UNIVERSITY of BRADFORD
Offices of the Vice-Chancellor

Andrew Lang
Chief Finance Officer

Caroline Blackburn

Head of Employer Services and Compliance

West Yorkshire Pension Fund

(by email)

21 December 2023

Re: WYPF Funding Strategy Statement consultation 2023

Dear Caroline,

Please find below our response to the Funding Strategy Statement consultation. We welcome the opportunity to engage with the Fund and agree it's an important time for review given the new funding and investment landscape created by the recent significant market changes.

Prior to providing our formal response, whilst we were aware that a consultation was being conducted, we did not receive a communication on the process, and formal request, until we chased this ourselves. Although we understand that mistakes can happen with circulation lists (which was acknowledged by your team) we hope that is not a broader indication that other employers have also been omitted from the request for responses as it is important that all have an opportunity to contribute.

We note that the consultation communication focuses only on the exit valuation basis, but we also consider that the Funding Strategy Statement must be consulted on as a whole, and not just in part, and so we have raised some wider considerations as part of our response. We view these as important issues, directly connected to the exit basis discussion, and we very much hope they are considered by the Joint Advisory Group.

Informed employer

As you are aware in our ongoing communications, we have taken detailed advice from our pension advisers, Isio. They are a firm with a specialist public services team with Local Government Pension Scheme expertise. Considering the investment we have made in becoming an informed employer, we believe our response should significant weight as part of the consultation. We also recognise that there is a history of inertia amongst LGPS employers, not just in WYPF, many of whom do not respond at all to such consultations, either through lack of expertise, or lack of time. There is a danger that nil responses are deemed to constitute a position of agreement. We do not think this is appropriate and we consider, taking into account our concerns around the quality of the consultation, that nil responses should not be counted.

Feedback on the employers' annual meeting

Thank you for the time given to preparing for and presenting at the recent annual employer meeting and signposting the consultation that would be shared. We do not believe that this has been done for previous consultations and we found this valuable to help us prepare. Thank you.

The session was useful to understand the Fund's view on the current funding position, the investment strategy, and the proposed consultation. However, there was no engagement with the audience (perhaps only because of technology failings), and limited evidence that the employers' perspectives

Andrew Lang
Chief Finance Officer

were understood or being considered. There were a few points raised by the actuary that we did not agree with (some of which are raised later in this document), or we wanted to understand further, but did not have the opportunity to question them at the time. We note that even though it was intended to give employers the opportunity to ask questions at the very end of the meeting, the technology wasn't switched on and so we were not able to contribute. Therefore, it should not be considered that there was general understanding and agreement from the audience as part of that helpful meeting.

Please can we ask that the Fund considers ways this could be improved in the future, such as changing the format of the meeting, and making sure there is a facility to ask questions and to hear the voice of the employers (without which there would be no fund).

We also suggest that a feedback request is issued following the meeting, providing an opportunity to follow up and to ask questions, which would be normal practice after a webinar.

Our response to the WYPF Funding Strategy Statement consultation November 2023

Executive summary

As you know from our previous correspondence, we strongly agree that the Fund's current exit valuation approach leads to poor outcomes in current market conditions. We are pleased this has been recognised and changes are being made. However, we are concerned the proposed changes aren't sufficient.

Our strong view is that WYPF should move back to a gilts based discount rate approach, rather than look to refine the current approach, which isn't working. We also consider that WYPF should adopt low-risk investment strategies for orphan liabilities and for participating employers as an option. These two changes should come hand in hand, but not changing the latter should not be an excuse for not considering the former.

We believe the current exit basis, combined with wider policies in the Funding Strategy Statement and Statement of Investment Principles are, through a number of different threads, limiting opportunities available to employers to utilise the significantly improved funding in their participations. In particular:

- The ongoing funding approach is not being changed, even though it is based on the same approach as the exit valuation approach – this hides recent funding improvements
- The policy for reviewing contributions between valuations seeks to disallow changes on account of changes to market conditions, which goes beyond the regulations and the statutory guidance
- The WYPF only supports a single investment strategy, which makes a gilts based exit valuation approach risky and results in a proposed approach which cannot be hedged
- Partial exit, whilst possible in theory, is not in practice because the proposed exit valuation basis continues to over-charge exiting employers, to the benefit of the remaining employers

We request the Fund also carries out a wider review of the Funding Strategy Statement in the context of the recent market changes, to enable employers to manage their cost and risk objectives and the Fund to meeting its cost efficiency objective. We also request the Fund reconsiders its decision to continue with a single investment strategy.

We outline our considerations supporting these views below.

Andrew Lang
Chief Finance Officer

1. **A gilts-based approach for exit valuations**

   In our view a gilts-based discount rate approach remains the most appropriate method for the exit valuation and the Fund should revert back to a gilts based discount rate.

   a. A gilts-based approach is in line with the pension industry standard approach for valuing "settlement amounts" and is also widely used across the LGPS, although we are aware of a recent trend towards alternative approaches used to discourage employer exits. (Note: we believe the best way to discourage employer exits would be to provide better risk management options.)

   b. A gilts-based approach is able to be hedged. It allows assets to be invested in a way that closely matches the funding approach. The current and proposed approach cannot be hedged.

      One of the arguments for the proposed new approach is that it provides more stability, but we do not believe this to be true. The Fund's assets and the proposed exit liabilities do not move in line and we are not aware of any investment strategy that can hedge the proposed approach. It is very important that the Fund considers what this means for employers for whom LGPS obligations often represent a very material balance sheet risk. Having an exit position that is not able to be hedged is not acceptable to us.

      Note that the fact that there is currently a single investment strategy, including for orphan liabilities, is not a reason to dismiss this argument in our opinion. The decision to stick with a single investment strategy is also not one we agree with.

   c. The current and proposed exit valuation approach is complex and non-transparent. It is not replicable, even with the assumptions disclosed. This means that employers cannot easily understand their underlying exposure to the Fund or the options available to them to manage risk. A gilts-based approach is more transparent and easily replicable and enables employers to understand and track their exit valuation.

   d. WYPF previously adopted a gilts-based approach. We do not believe it was appropriate to move away from this approach and the WYPF should now consider reverting to the approach applied prior to 2021.

      i. Whilst the previous consultation resulted in an improvement in exit positions for employers, had we had the chance to respond fully at the time (noting that it was a very short consultation, with little notice, held over the Christmas holiday period) we would have disagreed with the methodology even then.

      ii. We understand the consultation on the exit debt basis in 2021 was driven by market conditions at the time. The environment has now changed and the conditions that drove the previous change are no longer relevant.

          In 2021, the Fund's view was index-linked gilt prices did not represent value for money and so it was not appropriate to continue assuming that orphan exit liabilities would be backed by them. Whilst this may have helped reduce the cost of exit for employers at the time, we still consider it is appropriate to invest the assets in respect of settled liabilities with matching assets (i.e. an appropriate mix of index-linked bonds). Given the change in gilt prices, the Fund could now quite easily opt to back the orphan liabilities with gilts in a cost-efficient way, significantly reducing the level of risk for these liabilities.

Andrew Lang
Chief Finance Officer

iii. Has the WYPF considered reverting back to the gilts based approach rather than trying to fix an approach that you believe is no longer working? The consultation, including the responses to our questions, does not provide any supporting evidence of the alternative approaches considered.

e. We do not agree that with the assertion that the Fund and Aon are presenting gilts as risky. If you invest in gilts, but do not measure the liabilities using gilt yields then this creates funding risk, but this is an entirely unnecessary risk and should not be presented as a reason not to use a gilts-based approach. Even if you choose not to offer employers a low risk investment option (which we disagree with), the orphan liabilities should be invested in a low risk way. Also, reference to the crisis faced by trust-based schemes in 2022 as being evidence of gilts being risky is not appropriate. This was not about gilts being risky – if those schemes had been invested directly into gilts rather than LDI there would not have been a crisis for trust based schemes.

2. **Significant prudence**

The current approach results in an overly prudent basis that will overfund the Fund, overcharging exiting employers to the benefit of the remaining employers (who should not feel comfortable with this cross subsidy in their favour). We can see from the information received, that the current approach results in a single equivalent discount rate that is significantly below gilt yields and we expect this to remain the case after the proposed changes.

We also anticipate the current approach is more prudent than current insurer pricing. It is difficult to see how the WYPF can reasonably charge more than a third-party insurer.

a. High level analysis completed by our advisors on the 31 December 2022 exit valuation we received indicated the effective discount rate using the current approach was comparable to gilt yields less 0.9%. Based on the answers to our consultation questions, we can now see this difference is 1.2%. We can see that, as expected, the difference has extended much further and was 1.95% as at 30 September 2023. (We note that we would not have this information if we were only looking at the consultation materials.)

b. The consultation suggests the proposed changes reduce the discount rate by 0.6%, meaning the revised discount rate will still be significantly more prudent than a gilts-based approach. This is supported by the answers we have received to our previous questions.

c. We agree that, as stated in the employers' annual meeting, LGPS liabilities cannot be "bought-out", but this is a misleading statement and we do not believe that this argument should be used to support the justification for the change to the exit valuation basis. The important and relevant point is that the Fund could buy a "buy-in" product with a third-party insurer. This has been demonstrated by other LGPS funds.

d. A buy-in, save failure of the insurance provider, represents a complete de-risking of pension liabilities. Furthermore, a third-party insurer is going to take an approach to valuing liabilities which seeks to make profit. With the limited information they have available our advisers estimate the Fund's proposed approach is more prudent than the insurance market at the current time, reinforcing why it is not appropriate. In addition, for reasons discussed above, the proposed approach moves out of line with the cost of a buy-in policy.

3. **Detailed methodology and review of the proposed funding approach**

   You have not provided details supporting the proposed discount rate change which makes it difficult to understand how it has been derived, or what supporting analysis the WYPF has completed to arrive at the proposed approach. This is both disappointing and concerning.

   a. The proposal shared reduces the Probability of Funding Success from 95% to 90%. Whilst helpful to have an indication of the impact on the effective discount rate in current market conditions, it is difficult to understand how this is derived. The response to our questions does not shed any more light on this, it only goes to confirm that advice was given to the Fund and the Fund and the actuary used that advice.

   b. Crucially, you did not offer any details of Aon's asset return assumptions on which the whole approach rides. You have offered it as part of the answer to questions, but in a way which makes it difficult to share with our advisers. We do not have time to review the full information shared ahead of submitting our consultation response. We would also note that these were not provided at the annual employers meeting, despite these assumptions being a crucial part of the conclusion that the funding position has not improved. Not only do we not know the assumptions, we do not know how they are derived. In the answers to our questions it is stated that "..it is clear what the underlying parameters are..". This is not the case.

   c. You have not provided details of any analysis carried out to support the 5% change. How are you comfortable this reduction is sufficient? We would like to have a very clear explanation as to why the Fund believes the revised discount rate approach represents an acceptable level of prudence in current and future market conditions. The answers to our questions suggest that this finds the right balance between exiting and remaining employers, but without any detailed explanation or quantification.

   d. Presumably, there will be a need to regularly review the Probability of Funding Success in the future, given the fact that it is not resilient in the face of changing market conditions. This will add further complexity to the approach and make it even more difficult for employers to understand and track their exit position.

4. **Wider implications for the Funding Strategy Statement**

   a. ***Section 5. Solvency Issues, Target Funding Levels and Long-term Cost Efficiency***

   The ongoing funding approach, which drives the cash contributions employers pay, adopts the same methodology as the exit valuation with a different Probability of Funding Success. The unprecedented changes in market conditions have led to the review of the exit valuation approach. We strongly believe that the Fund should also review the ongoing valuation approach. Your answer to our consultation question on this simply states that this does not need to be reviewed until 2025, by which we infer it should be reviewed. But, by delaying this review, we believe opportunities to create good outcomes for your employers (including councils) are being missed.

   We are concerned that the underlying reason for not choosing to review the ongoing funding position is the significant potential practical consequences for the Fund. If this is the case, then the resourcing issues should be tackled head on and in a transparent manner.

Andrew Lang
Chief Finance Officer

b. ***Appendix 2: Policy on reviewing Employer Contributions between Triennial Valuations.***

Given the significant improvements in market conditions since the last valuation date, we are in discussion with WYPF on the options available for reviewing our contributions. We understand your view is that this would not result in a contribution reduction given:

- The Funding position hasn't improved under your funding strategy approach (even though you acknowledge it has on a typical exit basis)
- You are constrained under your funding strategy by how you categorise Employers. You state in your response dated 16 November 2023 that you don't believe it is appropriate to include University of Bradford in the lower risk contributions category as we are not a scheduled body.

In our view, given our position with a surplus on a very low risk basis, our covenant is now very strong, and it wouldn't be unreasonable to treat us as a lower risk employer. Furthermore, we believe that very high surpluses should be able to be recovered over short time periods.

Whilst the regulations on employer flexibilities are quite open, WYPF is constrained by the policies set out in the current Funding Strategy Statement. Given this was created in a very different market environment we believe that WYPF should now be reviewing these important elements of your funding policy as part of this consultation to provide better outcomes for the fund and its employers.

5. **Utilising surplus objective**

As you know we are having ongoing conversations with WYPF on the options available to utilise our surplus, ideally by de-risking our participation.

We can't meet our de-risking objectives for reasons we don't agree with, which means the University has value trapped in the Fund.

This issue will not be unique to us and there will be other employers in a similar position. We consider that through a combination of this consultation, and other factors that the Fund is not consulting on but should be (see above), the Fund is preventing good outcomes from taking place.

a. Our participation has a surplus on the ongoing basis, and even has a surplus on a low-risk (gilts based) basis. In our view, if there is a surplus in the Fund an employer should be able to use this, either to de-risk their participation or reduce the level of contributions paid.

b. We are not able to utilise the funding improvements seen:

- We can't de-risk through the investment strategy, given the Fund continues with a single investment strategy and has no plans to offer any de-risked options.
- We can't de-risk using partial exit, despite the fact that you have confirmed that this is possible, as it remains poor value for money with the current and proposed exit valuation basis.
- We can't reduce our contributions, because, despite the adjustments to the exit valuation approach you consider the ongoing valuation approach should not be reviewed until 2025,

Andrew Lang
Chief Finance Officer

c. We understand there are wide implications of making change, but the Fund must engage with current market conditions rather than avoid them. If additional resources are required for the Fund to deal with these, then these must be found and can be paid for from Fund assets.

d. We believe that the Joint Advisory Group should be able to deal with individual employer concerns, noting that this is not presently its remit. The Fund's role is to find the best balance of funding and risk between themselves and their employers and JAG needs to listen to the voice of the employers who support their Fund.

e. We would ask again for the Fund to urgently consider whether alternative investment options could work. We appreciate that providing the option for all employers to have a bespoke investment strategy will be complex, but we know a number of other funds within the LGPS do offer a lower risk investment strategy option as an alternative for employers.

6. **Consultation approach**

We would like to feedback that the timescales for the consultation period have again been very tight for employers to respond. We are also concerned about the validity of the consultation and whether the proposed changes are already a pre-made decision.

a. The consultation spans the Christmas period and also overlays with busy audit seasons for many of your education employers. As employers we need time to understand the proposals and what is being consulted on, seek advice, discuss, and agree our position internally and then draft the consultation response. Please can this be considered for future consultations to ensure all employers are given the chance to give this the time it needs. Otherwise, there is a risk to you that the consultation is not effective.

   We have raised several technical questions to help support our consultation response and only recently received a response on 18 December. Given we need to respond in this week before Christmas to meet the consultation deadlines, due to team holidays between Christmas and the consultation deadline, we haven't been able to fully incorporate them into our response.

b. The employer meeting gave the impression the proposed changes are a pre-made decision ready to be ratified at the January meeting. This is reinforced by the short consultation period, and the short amount of time given between the end of the consultation period and the JAG meeting on 25 January. Do you have sufficient time to review and fully consider all the consultation responses in the very short amount of time between closure of the consultation and the meeting papers being finalised in advance of the meeting? We hope the Fund has taken legal advice on the legal validity of the consultation and would be pleased to see this.

We expect the Fund to take full consideration of the points we have raised in this response when making their decision and provide feedback on the points we've raised. We would welcome the opportunity to discuss this response further and to present our views as part of the deliberations.

Yours sincerely,

Andrew Lang