Appendix 2

Report of the Director, West Yorkshire Pension Fund to the meeting of Joint Advisory Group to be held on 30 July 2020

Subject: Funding Strategy Statement (FSS)

Summary statement:

Following a consultation exercise with all stakeholders WYPF's current Funding Strategy Statement requires updating to cater for two key items:

- Changes to the Local Government Pension Scheme (LGPS) Regulations relating to exit credits, which came into effect on 20 March 2020, effective from 14 May 2018; and

- Changes to how new 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.

We have also taken the opportunity to clarify that the costs of employers joining and exiting the Fund will generally be re-charged to the relevant employers to avoid all employers in the Fund picking up these costs (which will principally relate to actuarial and legal fees).

Recommendation

The Joint Advisory Group approve the changes to the Funding Strategy Statement.

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Portfolio:

[Insert where appropriate]

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[Insert where appropriate]

1. SUMMARY

1.1 In accordance with Regulation 58 of the LGPS Regulations 2013:

- An administering authority must, after consultation with such persons it considers appropriate, prepare, maintain and publish a written statement setting out its funding strategy.
- The authority must keep the statement under review and, after consultation with such persons as it considers appropriate, make such revisions as are appropriate following a material change in its policy set out in the statement, and if revisions are made, publish the statement as revised.

1.2 A consultation exercise on the proposed amendments to the FSS ran for 4 weeks up until 31 May 2020.

2. CHANGES TO THE FSS

The Fund consulted on updates to WYPF's Funding Strategy Statement to cater for two key themes, exit credits and pass through, or pooling.

3. Exit credits

3.1 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.

3.2 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. Our proposed approach is set out in the attached Funding Strategy Statement, or FSS (principally the Policy on New Employers and Exit Valuations appended to the FSS). The proposed changes are highlighted to make it easier for you to review them. 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 back 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. You should note however that 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.

3.3 The Regulations require that exit credits are paid within 6 months of the exit date or later date agreed with the exiting employer. In order to achieve this, the Fund will require the exiting employer to provide all the necessary information within 2 months of the exit date. If all the information is not received on time, the presumption will be that the exiting employer has agreed to a period of 6 months from the date all information is provided. In addition, employers must provide any relevant information in relation to the contractual arrangements or other relevant factors within the period specified by the Fund (expected to be 2 weeks in most cases). If no response has been received within the period specified, the Fund may proceed to finalise its determination and pay the exit credit where required to meet the regulatory timescales.

3.4 The changes also clarify that where an employer has a guarantee from another employer that any unpaid exit deficit will be met by the guarantor, the default approach will be for the exit valuation to be carried out on a low risk basis. The guarantor will have the option to "subsume" the assets and liabilities on exit, in which case the Actuary will calculate the liabilities on exit using the same principles as adopted for setting contributions for the subsuming employer. The subsuming employer may, at its discretion, agree to subsume the assets and liabilities on condition that any surplus on exit is retained within its notional share of the Fund rather than being refunded to the exiting employer.

4. Pass through (pooling)

4.1 The Fund 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 lead to disproportionate administration time and advisory 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.

4.2 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.

4.3 In addition, we are pleased 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

5. Re-charge of Costs

5.1 The Fund has also taken the opportunity to update our policies to clarify that the costs of employers joining and exiting the Fund will generally be re-charged to the relevant employers to avoid all employers in the Fund picking up these costs (which will principally relate to actuarial and legal fees).

6 Revised FSS

6.1 The draft FSS (previously attached as Appendix A) is now Appendix 1 to the report to the Governance and Audit Committee.

7. Consultation responses.

7.1 Only one response was received during the consultation period. Details of the comments and WYPF's response to those comments are shown at Appendix A (Appendix B in the original version of this report)

8. Recommendation

8.1 The Joint Advisory Group approve the changes to the FSS.

9. Appendices

Appendix A - Consultation response.