Wiltshire Council

Wiltshire Pension Fund Committee

14 December 2022

Wiltshire Pension Fund – Cessation Policy review

Purpose of the Report

1. The purpose of this report is to seek approval for an important, but technical change, to the Fund Cessation Policy

Background

1. At the Fund's meeting on 17 November 2022, the Committee approved the adoption of a number of new/amended key policies and strategies. In relation to the Fund's cessation policy, officers proposed an initial approval of a general cessation methodology change (for some cessation types) but asked to bring back a key decision to this meeting once further analysis was possible.

2. In the following paragraphs (in italics), officers have repeated the considerations from the last paper as some context to this paper.

Cessation calculation methodology review (Low Risk basis/Employers with no guarantor)

3. *At present, when any employer leaves the Fund, the actuary will perform a cessation calculation to help identify what is an appropriate exit funding position for that employer and thus whether this creates the need for a cessation deficit to be recovered or cessation surplus to be paid. The Fund takes a different approach to this valuation depending on whether a scheme employer guarantor sits behind the existing employer.*

   Methodology A ('ongoing' – for employers with a scheme employer guarantor): The actuary performs the cessation valuation on a basis which is broadly similar to the approach used for the whole Fund valuation. This already includes a layer of prudence baked in by using a discount rate which should achieve fully funding in 75% of the actuary's 5,000 modelled outcomes (and a flat discount rate for years further in the future).

   Methodology B ('low risk' – for employers without a scheme employer guarantor): At present, the actuary takes a more prudent (but not modelled) approach to setting the discount rate by setting it equal to the yield of long dated gilts.

4. *The actuary and officers propose changing methodology B so that it more similar to methodology A but with a higher level of prudence than methodology A still applied. The new approach would remain different to methodology A in two ways:*

- *The discount rate set would need to be achieved in higher percentage of modelled outcomes.*
- *Rather than setting a specific likelihood of success, a corridor will be introduced instead with cessation deficits/surpluses only being due if the final cessation funding position sits outside of that corridor (and it only be necessary to make or receive payments to reach the boundary of the corridor rather than the centre).*

5. *To help inform the decision of what is the appropriate corridor to use, the Fund also needs to consider what is the appropriate investment strategy to be used for the orphaned liabilities which result from a cessation linked to methodology B. The available options are to use either the Fund's main investment strategy or to use an alternative investment strategy which is more appropriate for (generally) maturing, non-active member liabilities which would ultimately need to be funded by unconnected employers in the Fund should there be a shortfall in assets.*

6. *The Fund has asked Mercer to provide some advice on this. Unfortunately, this was not available in time for this meeting and therefore officers are seeking approval of the general change to the methodology B at this meeting but approval to the exact approach to methodology B at the December Committee meeting.*

7. *As context, due to two material, recent cessations, officers expect the orphaned liabilities pool to soon be around £100m-£150m in size (c4-5% of assets) which is sufficiently large that the decision made in this respect could have impact on the overall investment strategy.*

8. *Furthermore, at present, officers are currently considering using a likelihood of success corridor of either 87.5%-92.5% or 90%-95% but a final proposal will be brought to the next meeting.*

Key Considerations for the Committee

9. Unfortunately, Mercer's advice is still unavailable but after a further discussion with the Fund's actuary, officers propose that a likelihood of success corridor of 90%-95% is adopted. The reason for choosing this corridor is to select a level of prudence which is broadly similar to what has existed to date. The decision on what type of investment strategy to use for the orphaned liabilities pool can be decided at a later date. In the meantime, and possibly beyond, the likelihood of success will model again the main investment strategy.

10. Furthermore, in relation to a concern raised by Members at the last meeting that with the adoption of corridor, employers may seek to just target the lower end, Officers have discussed this point with the actuary and our response is as follows:

    - For employers approaching cessation on the methodology B basis, the Fund will continue to set contribution rates which target the mid-point of the range; and

- In practice, funding levels can be relatively volatile and therefore in reality it is not really possible for an employer to accurately target a specific percentage.

11. In general, the actuary and officers will keep the chosen corridor under review on an annual basis (or as needed). Any proposed changes to the prudence level will be brought back to this Committee.

Financial Considerations & Risk Assessment

12. These are detailed in the body of the paper. General risks are outlined within the Fund's risk register.

Legal Implications

13. There are no known implications at this time.

Environmental Impact of the Proposal

14. There are no known environmental impacts with this proposal.

Safeguarding Considerations/Public Health Implications/Equalities Impact

15. There are no known implications at this time.

Reasons for Proposals

16. To fulfil the Wiltshire Pension Fund's statutory obligation and to seek to fulfil best practice

Proposals

17. To **approve** the revised cessation methodology approach and a likelihood of success corridor of 90%-95% as described within this paper.

JENNIFER DEVINE
Head of Wiltshire Pension Fund

Report Author: Andy Cunningham, Pensions Administration Lead

Unpublished documents relied upon in the production of this report: