

Report of the Managing Director of West Yorkshire Pension Fund to the meeting of Joint Advisory Group to be held on 27 July 2023

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Subject: Review of Employer Exit Policy

Summary statement:

The Investment Advisory Panel will review WYPF's strategic asset allocation at its meeting on the morning of the 27 July 2023. Should the Panel agree to make changes to the strategic asset allocation, this could have implications for some of the calculations undertaken by the WYPF actuary, as the level and expected volatility of future investment returns are inputs in the model the actuary uses.

Given the above, this may also be an opportune time to review WYPF's Employer Exit Policy and in particular the exit basis for non-tax raising bodies whose liabilities become orphan on exiting the fund. These were last reviewed prior to the significant increases in inflation and interest rates which have taken place over the last couple of years.

The report sets out a proposal for how a review of the Exit Policy could take place and recommended changes be brought back for approval by the Joint Advisory Group at its January 2024 meeting.

EQUALITY & DIVERSITY:

None

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Portfolio:

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Overview & Scrutiny Area:

1. BACKGROUND

- 1.1 One of the most important aspects of any LGPS funds' funding strategy is how liabilities are valued for employers that cease to participate in the fund. This employer exit event occurs when an employer has no remaining contributing active members (and is not expected to do so in the short to medium term).
- 1.2 Historically, many exiting employers were required to pay substantial exit debts. If the liabilities were not being subsumed by another ongoing employer and were instead 'orphaned' – i.e. needing to be met by all remaining active employers, then the liabilities were typically valued on a prudent basis, for example assuming future investments returns were in line with risk-free Government bond yields. In addition there was no ability for employers to receive a payment from the fund should the funding position of their liabilities be in surplus.
- 1.3 However, amendments to the LGPS Regulations between 2018 and 2020 have allowed for exiting employers to potentially receive a return of surplus and have introduced the need for LGPS funds to develop relatively detailed exit policies.
- 1.4 Following the introduction of these amending regulations WYPF and its actuary Aon undertook a review of how liabilities are calculated for non-tax raising bodies whose liabilities become orphaned on exit. As a result the Fund changed the methodology used in these calculations in January 2022.
- 1.5 The Fund adopted a 'Probability of Funding success' approach, moving away from the more traditional method of assuming future investment returns would be in line with risk-free Government Bond yields. At the time this change typically reduced the value placed on the exiting employers' liabilities and therefore reduced the cost of employers exiting the Fund.
- 1.6 However, due to the significant increases in bond yields over the last 18 months, the current methodology now typically places a higher value on the exiting employer's liabilities than the Government bond based approach and may potentially be viewed as overly prudent.
- 1.7 One of the inputs in the model the actuary currently uses is the expected level and volatility of future investment returns from the WYPF asset portfolio. The Investment Advisory Panel will be reviewing WYPF's strategic asset allocation at its meeting on the morning of the 27 July 2023. Therefore it did not seem appropriate to ask the WYPF actuary to do any modelling prior to that meeting taking place.

2. PROPOSED PROCESS

- 2.1 Following the review of the strategic asset allocation which is taking place at the 27th July IAP meeting, it is proposed that the Fund Actuary (Aon) will be asked to review the impact any changes to the asset allocation may have on the exit basis using the current methodology and what impact reducing the Probability of Funding success from its current level of 95% may have.
- 2.2 A Joint Advisory Group sub-group is to be established to meet, as necessary during

autumn 2023 to consider any updated advice from Aon and proposed updates to the exit policy, which forms part of the WYPF Funding Strategy Statement.

- 2.3 If any material changes to the Funding Strategy Statement are proposed then these require consultation with stakeholders, in particular participating employers.
- 2.4 If a consultation exercise is required then it is envisaged that this is undertaken in advance of the January 2024 Joint Advisory Group meeting, with the revised FSS being in a position to be approved at that meeting.

3. LEGAL CONSIDERATIONS

- 3.1 In accordance with the Local Government Pension Scheme Regulations (LGPS 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.

4. RECOMMENDATION

- 4.1 The Joint Advisory Group approve a sub-group to convene during Autumn 2023 to consider advice received from the Fund Actuary.
- 4.2 Any proposed material changes to the Funding Strategy Statement to be consulted on with employers and brought to the January 2024 Joint Advisory Group meeting for approval.