clearly protects the interests of members and all employers of the West Yorkshire Pension Fund. In summary:

- For exits where the assets and liabilities are being "subsumed" (i.e. transferring to an ongoing employer, usually the authority which has let the contract), we will instruct the Actuary to calculate the liabilities on exit using the same principles as adopted for setting contributions for the subsuming employer. We think this is fairer to the exiting employer than an approach which changes the basis on which the liabilities are calculated on exit.

  Where there is a surplus on exit, the default approach will be to pay an exit credit which is the lower of the surplus and the total contributions paid by the employer, with a deduction to cover any costs incurred by the Fund in relation to the exit, e.g. actuarial and legal costs. We think this is fairer to the remaining

employers since the exiting employer won't be receiving more from the Fund than it has paid in.

We will liaise with the subsuming employer and exiting employer to ensure that there are no contractual arrangements in place which suggest an alternative approach, e.g. that no exit credit should be paid because all pension costs have been passed back to the letting authority. This is fair to both parties as it will enable us to reflect the specifics of any agreement in determining the exit credit payable.

However, we have retained the flexibility to vary the funding target (i.e. how the liabilities are calculated) in "exceptional circumstances". We don't yet know what those circumstances might be but felt it was important to have that flexibility to protect all employers should the need arise.

- For exits where there is no successor body to take on the liabilities of the exiting employer and a low risk funding target is adopted, the amount of any surplus on exit will be repaid to the employer, after deduction of any costs incurred by the Fund in relation to the exit, e.g. actuarial and legal costs. We think this is fair to the exiting employer since it is likely to have paid higher contributions than other employers due to there being no successor body. We also think it is fair to the other employers since the low risk funding target is intended to ensure that the Fund could (broadly) invest in a portfolio of government bonds to meet the liabilities, so reducing the investment risk required to pay members' benefits after the employer has exited.

2.2 Pass through (pooling)

WYPF has traditionally treated each employer individually for funding purposes, with each having its own individually assessed funding position and contribution rate. However, as the number of small admissions has risen, with many of these being in relation to contracts of less than 5 years, we have come to the view that these arrangements not only lead to contributions which can be very volatile for the employer, but they also require disproportionate administration time and advisory (actuarial) costs. We had been waiting for the long-promised Fair Deal changes before reviewing our approach, but Government has other priorities and it is not clear if, or when, any regulatory changes will be made.

We are therefore proposing to implement a default approach whereby contractors with fewer than 100 members and a contract period of less than 5 years will be "pooled" with the letting authority for funding purposes. This means the Actuary won't need to calculate a notional transfer of assets from the letting authority to the contractor nor assess the contractor's contribution rate on commencement. The contractor would simply pay the same contribution rate as the letting authority. In addition, no exit payment would be due to or from the contractor on exit and the contractor's assets and liabilities would be retained within the letting authority's pool (as if subsumed). The contractor would be charged for any additional contributions due on redundancy early retirement or where additional pension is granted but otherwise all funding risks would be shared within the pool. In effect, the Actuary would treat the contractor and letting authority as a single employer when calculating contribution rates.

In addition, we are able to offer this flexibility for other contracts, i.e. where the letting authority and contractor agree, the Fund is willing to administer this pooling approach for longer-term and larger contracts. Our template admission agreement will include standard wording to document these arrangements.

It is proposed that the new pass through / pooling arrangements will come into operation for any admissions with a commencement date on or after 1 April 2020.

3. CONSULTATION EXERCISE ON THE PROPOSED UPDATES TO THE FUNDING STRATEGY STATEMENT

3.1 In accordance with Regulation 58 of LGPS Regulations 2013 a consultation exercise has been completed with elected members and employer representatives on the proposed changes to the FSS to incorporate the changes described in 2.1 and 2.2 of this report.

3.2 Any comments received in response to the consultation will be considered before asking the Joint Advisory Group to approve the changes to the FSS.

3.3 A copy of the draft Funding Strategy statement can be found at Appendix A.

4. RECOMMENDATION

It is recommended that the Local Pension Board make any comments on the amendments they would wish the Joint Advisory Group to consider.

5. APPENDIX

Draft Funding Strategy statement