DECEMBER 2023

West Midlands Pension Fund

SPECIAL BRIEFING NOTE – FUND EMPLOYERS

Funding Strategy – Response to Surplus

BACKGROUND

Prevailing Legislation

Regulation 62(1) of the LGPS Regulations 2013 confirms the requirement for an administering authority to obtain an actuarial valuation of the assets and liabilities every three years, to include provision of a report by an actuary and a rates and adjustments certificate setting out the contributions payable over a three-year period.

Regulation 64(a)1 – Enabling legislation often known as "employer flexibilities" which allows an administering authority to obtain a revision of the rates and adjustments certificate when supported by the FSS and where:

a) It appears likely that the amount of the liabilities has, or could, change significantly since the last valuation.

b) It appears likely there has, or could, be a significant change in the Scheme Employer's covenant.

c) A Scheme employer requests a review of contributions on the basis of either a) or b) above and have undertaken to meet the costs of the review.

As this legislation constitutes enabling provisions, responsibility remains with individual administering authorities and their LGPS funds to review and implement as appropriate. The LGPS Scheme Advisory Board (SAB) has produced guidance to assist administering authorities and employers on the implementation of these regulations[1], confirming that relevant changes to pension liabilities (as outlined in (a) above) are those driven by changes in membership and/or member data and not those driven by any economic changes since the last triennial valuation.

Fund Policies

The LGPS Regulations 2013 require administering authorities to prepare and maintain a Funding Strategy Statement (FSS) having regard to the guidance produced by The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Fund's Investment Strategy Statement (ISS). The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded and, insofar as is practical, designed to support in ensuring that employer contributions over time result in sufficient asset share to meet the liabilities associated with the benefits promised to their members.

The funding and investment strategies are reviewed and development alongside the Fund's employer covenant and risk monitoring framework to ensure an integrated risk management approach to delivery of funding objective over the long term.

The Fund's FSS was most recently reviewed as part of the 2022 actuarial valuation and finalised following consultation with employers, in March 2023.

Referenced within the FSS is; a) the Termination Policy (Termination Policy 2023 (wmpfonline.com)), which sets out the Fund's policy for assessment of ongoing contribution requirements and termination payments on the cessation of an employer's participation in the Fund; and b) the Employer Risk Management Framework (Employers - Risk Management Framework (wmpfonline.com)), which sets out the Fund's approach and framework for monitoring employer covenant.

[1] LGPS Scheme Advisory Board - Employer Flexibilities (lgpsboard.org)

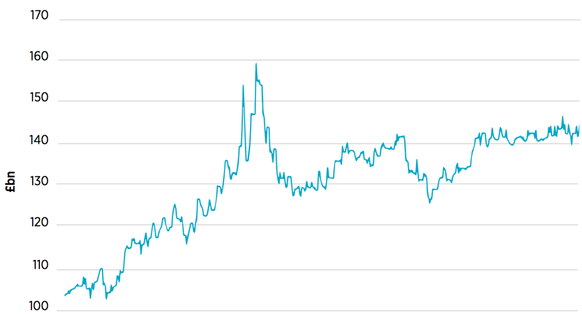
FUNDING POSITION AND INCREASE IN SURPLUS

Funding Development Since 2022

At the 31 March 2022 actuarial valuation[2], the Fund reported a funding level of 103%, this was an improvement of 9% from the prior triennial valuation (with a 13% improvement in funding level from 2016 to 2019) and driven primarily by favourable investment returns over the period.

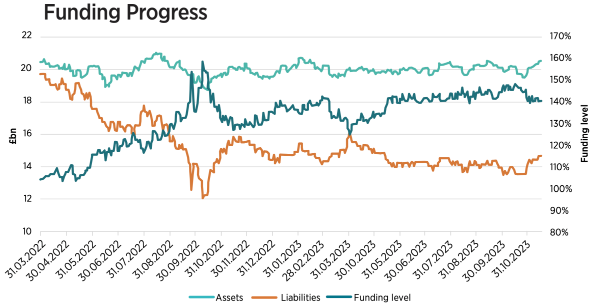
More recently, and primarily driven by increases in gilt (government bond) yields and the change to long-term assumptions used to measure liabilities at a point in time, the indicative funding level at Whole-Fund level has estimated to have increased to 140% as at 30 September 2023 on the ongoing valuation basis (note, this is based purely on a roll-forward of 2022 results and reassessment to reflect changes in market conditions and assumptions since 2022).

a) 'Whole-Fund' Funding Level 1 April 2022 to 30 September 2023



b) Asset and Liability Movement Since 2022

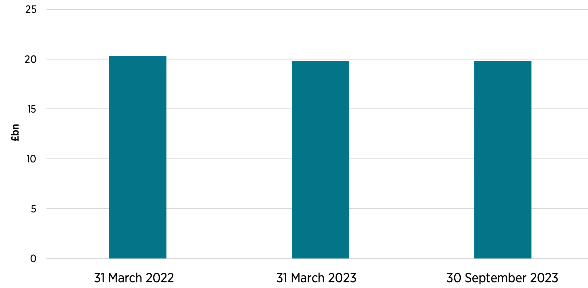
Funding Progress



This level of improvement is broadly consistent with that seen across the majority of LGPS funds and is predominantly driven by a remeasurement of liabilities, reflecting a high level of discount applied to assess the present value of future benefit payments. However, this is purely a reduction of market conditions and does not allow for other influencing factors such as membership movements, experience (including persistent inflation and realised investment returns) and wider review of assumptions in context of shifting economic environment.

As demonstrated in the chart C, showing assets/AuM as at 31/3/22 and 31/2/23 and 30/9/23, the assets under management by the Fund have remained broadly static since 31 March 2022 as valuations across market classes have been impacted by slowing growth and persistent inflation with outlook subdued in context of rising geopolitical risks and conflict.

c) Fund Assets under Management 31 March 2022 to 30 September 2023



The position for individual employers will naturally vary, reflecting the diverse make-up of our employer base, the differing membership maturity profiles, and also different time-horizons for funding.

In addition, the methodology used for assessing the funding position will also vary depending upon the circumstances. For instance, for certain employers approaching exit, consideration of the developing termination liability may be a more relevant focus.

Interpretation in the Context of Funding Strategy

a) Ongoing participation and the treatment of surplus

It is important to emphasise that the Fund's funding strategy is predicated upon achieving the solvency of the Fund and stability of contributions over the long-term. In doing so, we do not seek to reflect short-term market forces, but rather maintain a longer-term strategy with a review point every three years with each triennial actuarial valuation. Outside of the "employer flexibilities" legislation (above), and again recognising that these are purely enabling in nature, the LGPS Regulations do not make any provision for a review of employer contributions outside of the triennial cycle.

The LGPS SAB guidance confirms that changes in funding (driven by market conditions) since the last actuarial valuation should not, in general, be allowed for unless specifically justified. As a principle the appropriate starting point would be the approach from the Funding Strategy Statement (FSS) in force at the time, using assumptions as at the date of the actuarial valuation to which that FSS relates.

The Fund's policy on contribution reviews inter-valuation is set out in Addendum 3 of the FSS and provides further examples, not intended to be exhaustive, of the circumstances under which a review may be considered.

b) Accounting surplus at year-end

A prescribed set of assumptions are applied in accordance with accounting disclosures (FRS102/IAS19) when assessing an employer net asset positions. Obtaining accounting disclosures and the assumptions used, remain the responsibility of the employer, to be reviewed and agreed with their auditors, including the treatment of any surplus.

[2] Fund Actuary Report on the 31 March 2022 Actuarial Valuation

c) Surplus upon exit

When an employer exits the Fund, a termination assessment is carried out by the Fund actuary, using a methodology determined based upon the characteristics of the employer. In some cases, this assessment may confirm a surplus upon exit.

The Fund's approach towards payment of any surplus upon exit, is set out in section 4.7 of the Termination Policy, noting that the administering authority reserves the right to modify the approach on a case-by-case basis, in context of overarching responsibility to ensure long term solvency and mitigate risk falling on remaining employers.

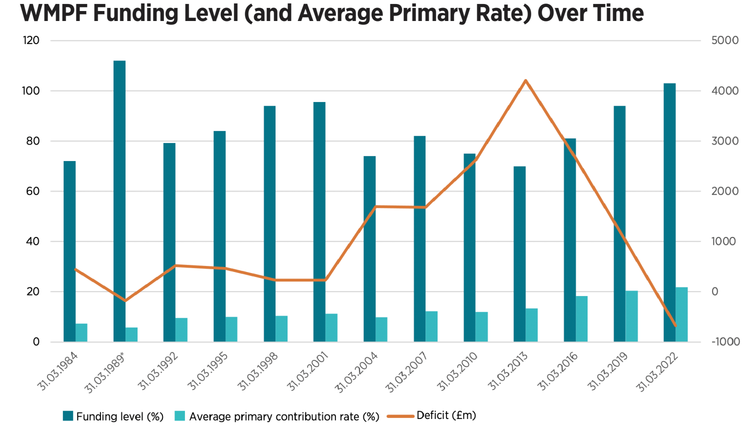
Summary

Reflecting upon the Fund's history over the last four decades, the current surplus environment (>100% funded) at Whole-Fund level is relatively unprecedented (the 'surplus' recorded in 1989 was set against a funding target of 75%) reflecting the step change in market indicators and assumptions around future investment growth, for which it remains to be seen whether it will translate into practice. This has naturally increased the focus upon LGPS funds' management of surplus both in the short and longer-term and we will continue to review the basis of our funding monitoring to signal potential for change in measurement.

As set out above, the Fund maintains a longer-term funding strategy and despite recent market conditions, acknowledging the prevailing legislation alongside our own policy framework, the Fund is not seeking to review employer contributions prior to the next triennial review, due 31 March 2025. Nonetheless, there may be individual employer circumstances which merit a review inter-valuation and these will be considered on a case-by-case basis, yet for the avoidance of doubt, market conditions and the associated impact upon assumptions (including the prevailing discount rate and measurement of liabilities) will not be deemed a suitable reason for review, all other things remaining equal.

The Fund regularly reviews our strategy and approach and, as part of FSS/ISS reviews following employer consultations concluding in 2020 and 2023, we sought to utilise funding upside to stabilise or reduce employer contributions and reduce investment risk. Further consideration will be given to employer contributions in the context of our Integrated Risk Management Framework (considering the appropriate balance of risk (and return) across funding and investment strategy and underpinned by employer covenant) ahead of, and for implementation at, the 2025 actuarial valuation. A further update will be provided in the summer of 2024 following a review of the 31 March 2024 position. In the meantime, we continue to value engagement and dialogue from participating employers on this matter, particularly in the context of your own business and budgetary planning.

WMPF Funding Level (and Average Primary Rate) Over Time



Contact us

For all employer/payroll provider queries related to ESS, including estimate requests or issues, data submission queries, or to request support in using ESS, please email:

WMPFEmployerSystemSupport@wolverhampton.gov.uk

For all other employer/payroll provider queries that are not specifically related to your use of the new system, including onboarding and cessation queries or member data queries, please email:

WMPFEmployerLiaison2@wolverhampton.gov.uk

Alternatively, for all types of employer query, you can call our Employer Services helpline:

0300 111 6516

Operating hours:

Monday to Thursday 8:30 – 12:00 and 2:00 – 5:00

Friday 8:30 – 12:00 and 2:00 – 4:30