Public Document Pack

# Pensions Committee

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| **Date:** | **Tuesday, 16 November 2010** |
| **Time:** | **6.00 pm** |
| **Venue:** | Committee Room 2 - Wallasey Town Hall |


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|---|---|
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# AGENDA

**1. MEMBERS' CODE OF CONDUCT - DECLARATIONS OF INTEREST**

Members are asked to consider whether they have personal or prejudicial interests in connection with any item(s) on this agenda and, if so, to declare them and state what they are.

**2. MINUTES (Pages 1 - 10)**

To receive the minutes of the meeting held on 27 September 2010.

**3. ASSET ALLOCATION (Pages 11 - 28)**

**4. LGC PENSION FUND INVESTMENT CONFERENCE (Pages 29 - 30)**

**5. STATEMENT OF INVESTMENT PRINCIPLES (Pages 31 - 58)**

**6. PUBLIC SERVICE PENSIONS COMMISSION (Pages 59 - 68)**

**7. RESTRICTING PENSIONS TAX RELIEF THROUGH EXISTING ALLOWANCES (Pages 69 - 78)**

**8. FUNDING STRATEGY STATEMENT (Pages 79 - 100)**

**9. ACTUARIAL VALUATION AS AT 31 MARCH 2010 (Pages 101 - 104)**

**10. EXEMPT INFORMATION - EXCLUSION OF MEMBERS OF THE PUBLIC**

The following items contain exempt information.

RECOMMENDATION: That, under section 100 (A) (4) of the Local Government Act 1972, the public be excluded from the meeting during consideration of the following items of business on the grounds that they involve the likely disclosure of exempt information as defined by the relevant paragraphs of Part I of Schedule 12A (as amended) to that Act. The Public Interest test has been applied and favours exclusion.

**11. MINUTES OF INVESTMENT MONITORING WORKING PARTY 13 OCTOBER 2010 (Pages 105 - 110)**

**12. PAYMENT OF DEATH GRANT (Pages 111 - 146)**

**13. ANY OTHER URGENT BUSINESS APPROVED BY THE CHAIR**

# PENSIONS COMMITTEE

Monday, 27 September 2010

| | | | |
|---|---|---|---|
| Present: | Councillor | G Watt (Chair) | |
| | Councillors | D Knowles<br>C Povall<br>G Davies<br>T Harney<br>J Hale (for Cllr Peter Johnson) | AER Jones<br>AR McLachlan<br>R Moon<br>H Smith |
| | Councillors | N Keats, Knowsley Council<br>Anderton, St Helens Council<br>Hanson, Liverpool City Council<br>D McIvor, Sefton (for Cllr Ann Ibbs)<br><br>Patrick McCarthy Non district Council employer | |
| In attendance: | | Phil Goodwin, Unison<br>Paul Wiggins, Unison | |
| Apologies | Councillors | Ann Ibbs, Sefton<br>Peter Johnson | |

20 **MEMBERS' CODE OF CONDUCT- DECLARATIONS OF INTEREST**

Members of the Committee were asked whether they had any personal or prejudicial interests in connection with any application on the agenda and, if so, to declare them and state the nature of the interest.

**No such declarations were made.**

21 **MINUTES**

The Director of Law, HR and Asset Management submitted the minutes of the meeting held 28 June 2010 for consideration.

**Resolved – That the minutes be agreed.**

22 **ACCOUNTS 2009-2010**

The Director of Finance submitted a report on the Merseyside Pension Fund; Statement of Audited accounts for the year ended 31 March 2010. Further to Minute 122, 28 June 2010, the Pensions Committee had formally approved the accounts prior to their submission to the Audit Commission. The Audit Commission had now undertaken an audit of the accounts and reported back to this meeting of the Pensions Committee with the Annual Governance Report (AGR). Members were

requested to consider this report with the Annual Governance Report and the Letter of Representation.

In accordance with the Accounts and Audit Regulations 2003, Members were requested to consider both the adjusted amendments to the annual accounts, and an unadjusted misstatement.

As the Pension Fund received a separate AGR, it was noted that this report would first be considered by the Pensions Committee, and then by the Audit and Risk Management Committee.

**Resolved –**

1. **That the Pensions Committee has given full consideration to the amendments to the Statement of Accounts for 2009/2010, the Annual Governance Report and the Letter of Representation.**

2. **That the recommendations be referred to the Audit and Risk Management Committee.**

3. **That the Action Plan within the Annual Governance Report be agreed, and that the Pensions Committee be informed of progress with its implementation.**

## 23 DRAFT ANNUAL REPORT

The Director of Finance submitted a report that advised Members of the proposed content of the Annual Report for 2009-10, a copy of which was made available at Committee. Members read the report in conjunction with the separate report on the Statement of Accounts.

**Resolved –**

**That content of the Annual Report be noted.**

## 24 AC ANNUAL GOVERNANCE REPORT

Liz Temple Murray Audit Manager gave a presentation on the Annual Governance Report summarising the findings of the 2009/2010 audit of Merseyside Pension Fund. She also circulated copies of the Audit Commission Progress Report on the 2009/2010 audit of Merseyside Pension Fund dated June 2010 and responded to Members questions.

**Resolved – That the AC Annual Governance Report be considered and noted.**

## 25 OCTOBER TRAINING EVENT

The Director of Finance informed Members of the training event at the Cunard Building arranged for 5 October 2010.

**Resolved – That Members attend the training day.**

26 **ANNUAL EMPLOYERS CONFERENCE**

The Director of Finance informed Members of the arrangements for the annual Employers Conference to be held on at Aintree Racecourse on Thursday 18 November 2010.

**Resolved – That arrangements for the annual Employers Conference be noted.**

27 **LAPFF CONFERENCE BOURNEMOUTH**

The Director of Finance submitted a report that recommended the Committee to approve attendance by the Chair and Councillor Ann McLachlan at the Local Authority Pension Fund Forum (LAPFF) Annual Conference, organised by PIRC, to be held in Bournemouth on 1-3 December 2010.

**Resolved – That attendance at the LAPFF conference by the Chair and Councillor Ann McLachlan be approved.**

28 **ALTAIR IT HARDWARE**

The Director of Finance submitted a report that gave details of the procurement of replacement computer hardware in relation to the Pensions Administration IT system (called 'altair').

**Resolved –**

**That the procurement of IT hardware, at an estimated cost of £35,500 and the ongoing lease charge over four years of approximately £13,500 be agreed. Provision is contained within the existing budget.**

29 **PUBLIC SECTOR PENSIONS COMMISSION**

The Director of Finance submitted a report that informed Members that the Government had created an independent Commission, headed by John Hutton, to undertake a "fundamental, structural review of public service pensions" and consider the case for short-term savings by September 2010 in time for the Government Spending Review.

He reported that the Public Sector Pensions Commission had been tasked with conducting a fundamental structural review of public service pension provision and had been asked to make recommendations to the Chancellor

and Chief Secretary on pension arrangements that:

were sustainable and affordable in the long term,
were fair to both the public service workforce and the taxpayer
were consistent with the fiscal challenges ahead,
protected existing scheme members' accrued rights

A copy of the letter dated 28 June 2010 from the Chair of the Commission John Hutton was also submitted for Members information.

**Resolved – That the report be noted.**

## 30 COMMITTEE MEMBERSHIP

The Director of Finance submitted a report that informed Members of the outcome of the recent ballot for a representative from the non district council employers on the Pension Committee.

It was reported that having come to the end of her four year term of office as the representative from the non district council employers on the Committee Mrs Jayne Brown of Liverpool John Moores University had relinquished the role after the 23 March 2010 meeting of the Pensions Committee.

Nominations for this vacancy had been sought from the non district council employers in the Pension Fund in May 2010 and two nominations had been received.

The candidate with the most votes was Mr Patrick McCarthy of Wirral Partnership Homes and he had been duly elected to the Pensions Committee to serve for a term of four years.

**Resolved –**

**That the election of Mr Patrick McCarthy as the representative of the non district council employers to the Pensions Committee be noted.**

## 31 LGPS REFORM

The Director of Finance submitted a report that informed Members of recent developments following the introduction of the revised LGPS on 1 April 2008 by the Department for Communities and Local Government (DCLG).

It was reported that the Pensions Committee had last considered legislative developments affecting the LGPS regulations on 28 June 2010 (Minute 128 refers).

It was noted that Terry Crossley the Head of the Pensions Division within the DCLG had written to the Local Government Employers Organisation (LGE) with replies to a number of matters that had been raised over the last year

and these were outlined in the Directors Report.

**Resolved –**

**That the report be noted.**

## 32 KNOWLEDGE AND SKILLS FRAMEWORK

The Director of Finance submitted a paper that informed Members of progress made in implementing the requirements of the Knowledge & Skills Framework (the Framework), the availability of an assessment tool developed by the CIPFA Pensions Network and requested that a training needs analysis be undertaken by all Members.

He reported that on 23 March 2010 Pensions Committee had accepted CIPFA advice that it would represent good practice for the Committee to demonstrate that it was actively managing the development of Members and had agreed to adopt the Framework to achieve this end.

He further reported that in July 2010, the CIPFA Pensions Network had announced the availability of a web-based knowledge and skills self-assessment tool (K&SF tool) linked to a repository of knowledge sources. MPF intended to adopt the K&SF tool as a part of officer development. The tool would also be available to Members. It was suggested that it be used by all Members to undertake a training needs analysis. This self-assessment would enable Members to plan their development and measure progress. Members could continue to avail themselves of events provided in the annual training programme to achieve their objectives. However, for those Members' unable to attend training and other events, it was hoped that the availability of on-line training modules would provide an accessible and convenient method of development.

**Resolved –**

**That it be agreed that Members undertake a training needs self-assessment in order to assist in planning training and development needs.**

## 33 LGPS TRUSTEE TRAINING FUNDAMENTALS

The Director of Finance submitted a report that provided Members with details of the 2010 'Fundamentals' training course.

He reported that the Statement of Investment Principles emphasised the importance of Member training as a crucial underpinning to effective decision-making and governance. The annual training programme sought to deliver this training to Members through a series of training events and access to a bespoke LGPS training course. The Local Government Pensions Committee (LGPC) had provided the Fundamentals course since 2002. LGPC aimed to provide training to Elected Members (and co-optees) that coverered all aspects of the LGPS, including the

benefits, governance and investments dimensions of the Scheme. It was recommended that new Members of the Pensions Committee attend this course, but it was also designed to provide refresher training for longer serving Members. The Director reported that the Pensions Committee had approved the adoption of the CIPFA Knowledge & Skills Framework for the LGPS. This would provide a benchmarking and reporting apparatus for both self-assessment and provide broader assurance that decision-makers at all levels of the governance structure were suitably competent to perform their roles. It was considered that completion of the 'Fundamentals' course would be compatible with meeting the standards set for Elected Members in the CIPFA Knowledge & Skills Framework

**Resolved –**

**That attendance at the LGPS Fundamentals 2010 course be approved for any Member who believes they would benefit from it.**

## 34 FRC STEWARDSHIP CODE

The Director of Finance submitted a report that provided an outline of the contents of the U.K. Stewardship Code, the background to its formation and its relevance to the Statement of Investment Principles. A statement of compliance with the Stewardship Code was included as an appendix to the report, and Members were requested to approve its publication.

**Resolved –**

**That the submission to the FRC of the appended statement of compliance with the Stewardship Code, and its publication on the MPF website be approved.**

## 35 EXEMPT INFORMATION - EXCLUSION OF MEMBERS OF THE PUBLIC

**Resolved – That the public be excluded from the meeting on the grounds that the following matters to be considered contain exempt information by virtue of paragraph 1 of Part 1 of Schedule 12A of the Local Government Act 1972.**

## 36 MANAGEMENT OF JAPANESE EQUITIES

The Director of Finance submitted a report that recommended that Members approve the retention of Nomura to their existing mandate to manage Japanese equities.

The report outlined the background to the procurement exercise, the results of the manager selection and a summary of the due diligence exercise.

**Resolved –**

**That the retention of Nomura to their existing mandate for Japanese equities be approved.**

37 **MANAGEMENT OF ASIA/PACIFIC EQUITIES**

The Director of Finance submitted a report that recommended that Members appoint Black Rock and Maple Browne to mandates for Pacific Rim Equities.

The report outlined the procurement exercise, the results of the manager selection and a summary of the due diligence exercise.

**Resolved –**

**That the Pensions Committee appoint both Black Rock and Maple Browne to mandates for the management of Pacific Rim Equities of 1.5% of the Fund (£80m current assets).**

38 **MANAGEMENT OF EMERGING MARKET EQUITIES**

The Director of Finance submitted a report that recommended that Members appoint Amundi and M&G to mandates for Emerging Markets Equities.

The report outlined the procurement exercise, the results of the manager selection and a summary of the due diligence exercise.

**Resolved –**

**That the Pensions Committee appoint both Amundi and M&G to mandates for the management of Emerging Markets Equities of 2.0% of the Fund (£120m current assets).**

39 **PROVISION OF PENSION ADMINISTRATION SERVICES TO LONDON BOROUGH OF BROMLEY**

The Director of Finance submitted a report that sought approval for Merseyside Pension Fund (MPF) to enter into an arrangement with a potential tenderer whereby MPF would submit a tender for the provision of pension administration services directly to the London Borough of Bromley.

**Resolved –**

**That the Pension Committee approve MPF working with the tenderer to provide pension administration services directly to Bromley LB Council.**

40 **NON RECOVERY OF SUM ON CLOSURE OF ADMISSION BODY - GREEN APPRENTICES**

The Director of Finance submitted a report that informed Members that efforts to recover the sum of £6,450 owed by Green Apprentices on its closure on 31 May 2009 had been unsuccessful.

The Committee was recommended to confirm that the outstanding sum of £6,450 be written off in accordance with a recommendation from the Director of Law.

It was noted that the Pension Committee had considered this matter at the 23 March 2010 meeting of the Pensions Committee (Minute 115 refers).

**Resolved –**

**That the Pensions Committee confirm the recommendation of the Director of Law that the sum of £6,450 owed by Green Apprentices on its closure on 31 May 2009 be written off as recovery is impossible.**

41 **MERSEYSIDE SPECIAL INVESTMENT FUND**

The Director of Finance submitted a report that informed the Pension Committee that £18.5m had been received from MSIF which had repaid the loan facility and interest in full. This repayment followed the sale of Vitaflo (the key portfolio company) for an undisclosed sum to Nestle. This was an unexpected development given the recommendations to the Pensions Committee on 28 June 2010 (Minute19 refers).

The report detailed the background to developments, details of the transaction, the current position and implications, together with proposed action.

**Resolved –**

**That the repayment of the loan facility be noted.**

42 **TRANSFEREE ADMISSION BODY APPLICATION - COMPUTACENTER (UK)**

The Director of Finance submitted a report that informed the Pension Committee of his decision taken under delegation, to approve the application from Computacenter (UK) for admission to Merseyside Pension Fund as a Transferee admission body .The Company had secured a contract with Liverpool City Council to run the delivery of the IT service in respect of the “Building Schools for the Future” project.

The application was to provide pension provision for 10 transferred staff who wished to continue to be scheme members for the duration of the contract period for 5 years from 7 June 2010 to 31 August 2015. It was reported that Computacenter (UK) was a private limited company registered in England and Wales, (number 01584718), and was the leading independent provider of IT infrastructure services in Europe. The Company had been formed in 1981 and today had over 10,000 employees across Europe and group revenues of £2.5 billion.

**Resolved –**

**That the approval of the application for admission body status, received from Computacenter (UK) be noted.**

43 **ACQUISITION OF SUPERMARKET STORE**

The Director of Finance submitted a report that informed Members of the purchase of the Tesco store in Heswall in a sale and leaseback transaction. He reported that the purchase of this property was in accordance with the strategy recommendations agreed with the strategic property adviser (CBRE) namely “the need to diversify the portfolio by spread of property types, unit sizes occupier businesses, quality, income expiry and geographical regions”.

The Director of Finance reported that the transaction had enabled MPF to acquire a dominant foodstore with limited competition and an affluent catchment population. The property was let on a 20 year lease with annual Limited Price Index increases of between 0 and 4%. Overall, the property would significantly improve the lease expiry profile and unexpired term of the portfolio.

**Resolved –**

**That the completion of this property transaction under delegation by the Director of Finance be noted.**

## 44 INVESTMENT MONITORING WORKING PARTY MINUTES

The Director of Finance submitted a report that provided Members with the minutes of the Investment Monitoring Working Party held on 8 September 2010.

**Resolved - That the minutes of the IMWP be agreed.**

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**WIRRAL COUNCIL**

**PENSIONS COMMITTEE**

**16 NOVEMBER 2010**

**REPORT OF THE DIRECTOR OF FINANCE**

**ASSET ALLOCATION**

## 1. EXECUTIVE SUMMARY

1.1 This paper outlines proposed changes to the strategic asset allocation following a detailed analysis undertaken by the investment consultant Mercer, and discussions held with the internal investment management team and the independent adviser.

## 2. BACKGROUND

2.1 The decision as to how and where the MPF should invest assets, the "strategic asset allocation", is of critical importance in determining the likelihood of the Pension Fund achieving its objectives of optimising investment returns and meeting its longer term liabilities within acceptable levels of risk.

2.2 The strategic asset allocation is the long-term allocation between the main asset classes and involves the following decisions:

- The balance between equities and bonds
- The allocation between UK and overseas equity investment, and the balance within the overseas equity portfolio between the major regional markets
- The allocation within the bond portfolio between fixed interest and index linked gilts
- The use of alternative investments, such as private equity, hedge funds and property.

2.3 Although the balance between equities and bonds has historically been the most important consideration, the development of more global equity markets and a number of technical factors affecting bond markets has raised the profile of investments in alternative assets to achieve greater diversification and potentially greater risk adjusted returns.

## 3. CURRENT ASSET ALLOCATION

3.1 The current strategic asset allocation is tabulated below.

| Current Strategic Asset Allocation MPF | | |
|---|---|---|
| | | |
| | | |
| **Asset Class** | **Weighting** | **Benchmark index** |
| | | |
| **UK Equities** | **30.00%** | FTSE ALL SHARE INDEX |
| | | |
| **Overseas Equities** | **29.00%** | |
| US | 8.00% | FTSE AW NORTH AMERICA |
| European | 10.00% | FTSE WORLD EUROPE EX UK |
| Japan | 4.00% | FTSE AW JAPAN |
| Pacific | 3.00% | FTSE AW DEV ASIA PAC EX JAPAN |
| Emerging Markets | 4.00% | MSCI EMERGING MARKETS FREE |
| | | |
| **Fixed Interest** | **20.00%** | |
| UK Gilts | 4.00% | FTSE A ALL STOCKS |
| Overseas Gilts | 0.00% | JPM GLOBAL GOVT EX UK |
| UK Index Linked | 12.00% | FTSE UK GILTS INDEXED ALL STKS |
| Corporate Bonds | 4.00% | ML £ NON GILTS |
| | | |
| **Property** | **10.00%** | IPD ALL PROPERTIES INDEX |
| | | |
| **Alternatives** | **10.00%** | |
| Private Equity | 4.00% | GBP 7 DAY LIBID |
| Hedge Funds | 6.00% | GBP 7 DAY LIBID |
| | | |
| **Cash** | **1.00%** | GBP 3 MONTH LIBID |
| | | |
| **TOTAL** | **100.00%** | **SPECIFIC BENCH MARK** |
| | | |

3.2 Based on the recent analysis undertaken by Mercer, MPF is currently targeting a 79% exposure to “growth” assets such as equities, property and “alternative” assets, and 21% to “matching” assets such as risk-free UK Government bonds or gilts which provide the best “match” for liabilities in terms of payments to members in future years.

3.3 In the latest review of the current investment strategy, Mercer has calculated a "best estimate return expectation" of 3.1% p.a. in excess of the return on the theoretical portfolio of gilts that would best match the projected future cashflow liabilities.

3.4 Mercer has reported that "all other things being equal, the current strategy is found to support the investment assumptions used within the funding strategy being developed as part of the 2010 valuation process".

3.5 Although the analysis suggests that no significant changes to the strategic asset allocation are required, following discussions a number of changes are being recommended.

## 4. REVISED ASSET ALLOCATION

4.1 The recommended revised asset allocation is tabulated below.

| **Proposed Strategic Asset Allocation MPF** | | |
|---|---|---|
| | | |
| | | |
| **Asset Class** | **Weighting** | **Benchmark index** |
| | | |
| **UK Equities** | **25.00%** | FTSE ALL SHARE INDEX |
| | | |
| **Overseas Equities** | **30.00%** | |
| US | 8.00% | FTSE AW NORTH AMERICA |
| European | 8.00% | FTSE WORLD EUROPE EX UK |
| Japan | 4.00% | FTSE AW JAPAN |
| Pacific | 4.00% | FTSE AW DEV ASIA PAC EX JAPAN |
| Emerging Markets | 6.00% | MSCI EMERGING MARKETS FREE |
| | | |
| **Fixed Interest** | **20.00%** | |
| UK Gilts | 4.00% | FTSE A ALL STOCKS |
| Overseas Gilts | 0.00% | JPM GLOBAL GOVT EX UK |
| UK Index Linked | 12.00% | FTSE UK GILTS INDEXED ALL STKS |
| Corporate Bonds | 4.00% | ML £ NON GILTS |
| | | |
| **Property** | **10.00%** | IPD ALL PROPERTIES INDEX |
| | | |
| **Alternatives** | **14.00%** | |
| Private Equity | 4.00% | GBP 7 DAY LIBID |
| Hedge Funds | 5.00% | GBP 7 DAY LIBID |
| Thematics | 3.00% | GBP 7 DAY LIBID |
| Infrastructure | 2.00% | GBP 7 DAY LIBID |
| | | |
| **Cash** | **1.00%** | GBP 3 MONTH LIBID |
| | | |
| **TOTAL** | **100.00%** | **SPECIFIC BENCH MARK** |

## 5. RECOMMENDED CHANGES

### 5.1. Equities

- UK equities are reduced from 30% to 25%. The reclassification of the Thematics portfolio to a cash benchmark will account for 3% of the reduction. 1% will be reallocated to overseas equities and infrastructure respectively.

- Overseas equities will increase from 29% to 30%.

- European equities will be reduced from 10% to 8% of the portfolio in line with the allocation to North American equities as there are no compelling reasons for this differential to persist.

- The allocation to Pacific equities will increase by 1% to 4% and Emerging Markets will rise to 6% from 4% to take account of greater opportunities for growth going forward and the increased share of emerging markets in world equity indices.

### 5.2. Fixed Interest

- No changes are recommended to the fixed income element of the portfolio with the overall allocation remaining at 20%.

### 5.3. Property

- No change is recommended to the property allocation which remains at 10%.

### 5.4. Alternatives

- It is recommended that the allocation to alternatives is increased to 14%. The reclassification of the Thematics portfolio to a cash benchmark accounts for 3% of this increase and it is recommended that infrastructure is represented within alternatives as a separate asset class with an allocation of 2%. MPF currently holds infrastructure related investments within its existing Property, Alternatives, and Thematics portfolios.

## 6. CONCLUSION

6.1 The strategic asset allocation is set within the context of the 2010 triennial valuation results and is designed to maximise the likelihood of achieving the longer term investment objectives within a controlled risk environment.

## 7. FINANCIAL IMPLICATIONS

7.1 Mercer has calculated that the strategy could provide an absolute return of 7.6% p.a. which is 3.1% p.a. in excess of the expected return on the "least risk portfolio" and ahead of the current funding assumption which assigns a target return of 1.4% p.a. above the return on gilts. According to the Mercer "best estimate", the current strategy is expected to achieve a 92% funding level in 10 years time with a 5% risk that the funding level is 41% or lower.

## 8. STAFFING IMPLICATIONS

8.1. There are none arising directly from this report.

## 9. EQUAL OPPORTUNITY IMPLICATIONS

9.1. There are none arising directly from this report.

## 10. COMMUNITY SAFETY IMPLICATIONS

10.1. There are no specific implications arising from this report.

## 11. LOCAL MEMBER SUPPORT IMPLICATIONS

11.1. There are no specific implications for any Member or Ward.

## 12. LOCAL AGENDA 21 IMPLICATIONS

12.1. There are no specific implications arising from this report.

## 13. PLANNING IMPLICATIONS

13.1. There are no specific implications arising from this report.

## 14. BACKGROUND PAPERS

14.1. Merseyside Pension Fund Risk Return Analysis and Strategy Healthcheck – Mercer – September 2010

14.2. Asset Allocation - November 2007

## 15. RECOMMENDATION

15.1 That Members approve the new strategic asset allocation strategy

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/209/10

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# Merseyside Pension Fund ("the Fund")

## Proposed Model Portfolio

In the table below we set out the proposed Mercer model portfolio for the Fund. In considering this portfolio it should be noted that it is based on a number of assumptions and inputs, namely: -

- Recent discussions between Mercer and the Fund regarding the results of the Mercer Risk and Return Healthcheck for the current target strategy (attached)
- Specifically, an assumption that the Fund wishes to maintain, or enhance, the return expectations of the Fund's current investment arrangements for now whilst reducing the overall level of risk of the arrangements where opportunities are identified to do so
- Mercer's dynamic asset allocation views over a 3 to 5 year horizon

| | **Fund Strategy** | **Model Portfolio** | **Difference** |
|---|---|---|---|
| **Asset Class** | **%** | **%** | |
| Equity | 59 | 58 | -1 |
| *UK* | *30* | *20* | *-10* |
| *Overseas (Developed)* | *25* | *30* | *+5* |
| *Emerging Market* | *4* | *8* | *+4* |
| Bond | 20 | 22 | +2 |
| *Index Linked Gilts* | *12* | *8* | *-4* |
| *Fixed Interest Gilts* | *4* | *3* | *-1* |
| *Corporate Bonds* | *4* | 6 | +2 |
| *High Yield* | *0* | 3 | +3 |
| *Infrastructure* | *0* | 3 | +3 |
| Alternative | 10 | 10 | - |
| *Other Investments* | *6* | *6* | - |
| *Private Equity* | *4* | *4* | - |
| Property | 10 | 10 | - |
| Cash | 1 | 0 | -1 |
| **Total** | **100** | **100** | |

We set out below the rationale for some of the changes to the current arrangements and also comment on the detail of how each section of the portfolio might be managed in practice.

**Equity Portfolio – Strategy**

- Equity exposure broadly maintained at current levels but strategic exposure to emerging market equities significantly increased
- The portfolio further “globalised” with a reduced exposure to UK equities used to fund the investment in emerging markets and developed overseas markets
- Analysis suggests that some currency hedging of the overseas equity exposure would have a marginally beneficial impact on the risk and return trade-off

**Equity Portfolio – Implementation**

- To enable active stock selection across global sectors we suggest consideration is given the introduction of a global equity mandate
- We also suggest the Fund considers introducing a specialist smaller capitalisation equity mandate into the portfolio (and increasing the Fund’s exposure to this section of the market beyond that implied by the current benchmark indices)

**Bond Portfolio – Strategy**

- Slight increase in bond exposure overall relative to current target
- Reduction in index-linked gilt exposure reflects Mercer view that this asset class is overvalued (even after taking into account the inflation protection it offers)
- Reduction in fixed interest gilt exposure reflects Mercer view that this asset class is also overvalued and forms only a small part of the identified Least-Risk Portfolio for the Fund
- Marginal increase in corporate bond exposure reflects preference for this asset class over gilts
- Introduction of high yield (corporate debt and emerging market sovereign debt) and infrastructure debt reflects sharp contraction in credit spreads on investment grade debt over last two years. Additional yield available on high yield and infrastructure now considered more attractive on risk-adjusted basis both from a strategic and tactical perspective

**Bond Portfolio – Implementation**

- We suggest the Fund gives consideration to widening the investment restrictions for the current bond managers in order to permit increased exposure to identified opportunities in global bond markets

- We also suggest that the Fund considers its approach to exploiting any significant increase in gilt yields that may occur in the future that might enable the Fund to "lock in" the positive funding experience this might generate (for example, the Healthcheck suggests that a 0.5% pa increase in real gilt yields across the yield curve has the potential to reduce the present value of the Fund's liabilities by just under 10%)

**Alternative and Property Portfolio – Strategy & Implementation**

- Current overall target exposures maintained
- Within property allocation, an explicit allocation to high lease to value properties could be considered a reasonable inflation hedge. Alternative or property exposure could also incorporate an exposure to the distressed property refinancing opportunity that has been previously discussed with the Fund

# Merseyside Pension Fund ("the Fund")

## Risk Return Analysis and Strategy Healthcheck

**Executive Summary**

- Our best estimate risk and return assumptions suggest a return expectation of 3.1% p.a. in excess of the expected return on the liabilities of 4.5%, with an expected risk level of c14.6%p.a. associated with the current strategy.
- The current strategy supports the funding strategy and valuation assumptions and implementation of 'increased Investment Return Allowance' up to 3.1% over the Least Risk Portfolio of matching assets.
- Our "best estimate" expectation of the funding level in 10 years time is c92%; albeit with a risk profile that could see a significant reduction in the funding level at any time.
- Therefore, all other things being equal, the current strategy supports the longer term funding strategy being developed as part of the 2010 valuation process.
- However, consideration needs to be given to the risks inherent within the strategy going forward noting that, as expected, both the deficit (in terms of the exposure to adverse changes in interest rates and inflation) and the bias towards equities within the current investment strategy pose the greatest sources of risk.

## Introduction

This paper has been prepared by Mercer with the aim of providing a review of the risk / return profile of the current investment strategy of the Fund. It is intended that this analysis will form part of the assumption setting process within the 2010 actuarial valuation of the Fund as well as providing an indication of the adequacy of the current strategy in the context of the longer term funding plan.

## Current Strategy

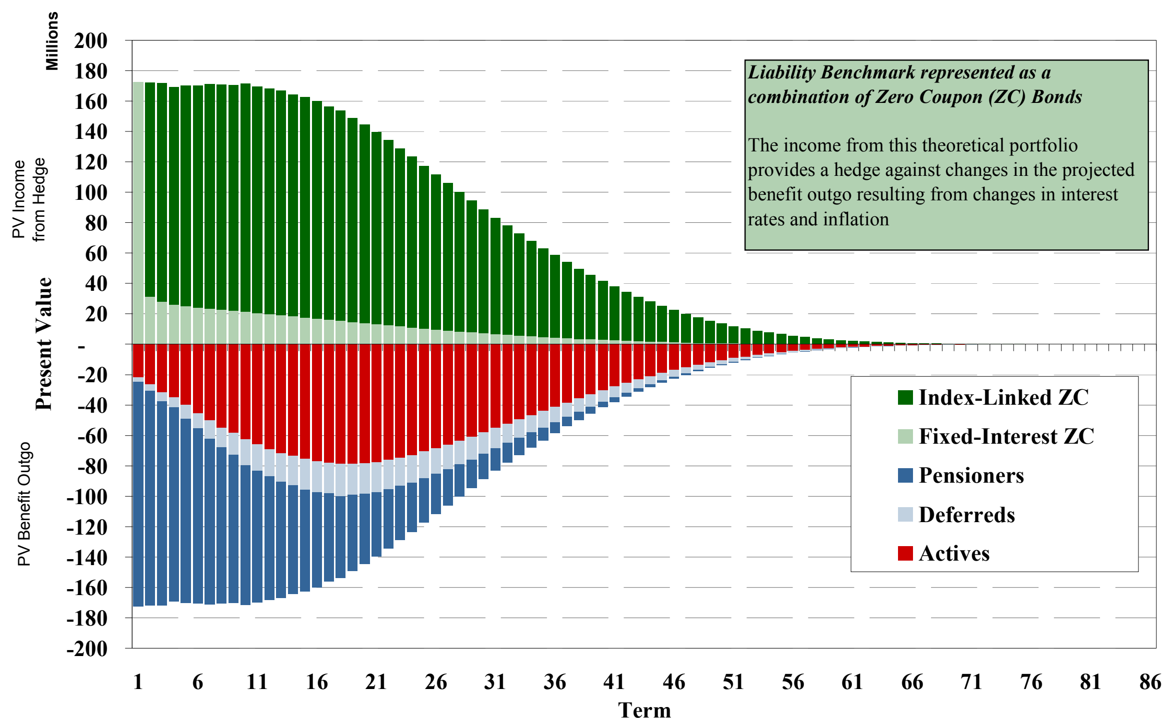
The Fund's asset allocation is set out below for completeness.

| Asset Class | % |
|---|---|
| Equity | 59 |
| *UK* | *30* |
| *Overseas* | *29* |
| Bonds | 20 |
| *Index Linked Gilts* | *12* |
| *Fixed Interest Gilts* | *4* |
| *Corporate Bonds* | *4* |
| Alternatives | 10 |
| *Other Investments* | *6* |
| *Private Equity* | *4* |
| Property | 10 |
| Cash | 1 |
| **Total** | **100** |

## Risk and Return of Current Strategy

The liabilities of the Fund are a stream of payments to be paid to members in future years. Therefore, the portfolio of assets that would best match these liabilities would be that which produces income cashflows at the same time as benefit payments need to be made. In theory, a portfolio of government bonds could be constructed, serving as a proxy for the liabilities, such that those bonds produce income payments at the right times. It is this portfolio that represents the baseline risk level and we term it the least risk portfolio ("LRP").

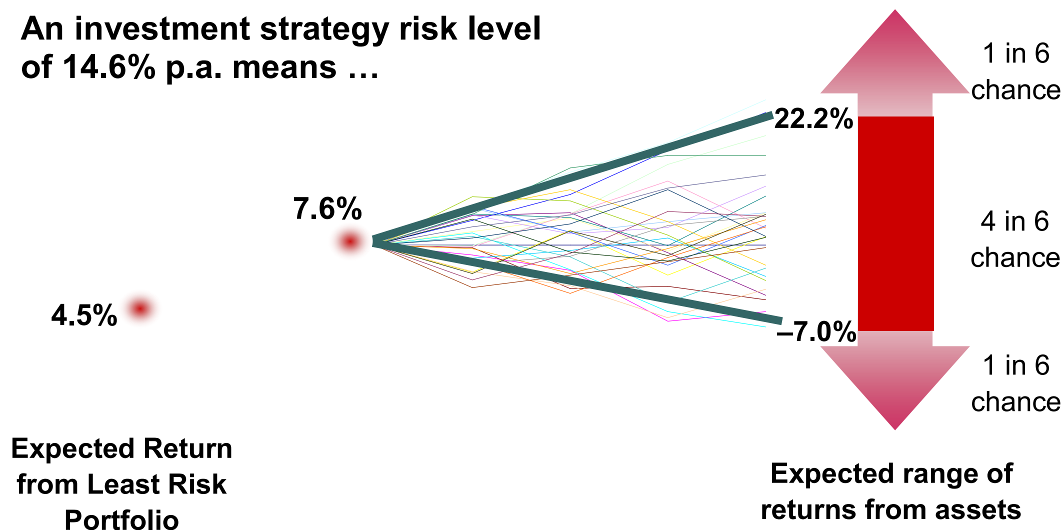
The LRP for the Fund is illustrated below by the green bars, which mirror the liability cashflows shown in red and blue.




The LRP for the Fund was found to be best represented by 86% index linked gilts and 14% fixed interest gilts with an average duration of 18 years.

We have calculated that the Fund's current strategy has an expected return of 7.6% p.a. which is 3.1% p.a. in excess of that of the LRP. (This compares to the current funding assumption of c.1.4% above gilts, reflecting the prudence in the actuarial assumptions). However, it is important to recognise that this is only an expectation and there are risks that the return from the current strategy will be lower than the return on the least risk portfolio which could lead to a decrease in the funding position. We estimate the risk level associated with the current strategy to be around 14.6% p.a. relative to the liabilities.

By stating a risk level of 14.6% p.a., along with an expected return of 7.6% p.a. we are saying (assuming that returns are normally distributed) that we expect the returns from the Fund's investments to fall within 14.6% of the expected return with a 2 in 3 chance, i.e. the current strategy is expected to return between -7.0% p.a. and 22.2% p.a. in 2 years out of 3 (on average). The following diagram illustrates the idea:

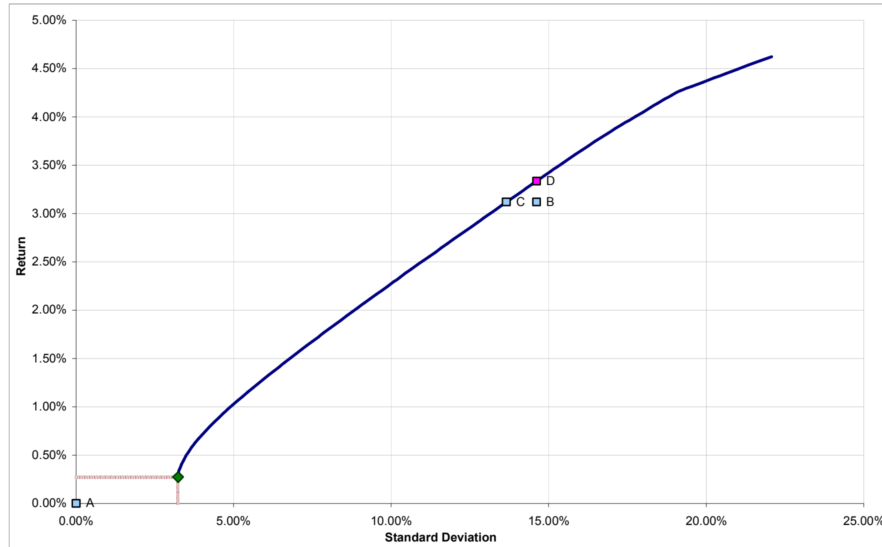



It should be noted that this initial analysis takes into account asset class risk and return only. The use of active management will alter the expected risk return profile to a degree and the Pensions Committee may wish to take this into account at a later stage in order to further refine the investment strategy. However, it is asset allocation (rather than manager structure) that accounts for the lion's share of risk and return and so we have not focused on manager issues here.

**Efficiency of the Current Strategy**

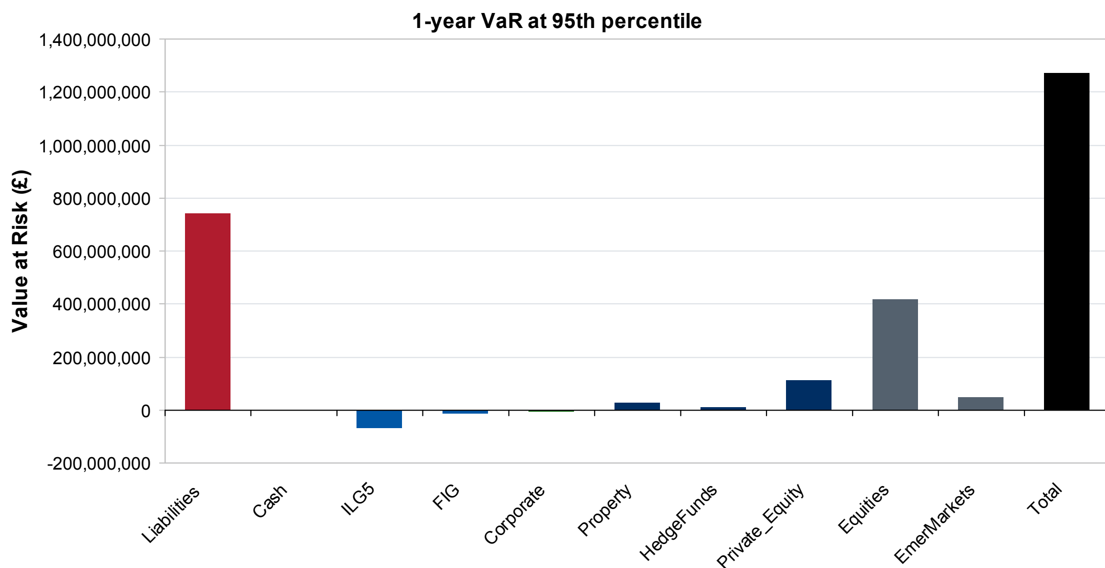
The chart below shows the "Efficient Frontier" as the blue line on the risk (horizontal axis) and return (vertical axis) space, with both risk and return expressed relative to the liabilities. The Efficient Frontier represents all asset portfolios with the best possible level of return for a given level of risk.

The LRP is shown by the blue square A. The current strategy is shown by the blue square B, and it can be seen that (based on our asset class assumptions) it is reasonably efficient. That said, there is further analysis and advice that we could provide with the aim of making the assets "work harder" (and move up to the Efficient Frontier as per strategies C and D) and we briefly cover this in the Conclusion to this note.




## Risk Attribution – Where Does the Risk Come From?

The following chart provides a breakdown of the exposure of the current investment strategy to interest rate and inflation risk (shown as liability risk) and asset class risks. We illustrate this in terms of a Value at Risk measure which represents the likelihood that the change in deficit in one year's time will exceed the amount shown with a 5% probability. So under the current strategy, there is a 5% chance that the amount by which the assets fall short of the liabilities will increase by at least £1.2 billion. However, please note that this represents the worst 5% of outcomes.



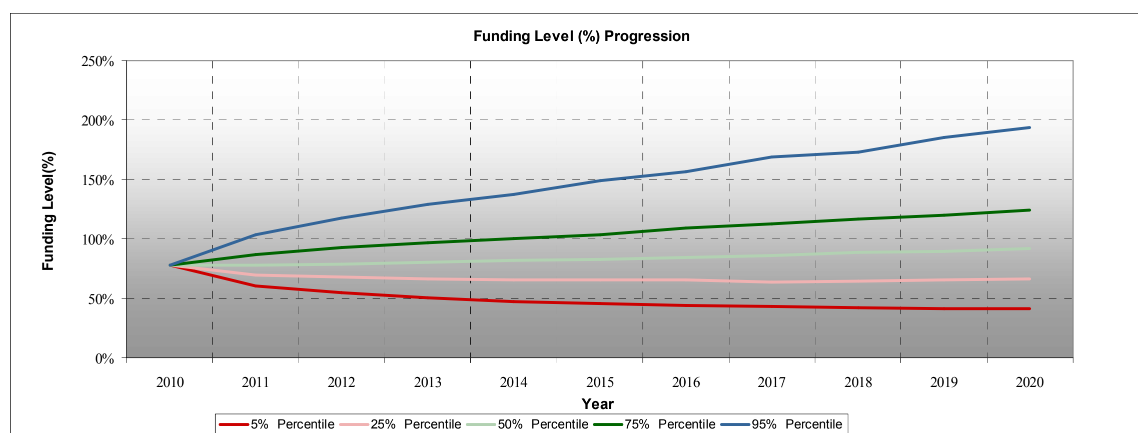

It can be seen that both the market risk, driven by the equity content, and interest and inflation (liability) risks inherent in the current strategy are significant. The interest and inflation risks derive from the fact that the duration of the current bond portfolio is materially different from that of the liabilities (interest rate risk) and that the portfolio is not inflation proofed to the same degree as the least risk portfolio.

In addition, the presence of a material deficit, i.e. liabilities that are not covered by any assets, contributes to the interest rate and inflation risks. It should be noted that the LRP is designed to match inflation increases in line with RPI. The benefits in the Fund will be linked to CPI from April 2011 which means that index linked government bonds are not a precise match for the benefit cashflows. However, in the absence of any instruments that match CPI inflation, an LRP derived from index linked gilts is the best available proxy.

Interest rate and inflation risk can be mitigated through the use of bonds (and derivatives) that match the payment profile of the liabilities. Equity risk can be mitigated by reducing the equity content and / or diversifying into alternative sources of return.

**Implications of Current Risk / Return Profile**

The chart below projects the Fund's expected funding level progression based upon the current investment strategy. The chart shows the range of potential outcomes in future years by allocating the results to different percentile groups. For example, the light green line indicates the central expectation under which 50% of results are better and 50% worse than the line. Results that fall below the red line are the very worst 5% of expected outcomes.




| Percentile | 31/03/2010 | 31/03/2011 | 31/03/2012 | 31/03/2013 | 31/03/2014 | 31/03/2015 | 31/03/2016 | 31/03/2017 | 31/03/2018 | 31/03/2019 | 31/03/2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 5.00% | 77.59% | 60.56% | 54.44% | 50.13% | 47.07% | 45.21% | 43.65% | 43.35% | 42.23% | 41.08% | 41.35% |
| 25.00% | 77.59% | 69.59% | 67.82% | 66.56% | 65.80% | 65.41% | 65.08% | 64.01% | 64.16% | 65.14% | 66.05% |
| 50.00% | 77.59% | 77.80% | 78.80% | 80.05% | 81.85% | 83.15% | 84.31% | 86.14% | 88.19% | 89.72% | 91.99% |
| 75.00% | 77.59% | 87.33% | 92.32% | 96.56% | 99.99% | 103.86% | 109.24% | 112.97% | 116.53% | 120.17% | 123.98% |
| 95.00% | 77.59% | 103.46% | 117.36% | 129.04% | 137.09% | 148.61% | 156.70% | 169.15% | 172.85% | 185.68% | 193.93% |

It can be seen that the funding level is expected to progress steadily over the next 10 years to a c92% funded position. That said, the downside risks are not insignificant, and there is a 1 in 20 chance that the funding level will fall to below 50% within the next 4 years.

The results shown are based on the preliminary estimate of the 2010 valuation results which show a funding level of approximately 78%, based on assumptions consistent with RPI inflation at this stage. The projections also assume a continuation of the current employer contribution rates and current benefit structure. This will be refined as part of the 2010 valuation process. However, we would not expect the outcome to materially affect our conclusions here.

**Conclusion**

Our best estimate risk and return assumptions suggest a return expectation of 3.1% p.a. in excess of the liabilities, with a "best estimate" expectation of c92% funding within 10 years; albeit with a risk profile that could see a significant reduction in the funding level over the medium term. Therefore, all other things being equal, the current strategy supports the longer term funding strategy being developed as part of the 2010 valuation process. However, consideration needs to be given to the risks inherent within the strategy going forward.

As expected, both the deficit (in terms of the exposure to adverse changes in interest rates and inflation) and the bias towards equities within the current investment strategy pose the greatest sources of risk.

The Fund has already taken steps to mitigate equity risk by diversifying into alternatives such as property and private equity. A further source of analysis could be to look at the drivers of risk and return within the Fund's "growth" assets, in order to help understand the underlying return drivers for various asset classes and to build a portfolio of assets that is not exposed to a small number of risk factors. Our growth portfolio toolkit could be utilised as such and we would be happy to provide further analysis as required.

We fully recognise that equities have an important part to play and we would also welcome the opportunity to share the thoughts we have on constructing a global equity portfolio that is well placed to capture "topical" sources of return, whilst aiming for protection against extreme events.

Mitigating interest rate and inflation risk typically points towards "liability driven investment", which in its most general sense involves heavy investment in bonds. A higher allocation to bonds at the expense of return seeking assets would increase the costs of funding, and in light of the current deficit within the Fund, and the prevailing market environment (i.e. low yields) we would not suggest that this type of de-risking is a priority at the present time. Again, we would be happy to discuss further if required.

**Important Notices**

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**Marc Littlewood**
**Mercer**
**November 2010**

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**WIRRAL COUNCIL**

**PENSIONS COMMITTEE**

**16 NOVEMBER 2010**

**REPORT OF THE DIRECTOR OF FINANCE**

**LGC PENSION FUND INVESTMENT CONFERENCE**

## 1. EXECUTIVE SUMMARY

1.1. This report requests the Committee to consider if it wishes to be represented at the Pension Fund Investment Conference organised by Local Government Chronicle to be held in Chester on 3-4 March 2011.

## 2. THE CONFERENCE

2.1. The Conference is scheduled for 3-4 March 2011. It is likely that delegates would require an overnight stay in Chester on 3 March 2011.

2.2. This is the sixth year of this conference organised by the LGC and is in addition to the annual conference to be held in Newport in September.

2.3. The attendance at such conferences has traditionally been in the ratio 1:1:1.

2.4. Conference costs including accommodation are £425 plus VAT per person, with travel an additional cost.

## 3. FINANCIAL IMPLICATIONS

3.1. The cost of will be met from the training budget.

## 4. STAFFING IMPLICATIONS

4.1. There are no staffing implications in this report.

## 5. EQUAL OPPORTUNITY IMPLICATIONS

5.1. There are none arising directly from this report.

## 7. COMMUNITY SAFETY IMPLICATIONS

7.1. There are no specific implications arising from this report.

8. **LOCAL MEMBER SUPPORT IMPLICATIONS**

8.1. There are no specific implications for any Member or Ward.

9. **LOCAL AGENDA 21 IMPLICATIONS**

9.1. There are no specific implications arising from this report.

10. **PLANNING IMPLICATIONS**

10.1. There are no specific implications arising from this report.

11. **BACKGROUND PAPERS**

11.1. None used in the preparation of this report.

12. **RECOMMENDATION**

12.1. That Committee is requested to consider if it wishes to send a delegation to attend this conference, and if so, to determine the number and allocation of places.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/219/10

**WIRRAL COUNCIL**

**PENSIONS COMMITTEE**

**16 NOVEMBER 2010**

**REPORT OF THE DIRECTOR OF FINANCE**

**STATEMENT OF INVESTMENT PRINCIPLES**

## 1. EXECUTIVE SUMMARY

1.1 The purpose of this report is to approve a revised Statement of Investment Principles (SIP) for Merseyside Pension Fund incorporating changes in the strategic asset allocation and the letting of four new investment management mandates.

## 2. BACKGROUND

2.1 The Pensions Committee approved the previous edition of the SIP on 23 March 2010. The revised SIP incorporates, and states compliance with, the six updated Myners Principles in relation to investment decision making and governance.

2.2 The revised strategic asset allocation is outlined in a separate report which is being presented at this meeting for approval. Subject to approval by the Pensions Committee, the revised strategic asset allocation will be incorporated within the SIP.

2.3 The revised SIP will also incorporate the appointment of Black Rock and Maple Brown to manage Far Eastern Equities, the retention of Nomura to manage Japanese Equities, and the appointment of Amundi and M&G to manage Emerging Markets Equities.

2.4 Reports on the tendering and due diligence exercises relating to these investment mandates were presented to the Pensions Committee on 27 September 2010.

2.5 The revised SIP is attached as an appendix to this report.

## 3. FINANCIAL IMPLICATIONS

3.1 There are none arising directly from this report.

## 4. STAFFING IMPLICATIONS

4.1. There are none arising directly from this report.

## 5. EQUAL OPPORTUNITY IMPLICATIONS

5.1. There are none arising directly from this report.

## 6. COMMUNITY SAFETY IMPLICATIONS

6.1. There are no specific implications arising from this report.

## 7. LOCAL MEMBER SUPPORT IMPLICATIONS

7.1. There are no specific implications for any Member or Ward.

## 8. LOCAL AGENDA 21 IMPLICATIONS

8.1. There are no specific implications arising from this report.

## 9. PLANNING IMPLICATIONS

9.1. There are no specific implications arising from this report.

## 10. BACKGROUND PAPERS

10.1. Statement of Investment Principles - March 2010.

## 11. RECOMMENDATION

11.1 That Members approve the revised Statement of Investment Principles.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/204/10

# STATEMENT OF INVESTMENT

# PRINCIPLES 2010

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# MERSEYSIDE PENSION FUND
## AND THE 2008 MYNERS PRINCIPLES

This Statement of Investment Principles (SIP) was approved by the Pension Committee of Wirral Council (constituting the primary governing and decision-making body of the Merseyside Pension Fund) at its meeting on 16 November 2010. The statement has been prepared in accordance with **Regulation 12 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009 No. 3093)**.

The SIP describes the high-level principles governing the investment decision-making and management of Merseyside Pension Fund (MPF) and the policy that has been developed to ensure their implementation. It has been prepared, in line with guidance received from the Secretary of State for Communities and Local Government, with reference to the Chartered Institute of Public Finance & Accountancy (CIPFA) Pensions Panel publication, **'Principles for Investment Decision Making and Disclosure in the LGPS in the United Kingdom 2009 – A Guide to the Application of the 2008 Myners Principles to the Management of LGPS Funds'**.

It is accepted that these six principles form the code of best practice for LGPS Funds; this SIP reports the extent of MPF's compliance with each of the **six** principles. A statement of compliance can be found on page 26 of this document.

This statement supersedes the SIP approved by Pensions Committee on 23 March 2010.The SIP, and the policy approaches it describes, has been developed with the benefit of proper advice from the Fund's consultants and advisers, whom it considers to be suitably qualified and experienced in investment matters. The Fund consults its stakeholders over matters of policy, including scheme employers, trade unions and other interested parties.

The SIP will be made available on the Fund's website at: (http://mpfmembers.org.uk) and compliance with the CIPFA Principles will be reported in the Fund's Annual Report. This statement should be read in conjunction with the following statements, also available on the Fund's website:

- Funding Strategy Statement;
- Governance Policy Statement;
- 2007 Actuarial Valuation and Review;
- Communications Strategy Statement

# EFFECTIVE DECISION MAKING

**Administering Authorities should ensure that:**

*Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and*

*Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.*

- Wirral Council is the Administering Authority with overall responsibility for Merseyside Pension Fund (MPF), which it delegates to its Pensions Committee. This body comprises 10 Wirral councillors, with representation from other principal employers in the Fund (5) and Trade Unions (3), representing beneficiaries' interests. There is also an Investment Monitoring Working Party (IMWP) to which all members of the Pensions Committee and Trade Unions are invited; the IMWP meets six times a year.

- The terms of reference for the Committee, IMWP and the Director of Finance are set out in the scheme of delegation for Wirral Council; the structural and operational details of the delegation are set out in a Governance Policy Statement for Merseyside Pension Fund, which can be viewed at: http://mpfmembers.org.uk/pdf/gov_policy.pdf.

- The Pensions Committee takes strategic decisions on asset allocation, investment manager selection and other high-level investment policy matters and delegates tactical asset allocation and investment monitoring through the IMWP. The IMWP is a deliberative body, acting as a forum where investment issues can be discussed in depth, with the power to make recommendations to Committee. The Director of Finance of Wirral Council (Section 151 Officer) is delegated to implement Committee policy and manage the Fund, leading a well qualified and experienced internal team (Fund officers).

# EFFECTIVE DECISION MAKING

- The Committee receives what it considers to be proper advice from Fund officers and, in addition, has appointed an external consultant to provide advice on its high-level investment strategy. The Committee has also appointed an independent adviser to the IMWP, to further inform and support decision-making across the breadth of issues that are considered by the IMWP.

- The Committee considers that its strategic objectives are best met by further delegating investment decision-making, at the level of portfolio management, to a combination of Fund officers and a roster of external investment managers. Fund officers are tasked with making recommendations to Committee regarding the appointment of external managers; a task supported by use of a Committee-approved 'framework list' of investment manager selection consultants. Fund officers also make use of specialist advisers in managing those areas over which they exercise delegated responsibility (including property, private equity and responsible ownership).

- The Fund has an ongoing training programme (updated annually) for Committee Members and Fund officers to ensure that decision-making is on an informed basis. Members have each been issued with a manual which outlines the regulatory framework of the LGPS, the Fund's governance structure, fundamental concepts in pensions administration and investment policy and a glossary of technical terminology. The manual emphasises the quasi-trustee status and fiduciary role of Committee Members. The manual also serves as a tool for Members to assess where their individual training needs may lie. It is intended that this will be developed into a formal self-assessment exercise, following publication of a knowledge and skills framework for the LGPS.

# CLEAR OBJECTIVES

## An overall investment objective(s) should be set out for the Fund that:

*Takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers; and*

*The attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.*

- The Fund's objective is to achieve a funding level position of 100% whilst minimising the level and volatility of employer contributions. Investment strategy is decided with clear reference to this objective, as described in MPF's Funding Strategy Statement, which can be viewed at: http://mpfmembers.org.uk/pdf/fss2009.pdf.

- Over the long-term, the Fund's objective is to set policies that will seek to ensure that investment returns achieved will at least match the assumptions underlying the actuarial valuation and therefore be appropriate to the liabilities of the Fund.

- Having regard to its liability profile, the Fund has determined that adopting a bespoke benchmark should best enable it to implement an effective investment strategy. This strategic benchmark is reviewed every three years, at a minimum, at the time of the actuarial valuation but will be reviewed as required particularly if there have been significant changes in the underlying liability profile or the investment environment.

- The Fund has carefully considered the expected returns from the various permitted asset classes and has concluded that in the longer-term the return on equities will be greater than from other conventional assets. Consequently, the benchmark is biased towards equities and skewed towards active management, particularly in less developed markets.

# CLEAR OBJECTIVES

- The Fund is also cognisant of the risk that the shorter-term returns may vary significantly from one period to another and between the benchmark and actual returns.  Diversification of assets is seen as key to managing this risk and the risk/return characteristics of each asset and their relative correlations are reflected in the make-up of the strategic benchmark.

- Following the changes in investment management arrangements and the award of external mandates the overall investment target for the Fund is to outperform its strategic benchmark by 1.25% per annum over a rolling three years.

# CLEAR OBJECTIVES

## Focus on Asset Allocation

Following an asset/liability study from the Fund's actuaries and consultation with its various advisers and officers, the following strategic benchmark was agreed by the Pensions Committee on 16 November 2010.

| Asset | Benchmark | Benchmark Index |
|---|---|---|
| **UK Equities** | **25** | FTSE ALL SHARE INDEX |
| **Overseas Equities** | **30** | |
| US Equities | 8 | FTSE AW NORTH AMERICA |
| European Equities | 8 | FTSE WORLD EUROPE EX UK |
| Japan | 4 | FTSE AW JAPAN |
| Pacific | 4 | FTSE AW DEV ASIA PAC EX JAPAN |
| Emerging Markets | 6 | MSCI EMERGING MARKETS FREE |
| **Fixed Interest** | **20** | |
| UK Gilts | 4 | FTSE A ALL STOCKS |
| Overseas Gilts | 0 | JPM GLOBAL GOVT EX UK |
| UK Index Linked | 12 | FTSE UK GILTS INDEXED ALL STKS |
| Corporate Bonds | 4 | ML 3 NON GILTS |
| **Property** | **10** | IPD ALL PROPERTIES INDEX |
| **Alternatives** | **14** | |
| Private Equity | **4** | GBP 7 DAY LIBID |
| Hedge Funds | **5** | GBP 7 DAY LIBID |
| Thematics Fund of Funds | **3** | GBP 7 DAY LIBID |
| Infrastructure | **2** | GBP 7 DAY LIBID |
| **Cash** | **1** | GBP 3 MONTH LIBID |
| **TOTAL** | **100** | **SPECIFIC BENCHMARK** |

*(Table 1: MPF Multi Asset Portfolio)*

**PLEASE NOTE:** The control range around the main asset classes is +/-5%

# CLEAR OBJECTIVES

## Explicit Mandates

- The Fund mandates are governed in compliance with the following principles.

- Investment managers are prohibited from holding investments not defined as such in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 by clear reference in their Investment Management Agreements. Clear instructions for fund managers as to how the investment portfolio is to be managed including; the objective, asset allocation, benchmark flexibility, risk parameters, regulatory requirements, performance targets and measurement timescales.

| Manager | Asset Type/Brief |
|---|---|
| **Legal & General** | Active bonds |
| **Schroders** | Active bonds |
| **Internal** | Alternatives / private equity |
| **Internal** | Cash |
| **Unigestion** | European (ex UK) equities (unconstrained) |
| **Internal** | European equities |
| **JP Morgan** | European equities |
| **State Street** | Global custodian |
| **Nomura** | Japan equities |
| **Black Rock** | Far East equities |
| **Maple Browne** | Far East equities |
| **Amundi** | Emerging Markets equities |
| **M&G** | Emerging Markets equities |
| **Legal & General** | Passive equities & bonds |
| **UBS** | Passive North American equities |
| **Internal** | Property |
| **CB Richard Ellis** | Property Managers |
| **CBRE Investors** | Strategic Property advisers |
| **Internal** | UK equities |
| **BlackRock** | UK equities (unconstrained) |
| **M&G** | UK equities (unconstrained) |
| **Newton** | UK equities (unconstrained) |
| **TT International** | UK equities (unconstrained) |

*(Table 2: Managers – appointed by the Fund)*

# CLEAR OBJECTIVES

- The Fund is aware of the need to monitor transaction costs for external managers and uses Inalytics Ltd to monitor the explicit and implicit costs arising from transactions.

- The Fund does not practice soft commissions through its internal managers. Where external managers operate a soft commission policy the Fund has where possible set up recapture arrangements.

- The Fund has appointed internal monitoring officers to closely monitor the external managers and ensure compliance with mandates.

- The Fund has utilised the use of the extensions in investment limits per Schedule 1 - The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 to allow investments in its Legal and General passive mandate to 35% of the Fund. The extension is to cover urgent transitions required due to the termination of a Fund Manager's contract and is to last for the period from the termination of a contract until the implementation of a new strategy for the assets in question. This facility will be reviewed on an annual basis as part of the SIP review process.

# RISK
# AND LIABILITIES

**In setting and reviewing their investment strategy, administering authorities should:**

*Take account of the form and structure of liabilities. These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.*

The Fund believes that, over the long term, a willingness to take on volatility and illiquidity is likely to be rewarded with outperformance. The Fund considers that its strong employer covenant, maturity profile and cash-flows enable it to adopt a long term investment perspective. A mix of short-term assets such as bonds and cash is maintained to cover short-term liabilities while equities (both passive and active), private equity and direct property are held to benefit from the potential rewards arising from volatility and illiquidity risks.

The Fund recognises that risk is inherent in investment activity and seeks to manage the level of risk that it takes in an appropriate manner.

The Fund manages investment risks through the following measures as illustrated in this SIP

- Broad diversification of types of investment and investment managers
- Explicit mandates governing the activity of investment managers.
- The use of a specific benchmark, related to liabilities of the Fund for investment asset allocation.
- The appointment of independent investment advisors to the IMWP.
- Comprehensive monitoring procedures for investment managers including internal officers and scrutiny by elected Members.

# RISK AND LIABILITIES

The Fund complies with The Local Government Pension Scheme (Management and Investment of Funds Regulations 2009, where use of the extensions in investment limits per Schedule 1 are utilised.

The Fund manages operational risks through the following measures as illustrated in this SIP.

- The use of a global custodian, currently State Street, for custody of assets.
- Having formal contractual arrangements with investment managers.
- Maintaining independent investment accounting records.
- Having access to the internal audit service of Wirral Council.

# RISK AND LIABILITIES

## Stock Lending Policy

The Fund participates in stock lending of its segregated assets, as permitted under Regulation 3 (8) and 3 (9) of the LGPS (Management and Investment of Funds) Regulations 2009, and within the limits specified in these Regulations.

Lending currently takes place via the Fund's Global Custodian as Agent Lender. The Fund has in place a legal agreement with the Custodian, which includes an indemnification to the Fund in the event of loss, providing for full replacement of the lent securities regardless of the value of the collateral, or for the return of the cash value of the lent securities at the time of default.

Regular reviews of the lending programme take place with the Custodian.

As part of tender process for the next global custodian contract, scheduled to commence 1 October 2011, consideration will be given to both the use of the successful global custodian as agent lender, but also the risks and rewards of using a third party lender.

The stock lending industry is dynamic, and therefore subject to change. Should the tender exercise referred to above indicate that it is appropriate to amend some of the current arrangements, a comprehensive risks and rewards analysis will be included in a report to Pensions Committee at the relevant time.

## Risks in a Stock Lending Programme

Identified risks in participating in such a programme, and the mitigating arrangements, include:

### Agent Lender Risk

As agreed by Pensions Committee, a Custodian Monitoring service will be activated in the financial 2010/2011. This will measure, among other issues, the financial stability of the Custodian.

# RISK AND LIABILITIES

## Counterparty Risk

The Custodian reviews counterparties on a daily basis, and adds or terminates counterparties in the light of market information. Counterparty selection is in accordance with the above Regulations. This risk is measured by value of stock loaned to any one counterparty at any one time. The risk is managed in conjunction with the Custodian to ensure no undue concentration of risk with counterparties.

The Fund has not entered into any exclusive arrangement with a single counterparty, as this would represent an unacceptable concentration of counterparty risk. Counterparty risk is also mitigated by the policies on collateral risk and market risk described below. In addition, all borrowers must have in place with the Custodian an industry standard Global Master Securities Lending Agreement.

There is a move within the industry to collateral arrangements via a central counterparty. Should the pace of this development necessitate a revised approach during the currency of this Statement of Investment Principles, an appropriate report seeking authority for a change will be brought to Pensions Committee.

## Collateral Risk

Other than in delivery by value when equities from approved Indexes are required, collateral is restricted to G10 sovereign debt. Such collateral is very liquid, hence easy to sell in the event of a default by a borrower. This represents a conservative approach to collateral risk. Although now permitted by the Regulations, cash is not currently taken as collateral.

As the value of the lent securities varies from day to day, it is marked to market on a daily basis and the value of the collateral is appropriately adjusted. In addition, an excess margin is obtained from the borrower above this mark to market value. This margin is adjusted in the light of market conditions and perceived risks. This excess margin will help to protect the Fund against the possibility that the value of the collateral will fall relative to the lent securities in the period between default by the borrower and the realization of the collateral.

## Currency Risk

This is partly mitigated by certain collateral being in the same currency as the stock lent out.

## Settlement Risk

Would arise if, for example, lent securities were delivered in one settlement system prior to the receipt of collateral securities in another system. Steps are taken to ensure that daylight exposure is recognised and properly controlled. The common way of avoid this risk is for the Agent Lender to require settlement of both legs in a delivery-versus-payment system

## Operational Risk

The possibility that a transaction does not work as planned because of human or system error giving rise to a financial exposure. The Fund is protected against this risk by the Indemnity from the Global Custodian.

## Reputational Risk

The damage to the reputation of MPF should any loss be incurred in stock lending. The risk is managed by ensuring both that the Fund has a high level of understanding of the industry and that Members are aware of the nature of the activity, its risks, its risk controls and its rewards.

## Performance Risk

Earnings from the programme are compared with industry averages.

## Corporate Governance in Stock Lending

Stock lending involves the temporary loss of title to a security, and its replacement with a legal contract for the return the stock on a fixed day or upon request, together with the provision of appropriate collateral and for an agreed fee. In addition, the lender retains the economic rights in respect of corporate actions and dividends.

The return of stock is in accordance with normal settlement timescales. As such, should the lending period of the stock coincide with a contentious voting issue, the Fund will recall the stock to exercise its vote, in accordance with its corporate governance responsibilities. Additionally, the Fund will have regard to the market environment and liquidity of individual stocks in committing holdings to the programme.

The Fund engages with the industry to promote best practice. Currently it represents the Local Authorities Pension Fund Forum at the International Securities Lending Association (ISLA) and is active within the Corporate Governance sub group of ISLA.

# PERFORMANCE ASSESSMENT

## Arrangements should be in place for:

*For the formal measurement of performance of the investments, investment managers and advisers. Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.*

- In setting the overall investment objective and asset allocation and in the award of mandates to individual investment managers the Pensions Committee has set benchmarks for each asset class, these are set out in the asset allocation table under Principle 2 on page 9.

- The different benchmarks culminate in the specific benchmark for the Fund, which is determined by the core asset allocation, which has been made with reference to the Fund's liabilities.

- The Fund engages the WM Company to provide an independent measurement of investment returns. These are used for comparison purposes against specific and peer group benchmarks. The reporting from the WM Company also comprises performance attribution broken down by asset class, and owing to the impacts of asset allocation and stock selection. The Fund has recently re-negotiated contracts with WM to ensure that information is available for comprehensive monitoring of individual fund managers. The Fund has dedicated internal staff resource to providing timely valuations of its assets.

- The Pensions Committee and IMWP receive WM reports and are therefore able to consider the performance of all asset classes and managers against a variety of time frames on a regular basis. These considerations form the basis of decision making.

# PERFORMANCE ASSESSMENT

- The Investment Monitoring Policy, which can be viewed at: http://mpfmembers.org.uk/pdf/impolicy09.pdf, establishes the framework for the monitoring of the Fund's internal and external investment managers. This framework is linked into the reporting and governance framework of the Fund and defines a range of status levels linked to management actions, which are assigned to each investment manager. It takes account of quantitative measures, such as performance against benchmark and target, but assessment of status is weighted toward longer-term measures, such as one and three-year annualised returns. The monitoring policy is not felt to be overly prescriptive, as it does allow for qualitative factors to be taken into account in status assessment, as well as flexibility over the range of management actions to be taken and the outcomes expected.

- Neither the Pensions Committee, nor the IMWP, presently undertake a formal self-assessment of their effectiveness as decision-making bodies. Historically, the reasons for this lie in the lack of a suitable framework for conducting such an assessment. However, this position will be reviewed following publication of the CIPFA Pensions Panel's knowledge, skills and competencies framework for elected Members and officers involved in managing the LGPS. Likewise, there is no performance framework in place for monitoring the effectiveness of the Fund's consultants and advisers. However, as these are contractual relationships, they will be subject to a formal review and re-tendering exercise on a five-to-seven yearly cycle.

# RESPONSIBLE OWNERSHIP

## Administering Authorities should:

*Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents include a statement of their policy on responsible ownership in the SIP; and report periodically to scheme members on the discharge of such responsibilities.*

- Merseyside Pension Fund has long since regarded the fiduciary duty it has toward its stakeholders as fully including a duty of stewardship over the assets owned by the Fund. As the core purpose of the Fund involves being a long-term investor to meet long-term liabilities, the Fund considers it prudent to view the long-term absolute performance of its investments as being subject to a wide range of factors. Such factors, as may not appear to be materially or financially pertinent in the present, may well prove to be so in the future; and, as such, the Fund considers its interests not best served by a disinterested attitude to asset ownership.

- It is a core belief within the investment philosophy of Merseyside Pension Fund that environmental, social and governance (ESG) factors can affect investment performance and, therefore, should be a feature of investment analysis and management. The Fund is mindful of legal opinion on the nature of its fiduciary responsibility and regards the 'Freshfield opinion' (as commissioned by the United Nations Environmental Project Finance Initiative) as being authoritative. This states that it is a breach of fiduciary duty not to have due regard to ESG issues within the framework of investment policy.

# RESPONSIBLE OWNERSHIP

- Therefore, the Fund has adopted a policy of responsible investment and, in November 2007, became a signatory to the United Nations Principles for Responsible Investment (UNPRI). The UNPRI are:

  1. Integrate ESG factors into investment analysis and decision-making;
  2. Active ownership - integrating ESG factors into asset ownership;
  3. Seek effective ESG disclosure in investee entities;
  4. Promote acceptance of UNPRI within the investment industry;
  5. Work with others to enhance our effectiveness in implementing the Principles;
  6. Report on our activities and progress toward implementing the Principles.

- The Fund's policy for acting on its UNPRI commitment can be summarized as one of constructive engagement with its investee companies and asset managers on ESG matters; often acting in collaboration with other like-minded investors. Engagement encompasses a broad range of activity, including meaningful dialogue with companies and active use of voting rights. The Fund considers the engagement approach to be best suited to meeting its investment objectives and fulfilling its fiduciary duty to stakeholders; as opposed to an approach based on the positive or negative screening of assets from a portfolio on ESG or ethical grounds. This latter approach could be seen as effectively negating the value of responsible ownership.

- Active use of the voting rights attached to equity shares is the principal tool used in the Fund's engagement strategy. The Fund considers voting rights to be part of the intrinsic value of share ownership; and the use of these rights is an important mechanism for communicating the Fund's views to the management of investee companies. Therefore, the Fund has appointed a specialist adviser (Pensions Investment & Research Consultants Ltd, aka PIRC) to assist in implementing a comprehensive voting policy that covers the Fund's global equities portfolio. The Fund considers PIRC's Global Shareholder Voting Guidelines to insist upon the highest standards of corporate governance and responsibility. Accordingly, MPF's voting policy at all

# RESPONSIBLE OWNERSHIP

- MPF does not view its voting policy as seeking to enforce a 'tick box' compliance regime within its equity portfolio, but rather as a means of promoting the highest standards of corporate governance. The practical arrangements for implementing the voting policy are determined by the Fund's preference for retaining the beneficial ownership of its equity investments, separate from its investment managers, by using a single global custodian. PIRC are mandated by the Fund to issue voting instructions to the custodian.

- MPF further pursues its engagement strategy through its active membership of the Local Authority Pension Fund Forum (LAPFF). It states its mission thus, "LAPFF exists to promote the investment interests of local authority pension funds, and to maximize their influence as shareholders whilst promoting corporate social responsibility and high standards of corporate governance among the companies in which they invest." The LAPFF membership agree annual research and engagement work-plans that cover a broad range of ESG subjects and are appropriate to the typical member's investment portfolio. LAPFF members then work with a partner organization (PIRC Ltd) to implement these work-plans. The combined ownership influence of LAPFF enables it to conduct high-level engagement with investee companies and policy-makers, both on a sustained long-term basis and with pertinent issues as they arise.

- The Fund recognizes the importance of global climate change and the impact it, and efforts to adapt to and mitigate its effects, will have on its investment strategy. MPF is a member of the Institutional Investors Group on Climate Change (IIGCC), which brings together asset owners and asset managers to catalyse greater investment in a low carbon economy by bringing investors together to use their collective influence with companies, policymakers and investors.

# RESPONSIBLE OWNERSHIP

- MPF has taken account of the recommendations of the Walker Review, (http://www.hm-treasury.gov.uk/walker_review_information.htm) and the publication of the Institutional Shareholders' Committee (ISC) Code on the Responsibilities of Institutional Investors. Although Walker's main focus was on the governance of banks and other financial institutions, the Review placed a welcome emphasis on the role of institutional shareholders and their duty of stewardship by recommending adoption of the ISC Code. The ISC Code sets out best practice for institutional investors that choose to engage with the companies in which they invest. The Fund considers that its responsible ownership policy already complies with, and may even exceed, the principles in the ISC Code. However, the Fund believes it has direct relevance for managing its relationships with external investment managers, and will require its managers to state their approach to the ISC Code on a 'comply or explain' basis, while highlighting the Fund's policy on engagement and support for the UNPRI.

- The Fund does not believe that it is necessary, nor practicable, to make responsible ownership an explicit part of its investment manager mandates. It considers that it best promotes its belief in responsible investment, and guards against the dilution of its ownership principles, by urging adoption of the ISC Code and promoting the UNPRI as the highest standard of best practice. Therefore, the Fund's selection criteria for investment manager selection will reflect a preference for investment managers that adopt the ISC Code and are signatories to the UNPRI. MPF wishes to see the consideration of ESG factors, and the fulfillment of a duty of stewardship, become part of the mainstream of investment management practice.

- The Fund will publish annually a Responsible Investment Review. The Review will report on the Fund's activities and progress in implementing its responsible investment policy over the calendar year. This will include disclosure of the Fund's voting record, the activity of LAPFF and IIGCC and a review of the approach of the external investment managers toward responsible investment and ownership practice.

# TRANSPARENCY AND REPORTING

## Administering Authorities should:

*Act in a transparent manner, communicating with stakeholders on issues relating to their management of investments, its governance and risks, including performance against stated objectives; and provide regular communication to scheme members in the form they consider most appropriate.*

The decision making structure for the Fund has been set out earlier. The key decision making forum is the Pensions Committee. The minutes of this Committee are available to the public through the Wirral Council website at: http://www.wirral.gov.uk.

This SIP will be made available to stakeholders on request and its availability will be publicised through newsletters, the annual conference and on the Fund's Website.

The Fund will also make available other documents relating to investment decision making and performance to interested stakeholders.

In accordance with LGPS (Administration) Regulations 2008, MPF has published a Communications Policy Statement, which can be viewed at: http://mpfmembers.org.uk/pdf/commspolicy2009.pdf, which describes the Fund's policy on:

- Providing information to members, employers and representatives,
- The format, frequency and method of distributing such information,
- The promotion of the Fund to prospective members and their employing bodies.

The Fund recognises the need to communicate its purpose and ethos to a wider body of stakeholders, and in furtherance of this, it has developed a media protocol supported by Wirral Council's corporate communications division. The protocol outlines engagement with local and national media, as

## Applying the 2008 Myners Principles to the Management of LGPS Funds

| | | |
|---|---|---|
| 1 | **Effective Decision Making** | The Fund is wholly or substantially compliant with the CIPFA principles. |
| 2 | **Clear Objectives** | The Fund is wholly or substantially compliant with the CIPFA principles. |
| 3 | **Risk and Liabilities** | The Fund is wholly or substantially compliant with the CIPFA principles. |
| 4 | **Performance Assessment** | The Fund is taking steps towards compliance with the CIPFA principles. |
| 5 | **Responsible Ownership** | The Fund's policy and practice exceed compliance requirements. |
| 6 | **Transparency and Reporting** | The Fund's policy and practice exceed compliance requirements. |

**Merseyside Pension Fund**
PO Box 120
Castle Chambers
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Liverpool L69 2NW

| | |
|---|---|
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| **Opening Times:** | Mon to Fri 9am -5pm |
| **Member Website:** | www.mpfmembers.org.uk |
| **Employer Website:** | www.mpfemployers.org.uk |
| **E-mail:** | mpfadmin@wirral.gov.uk |


ADMINISTERING AUTHORITY

**WIRRAL COUNCIL**

**PENSIONS COMMITTEE**

**16 NOVEMBER 2010**

**REPORT OF THE DIRECTOR OF FINANCE**

**PUBLIC SERVICE PENSIONS COMMISSION**

## 1. EXECUTIVE SUMMARY

1.1. This report informs Members of the interim report published on 7 October 2010 by the Public Service Pensions Commission headed by Lord Hutton.

## 2. BACKGROUND

2.1 The Pensions Committee considered the creation of the Public Service Pensions Commission on 27 September 2010 (Minute 29 refers).

2.2 The Public Service Pensions Commission has been tasked with conducting a fundamental review of public sector pension provision and has been asked to make recommendations to the Chancellor and Chief Secretary on pension arrangements. The Commission has been invited to produce a final report in time for the Budget 2011, but was also tasked with producing an interim report. A copy of the Treasury press release for the interim report is attached for information (Appendix 1).

**The Public Service Pension Commission Interim Report**

2.3 The interim report was published on 7 October 2010. The terms of reference also invited the Commission to consider the case for delivering savings on public service pensions within the spending review period of 2011-15.

2.4 The report states that public service pension schemes are a valuable recruitment and retention instrument, which also provide a reasonable standard of living at retirement without becoming a burden on the welfare state. The report also rejected the claims that public service pensions are "gold plated". Nonetheless, Lord Hutton points out that the status quo is not tenable. Further reform is necessary in order to strike a fairer balance, not just between current tax payers and public service employees, but also between future and current generations. He does, however reject a "race to the bottom" approach by following the private sector decline in pension provision. The report does state that it would not be desirable to move towards a funded, individual defined contribution model.

**Short-term options**

2.5 The report considers a range of options for making short-term savings and concludes that the most effective way to do so is to increase member contributions. The Commission believes that it is a matter for the Government to decide the manner and level of any necessary contribution increases but that any increase should provide some measure of protection for the low paid. In the Spending Review on 20 October 2010 the Government indicated that increases to public sector employee pension contribution rates should be phased in over three years from 2012 -13 to 2014 -15.

**Long-term**

2.6 The report has concluded that the necessary longer term structural reform cannot be achieved via traditional final salary defined benefit (DB) pension schemes, which are considered to primarily reward high earners who may also have a longer life expectancy. It is also suggested that final salary schemes do not provide a robust and fair mechanism for the majority of the public sector workforce.

2.7. The long-term reform recommendations that the Commission will be making in its final report to the Government will be based on the following set of principles: -

- Affordable and sustainable;
- Adequate and fair;
- Support productivity;
- Transparent and simple.

2.8. In the final report the Commission will examine other international public sector pension models but will also look at other pension arrangements which share the risk between employee and employer. These will include:

- Career average defined benefit schemes;
- Notional Defined Contributions (DC) schemes with added protections that, while not being funded, still determine the value of benefits at retirement by an assumed return on contributions and annuity rates.
- Collective DC schemes where all contributions are placed in one fund that is then managed on behalf of members. Members' pensions will vary according to the underlying investment performance. However, this gives an option to use inter-generational sharing to smooth the effects of market conditions;

- Cash balance schemes where the employer puts a notional amount into the member's pot every year, which is then guaranteed. This credit can be expressed as a percentage of salary for each year worked. If cash contributions from the employee and employer, plus investment returns do not match the promised guarantee then the employer will have to meet any shortfall.
- Sequential hybrids (or nursery schemes) which have more than one section or part where a member may earn both a DB pension and DC pension during their career with an employer. Members, would however, be earning either DB or DC benefits at any one time.
- Capped DB schemes, where there is a limit on the amount of salary that counts for pension purposes or on pension payments from the scheme; and
- Combination hybrids, where members simultaneously earn benefits that are part DB and part DC. For example, a capped DB pension, based on earnings up to a certain level and a DC benefit on earnings above this level.

## 3. OTHER MATTERS

3.1. The Commission has concluded that the LGPS should remain a funded scheme.

3.2 The Commission will in its final report consider pension scheme administration costs and the scope for rationalisation and cost reduction. This will include possible simplification and consolidation of functions across different schemes and units within a scheme.

3.3 Existing rights

As far as the accrued rights of existing members are concerned the Commission will be considering the extent of those accrued rights, their protection and the implications for future pension terms. The Commission is clear that protecting accrued rights does not extend as far as protecting current terms for future pension accrual.

3.4 Fair Deal

The Commission believes the evidence presented to it makes clear that current pension structures, combined with the requirement to provide comparable pension ("Fair Deal") are a barrier to outsourcing public service provision. The Commission does not appear to accept that the LGPS approach to this by offering admitted body status to contractors provides a long-term, sustainable solution for the public sector. The Commission will address this issue in its final report. The Government is to carry out a further consultation on the Fair Deal policy.

3.5 Additionally, the Commission is interested in gathering further views on public service pensions to inform the final report at Budget 2011. The Commission will therefore be issuing a second call for evidence, asking for contributions by early December 2010.

## 4. FINANCIAL IMPLICATIONS

4.1 The outcome of this review is likely to have significant financial implications for all stakeholders in the Local Government Pension Scheme and other public sector pension schemes should the Government accept and act upon the recommendations.

## 5. STAFFING IMPLICATIONS

5.1. There are none directly arising from this report.

## 6. EQUAL OPPORTUNITY /EQUALITY IMPACT ASSESSMENT

6.1. There are none arising from this report.

## 7. COMMUNITY SAFETY IMPLICATIONS

7.1. There are none arising from this report.

## 8. HUMAN RIGHTS IMPLICATIONS

8.1. There are none arising from this report.

## 9. LOCAL AGENDA 21 IMPLICATIONS

9.1. There are none arising from this report.

## 10. PLANNING IMPLICATIONS

10.1. There are none arising from this report.

## 11. MEMBER SUPPORT IMPLICATIONS

11.1. There are none arising from this report.

## 12. BACKGROUND PAPERS

12.1. The interim report of the Public Service Pensions Commission - 7 October 2010.

## 13. RECOMMENDATION

13.1 That Members note the report.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/214/2010

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Independent
Public Service
**Pensions Commission**

**PRESS RELEASE – FINAL** 7 October 2010

**JOHN HUTTON PUBLISHES INTERIM PUBLIC SERVICES PENSION REPORT**

Lord Hutton of Furness today set out the case for change in public service pensions: longer lives, the unfairness of a system that rewards high-flyers disproportionately, the imbalance of risk between taxpayers and employees and contribution rates that do not reflect the value of benefits received all demonstrate the need for reform.

In publishing the Independent Public Service Pensions Commission's Interim Report, John Hutton said:

"The current public service pension system has been unable to respond flexibly to changes in life expectancy over the past few decades – someone retiring now can expect to spend 40% of their adult life in retirement. This has driven up costs – by a third in the past decade – and these extra costs have fallen almost entirely to taxpayers. The final salary link in public service pensions is inherently unfair and can lead to high flyers getting almost twice as much back in pensions than those on more modest earnings for the same amount of pension contributions. It is also acts as a barrier to free movement of employees from the public to private sector. The case for reform is clear.

"But it is wrong to say that public service pensions are gold-plated. The average pension paid to pensioner members is about £7,800 a year. About half of pensioners receive less than £5,600 a year. And 90% of pensioners receive less than £17,000 a year. Although these figures are partly accounted for by part-time or part-career working these pensions provide a modest – not an excessive - level of retirement income.

"I also reject the argument that the downward drift of pensions in the private sector is justification that pensions in the public sector must follow the same course. I have rejected a race for the bottom."

Speaking in Liverpool at the National Association of Pension Funds (NAPF) annual conference on the day of publication, John Hutton said:

"Long-term structural reform is needed, as the issues with the current system cannot be dealt with through traditional final salary defined benefit schemes. But neither can they be dealt with appropriately through a funded individual account defined contribution model given that this would place a major financing burden on taxpayers, ignore the ability of Government as a large employer

to manage risk, and increase uncertainty of post-retirement income for scheme members, which is difficult in particular for the low paid to manage. We need an alternative scheme model that provides a fair sharing of risk between the employer and employee and adequate pensions to members."

The Commission's final report, looking at long term structural reform options, will be delivered in time for the 2011 Budget.

John Hutton continued:

"In my final report I will consider a range of alternative structures. This will include a career average alternative to the current final salary defined benefit schemes. Drawing upon international experience, alternatives such as Sweden's use of notional defined contribution schemes and the Netherlands' collective defined contribution schemes will be examined, as will risk sharing models, such as hybrid schemes that combine elements of defined benefit and defined contribution models."

In line with the Commission's Terms of Reference, the interim report also considers the case for delivering savings on public service pensions within the spending review period. It concludes that given the implementation time for any longer term reforms there is a case for short term changes, especially given that the Commission found that current Government assumptions may well underestimate the cost to the taxpayer and past increases in life expectancy have been paid for in the most part by taxpayers.

The Commission feels that, if the Government wishes to make short-term savings, then raising contribution rates would be the most effective way. But in doing so they should have regard to protecting the low paid and should not introduce contribution rates for the armed forces at this time.

**NOTES FOR EDITORS**

1.Lord Hutton of Furness was commissioned by the Chancellor, George Osborne, at the June 2010 budget to carry out a review of public service pensions. A further and final report will be published in time for Budget 2011.

2.It is for the Government to decide how or whether to action the Commission's Interim findings.

3.Press enquiries to Malcolm Graves at the Independent Public Services Pensions Commission on 07785 316773. Public enquiries to 020 7270 5186.

4. KEY FACTS

- About one in five UK citizens has some entitlement to a public service pension
- Public service schemes paid out £32 billion in 2008-09, about two thirds of the cost of the basic State Pension
- Pension payments from the leading 5 public service schemes (local government, NHS, teachers, civil service and armed forces) increased by 32 per cent from 1999-2000 to 2009-10.

- The average pension paid to pensioner members is around £7,800 per year
- Around half of pensioners receive less than £5,600 per year
- 90 per cent of pensioners receive less than £17,000 per year
- 1 in 10 public service pensions are £1,000 a year or less
- A female NHS worker who retired aged 60 in 1956 was expected to live for a further 20 years. By 2004, this had increased to 28 years, and by 2010 to 32 years
- Current pensioners can expect to spend about 40 to 45 per cent of their adult lives in retirement if they retire at 60, compared with about 30 per cent for pensioners in the 1950s
- Measured by standard contribution rates, the cost of a teacher's pension in 2004 was a third higher than it would have been if assumptions about life expectancy were the same as those in 1955
- Public service pension benefit expenditure from unfunded schemes is expected to reach 1.9 per cent of GDP in 2010-11 and remains close to this level for the next decade before decreasing to 1.4 per cent of GDP by 2060
- Net of employee contributions, benefit payments peak at 1.5 per cent of GDP in 2010-11, before falling to below 1.1 per cent by 2060
- In 1925 members of the Teachers' Pension Scheme paid 5 per cent employee contributions, which was matched by a 5 per cent contribution from the employers. Current members pay 6.4 per cent with the employer paying over twice as much at 14.1 per cent
- Around 85 per cent of public service employees have some form of employer-sponsored pension provision compared to around 35 per cent in the private sector

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**WIRRAL COUNCIL**

**PENSIONS COMMITTEE**

**16 NOVEMBER 2010**

**REPORT OF THE DIRECTOR OF FINANCE**

**RESTRICTING PENSIONS TAX RELIEF THROUGH EXISTING ALLOWANCES**

## 1. EXECUTIVE SUMMARY

1.1. This report informs Members of HM Revenue & Customs (HMRC) summary of responses to its discussion document on restricting pensions tax relief which was published on 14 October 2010, and proposals for change.

## 2. BACKGROUND

2.1 Following an announcement in the Budget on 22 June 2010 that the Government was considering an alternative approach to restricting tax relief, a discussion document "Restriction of pensions tax relief: a discussion document on the alternative approach" was published in July 2010. Change was deemed necessary as it is considered that the existing system gives an unfair tax advantage to high earners.

2.2 A copy of the technical response on the discussion document submitted to HMRC by the Merseyside Pension Fund is attached at Appendix 1.

2.3 The Government response to that consultation was published on the 14 October 2010.

## 3. PROPOSED CHANGES

### 3.1. Annual Allowance

The Annual Allowance is a limit against which pension benefits may increase each year whilst preserving their tax exempt status.
It is proposed that from April 2011 the annual allowance for tax-privileged savings will be reduced from its current level of £255,000 to £50,000. Tax relief will be available at an individual's marginal rate. For defined benefit schemes including the LGPS the deemed contribution will be valued using a factor of 16 against the pension plus any lump sum accrued. Individuals will be allowed to offset contributions exceeding the annual allowance against unused allowance from the previous three years.

3.2 It is proposed that where an individual has contributions above the Annual Allowance in a pension arrangement, pension schemes must provide members with their relevant information, including details for the previous three years.

3.3 **Lifetime Allowance**

The Lifetime Allowance is calculated when pension benefits become payable and is currently £1.8M. For defined benefit schemes including the LGPS the value of the benefits paid is calculated by multiplying the pension by a factor of 20 and adding any lump sum payment due. The lifetime allowance will be reduced, from its current level of £1.8M to £1.5M. The Government is minded that the reduced lifetime allowance will operate from April 2012. The Government invites views on the detail of this approach, including possible protection for those who currently have accrued benefits in excess of £1.5M and on the relative burdens for schemes and employers of implementation in 2011 compared with 2012. A copy of a response dated 27 October 2010 submitted on this matter to HMRC by MPF is attached for information at Appendix 2.

## 4. FINANCIAL IMPLICATIONS

4.1 There may be an additional Annual Allowance charge against some members with long service who receive a significant increase in pensionable pay. Other high earners may be subject to a tax charge as a result of the reduction in the Lifetime Allowance, depending upon protections that may be available.

4.2 MPF may incur additional administration charges through having to communicate these changes, and provide details of Annual Allowance charges for each year from April 2012 and the previous three years.

## 5. STAFFING IMPLICATIONS

5.1. There are none directly arising from this report.

## 6. EQUAL OPPORTUNITY /EQUALITY IMPACT ASSESSMENT

6.1. There are none arising from this report.

## 7. COMMUNITY SAFETY IMPLICATIONS

7.1. There are none arising from this report.

## 8. HUMAN RIGHTS IMPLICATIONS

8.1. There are none arising from this report.

9. **LOCAL AGENDA 21 IMPLICATIONS**

9.1. There are none arising from this report.

10. **PLANNING IMPLICATIONS**

10.1. There are none arising from this report.

11. **MEMBER SUPPORT IMPLICATIONS**

11.1. There are none arising from this report.

12. **BACKGROUND PAPERS**

12.1. "Restricting Pensions Tax Relief through existing allowances: a summary of the discussion document responses" – HMRC - 14 October 2010.

13. **RECOMMENDATION**

13.1 That Members note the report.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/216/10

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Pensions Tax Relief
Room 2/E2, HM Treasury
1 Horse Guards Road,
London,
SW1A 2HQ

Our Ref: PS/PM

Your Ref:

Direct Line: 0151 242 1390

Please ask for: Peter Mawdsley

Date: 26 August 2010

Dear Sirs,

**RESTRICTION OF PENSIONS TAX RELIEF: CONSULTATION ON ALTERNATIVE APPROACH**

I refer to the above mentioned discussion document dated July 2010 and am responding to the invitation for comments on behalf of Wirral Council in its capacity as the Administering Authority of the Merseyside Pension Fund.

*Wirral Council is responsible for the administration of the Merseyside Pension Fund which is part of the Local Government Pension Scheme (LGPS). The Merseyside Pension Fund deals with the LGPS pension administration and investments on behalf of the 5 Merseyside District Councils, and over 100 other employers on Merseyside and elsewhere throughout the UK.*

*The Fund has over 50,000 active contributing members, 41,359 pensioners and just over 34,000 deferred pensioners. It is responsible for the investment and accounting for a pension fund of £4.5 billion. The LGPS is a defined benefit, final salary public sector occupational scheme.*

Whilst the Fund welcomes the Government's acceptance that the measures currently due to come into force next April to limit tax relief on pensions contributions have serious technical flaws and will result in unacceptable and inequitable tax charges for some high earners, it is nevertheless concerned that any alternative system does not introduce other equally undesirable consequences and difficulties, for much larger numbers of members of defined benefit schemes, their employers and those running the Funds.

After a prolonged period of discussion with experts within the pensions industry the previous Administration introduced the current simplified tax regime for pensions from 6 April 2006 (A day), including the concepts of the Annual and the Lifetime Allowance which were set at what was agreed to be maximum reasonable levels for an individual to make pension provision with tax relief over a working life.

One of the stated aims of successive Government's has been to encourage people to save towards adequate financial provision for their retirements with the benefit of the incentive of tax relief on pension contributions in the knowledge that this would reduce the amount of means tested State welfare benefits payable in the long term.

The Fund is concerned that the potential for increased complexity, confusion, compliance costs, and perceived unfairness in the latest proposals for changes to the system of calculating tax relief will only further undermine support for pensions savings from employees and employers as a whole, leading to less pensions saving and as a result increased future costs in terms of State welfare provision.

The Fund is therefore particularly concerned that any new system of tax relief takes account of the characteristics of defined benefit schemes like the LGPS and would ask you to properly consider whether using age related factors to convert defined benefit accrual into an equivalent "contribution" which would treat all employees fairly may be better than the use of flat rate factors.

The Fund would support the view that the Annual Allowance charge should be calculated on current accrual only and should not be applied retrospectively.

The Fund's actuary has suggested that under the latest proposals employees on incomes just above the higher rate tax threshold could inadvertently become liable for tax charges greater than the amount of pension they have accrued. The proposals would also appear to risk encouraging the current generation of senior management to drop out of pension provision, undermining enthusiasm for the whole pensions saving regime.

In its submission dated 23 August 2010 the Head of Pensions of the Local Government Employers Organisation (LGE) has illustrated a number of significant difficulties with the impact that the latest proposals would have on large numbers of members of defined benefits schemes such as the LGPS and the administrators of these schemes, these include:

- The fact that the statement made that "the approach of restricting tax relief through existing allowances would affect the highest pension savers" is not true in relation to members of defined Benefit Schemes as a result of the method of valuing benefit accrual in such schemes as the LGPS.

- Concerns about the ability of the new proposals to ensure fairness of treatment between members of defined benefit and defined contribution schemes a problem which the Fund does not believe has been resolved.

- Problems of potential indirect age discrimination in a defined benefit scheme because older employees are more likely to have longer periods of pensionable membership they are more likely to suffer a tax charge than younger employees as illustrated in the examples set out in the LGE response.

- Problems of potential indirect sex discrimination in a defined benefit scheme because significantly more women than men work part time, therefore proportionately more men than women are likely to become subject to a tax charge (See example in LGE response).

The Fund does not support the change proposed to apply the revised annual check in the year of retirement and in particular believes that all ill health retirements should continue to be exempt from such checks.

**Alternative Approaches for consideration to delivering savings**

If the Government believes that reductions in the value of tax relief which are currently allowed under the existing system are necessary the Fund would suggest that consideration be given to reintroduction of a mandatory maximum pensions earnings cap for future benefits accrual.
Prior to 6 April 2006 there was a maximum permitted pay to be used for calculation of tax approved pension benefits and on which contributions and tax relief could be calculated (Section 590C of the Income and Corporation Taxes Act 1988). If such an earnings cap was reintroduced, coupled with a maximum contribution limit (calculated as a specified percentage of the earnings cap figure) the required cost savings could be delivered much more simply and cheaply in terms of administration. Restricting the pay eligible for tax relief in the first instance would eliminate the need for complex annual calculations, monitoring and compliance and individuals being faced with unexpected tax charges after the event.

Alternatively it could be argued that another simpler and more equitable way of delivering the policy objective of cost savings would be to limit tax relief on employee contributions to basic rate (20%) for all employees either on all pay or on an annual maximum amount related to the current or revised annual and lifetime allowances.

With the planned timescales for change being April 2011 as set out in the discussion document, the timescales for consultation or even communication of the outcomes with scheme employers and members and changes to computer systems and literature would appear virtually impossible.

If you require any further information or assistance please do not hesitate to contact me.

Yours sincerely

**Deputy Head of Pension Fund**

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Our Ref: PS/KG

Your Ref:

Direct Line: 0151 242 1354

Please ask for: Kevin Greenough

Date: 27 October 2010

Pensions Tax Relief
Room 2/E2,
HM Treasury,
1 Horse Guards Road,
London
SW1A 2HQ

Dear Sirs,

**Restricting pensions tax relief through existing allowances: a summary of the discussion document responses.**

I refer to the above mentioned document dated 14 October 2010 and am responding on behalf of Wirral Council in its capacity as the Administering Authority of the Merseyside Pension Fund to the request for representations on the issues around reducing the Life Time Allowance (LTA).

Wirral Council is responsible for the administration of the Merseyside Pension Fund which is part of the Local Government Pension Scheme (LGPS). The Merseyside Pension Fund deals with the LGPS pension administration and investments on behalf of the 5 Merseyside District Councils and over 100 other employers on Merseyside and elsewhere throughout the UK.

The Fund has over 50,000 active contributing members, 41,359 pensioners and just over 34,000 deferred pensioners. It is responsible for the investment and accounting for a pension fund of £4.5 billion. The LGPS is a defined benefit, final salary public sector occupational scheme.

The Fund is concerned that sufficient consideration is given to the preservation of existing primary and enhanced protections against the LTA, and that suitable protection is granted for those members who have accrued pension benefits in excess of £1.5M by April 2012 up to an overall limit of £1.8M. It is suggested that this can be achieved by revisiting the Primary Protection model used when the LTA was first introduced. The Fund does not support the re-introduction of enhanced protection in advance of April 2012, as this was a process full of complexity which was difficult to communicate to members and a burden to administer.

The Fund also feels that the factor used for the valuation of defined pension benefits should remain as a flat factor of 20. To change it or to introduce any age related factors would inevitably complicate existing protections, and the administration of the LTA charge.

The proposed changes announced to the Annual Allowance (AA) to restrict tax relief should yield sufficient tax revenue, and will require pension administrators to communicate, monitor and report to their members on the potential impact on individuals, without also further complicating the LTA regime.

It is also felt that the existing anti-forestalling provisions and the introduction of the new AA regime from 2011 should be sufficient to limit and prevent individuals' ability to avoid the new LTA charge before its introduction in 2012, removing any need to introduce the changes earlier. Indeed, pension administrators will need until 2012 to communicate these changes and any relevant protections to their members and to make any necessary procedural changes. Indeed 2011 will be a busy enough time introducing new processes and communicating to members regarding the changes to Annual Allowance charges.

If you require any further information or assistance do not hesitate to contact me.

Yours sincerely

**Director of Finance**

**WIRRAL COUNCIL**

**PENSIONS COMMITTEE**

**16 NOVEMBER 2010**

**REPORT OF THE DIRECTOR OF FINANCE**

**FUNDING STRATEGY STATEMENT**

## 1. EXECUTIVE SUMMARY

1.1 This report proposes amendments to the Funding Strategy Statement (FSS) to reflect updated advice received from the Actuary on dealing with arrangements for funding of employer contributions and changes proposed to the Statement of Investment Principles (SIP) following completion of the 31 March 2010 actuarial valuation.

1.2 Members are recommended to approve the proposed amended Funding Strategy Statement attached at Appendix 1.

## 2. CURRENT FUNDING STRATEGY STATEMENT

2.1 The previous Funding Strategy Statement (FSS) was approved by the Pensions Committee on 22 September 2009 (Minute 43 refers).

2.2 The Local Government Pension Scheme (Administration) Regulations 2008 require that each Administering Authority revise and publish a funding strategy statement wherever there is a material change in either the policy on matters set out in the FSS or the Statement of Investment Principles (SIP).

## 3. REVISED FUNDING STRATEGY STATEMENT

3.1 Following consultation with Scheme Employers the assumptions and methodology set out below are to be used in completion of the valuation and determination of employer contribution rates.

### 3.2 Mortality

3.2.1. Use assumptions based on the most up to date information published by the Continuous Mortality Investigation Bureau, making allowance for future improvements in longevity and the experience of the LGPS.

### 3.3 Future Ill Health Experience & Other Demographics

3.3.1. Following an analysis carried out by the Actuary, the ill health and proportions married assumptions have been modified from the 2007 valuation.

### 3.4 Recovery Plan and period for deficit repayment

3.4.1. A maximum deficit recovery period of 25 years will apply for scheme employers and a 15 year maximum period will apply to admitted bodies. For employers who do not admit new members, the recovery period will be limited to the future working lifetime of the membership or 15 years if shorter. Shorter periods will also be applied for employers who have a limited participation in the MPF.

3.4.2. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may also be applied in respect of particular employers where the Administering Authority considers this to be warranted.

3.4.3. The revised FSS reflects the recommendations of the Actuary that in current circumstances, as a general rule, it would not be appropriate for contribution reductions to apply where substantial deficits apply. As a result in addition to the maximum deficit recovery period of 25 years, MPF will operate a default deficit recovery period, set at 20 years for scheduled and resolution bodies and 10 years for non -Transferee admission bodies at the 2010 valuation. All employers in deficit will be required to adopt a deficit recovery period in line with the default period (or shorter) before any reduction in overall contributions would be allowed.

### 3.5 Method of expressing, and payment of, employer contributions

3.5.1. With effect from 1 April 2011 employer contributions will be expressed and certified as two separate elements:

(1) a percentage of pensionable payroll in respect of future accrual of benefits, and

(2) a schedule of fixed amounts over 2011/14, building in an allowance for increases annually in line with the valuation funding assumption for long term pay growth, in respect of the past service deficit or surplus subject to review from April 2014 based on the results of the 2013 actuarial valuation.

3.6 **New Community Admission Body (CAB) admissions**

3.6.1. For new Community Admission Body (CAB) admissions only, from 1 April 2011, who do not have a guarantor of sufficient financial standing based on the assessment of the Administering Authority, the basis of assessment for both the contributions and termination will be on a gilts or "least risk" basis. The employer's assets will then be deemed to be invested in Government bonds of the appropriate duration to the liabilities and be credited with the returns derived from such assets based on the advice of the Actuary.

3.6.2. Where a guarantor is available the assessment will be on the normal valuation basis if the guarantor agrees to underwrite the obligations of the employer in the long term.

3.7 **Optional funding basis for other Admission Bodies**

3.7.1. From 1 April 2011 all existing admitted bodies up to that date, will have the option of adopting a funding basis in line with the existing termination approach based on corporate bond yields. The employer's assets will then be deemed to be invested in corporate bonds of the appropriate duration to the liabilities and be credited with the returns derived from such assets on the advice of the Actuary.

3.7.2. In all cases the Administering Authority will reserve the right to apply a different approach at its sole discretion taking into account the risk associated with an employer in proportion to the Fund as a whole.

4. **FINANCIAL IMPLICATIONS**

4.1 There are none arising directly from this report.

5. **STAFFING IMPLICATIONS**

5.1 There are none arising directly from this report.

6. **EQUAL OPPORTUNITY IMPLICATIONS**

6.1 There are none arising directly from this report.

7. **HUMAN RIGHTS IMPLICATIONS**

7.1 There are none rising directly from this report.

## 8. COMMUNITY SAFETY IMPLICATIONS

8.1 There are no specific implications arising from this report.

## 9. LOCAL MEMBER SUPPORT IMPLICATIONS

9.1 There are no specific implications for any Member or Ward.

## 10. LOCAL AGENDA 21 IMPLICATIONS

10.1 There are no specific implications arising from this report.

## 11. PLANNING IMPLICATIONS

11.1 There are no specific implications arising from this report

## 12. BACKGROUND PAPERS

12.1 Merseyside Pension Fund 2010 Actuarial Valuation – Mercer

## 13. RECOMMENDATION

13.1. That the Committee approve the revised Funding Strategy Statement.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/217/10

**APPENDIX 1**

# Funding Strategy Statement 2010 (draft)

## Introduction

The Local Government Pension Scheme (Administration) Regulations 2008 replaced the Local Government Pension Scheme Regulations 1997 providing the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Fund the Administering Authority will prepare and publish its funding strategy;

- In preparing the FSS, the Administering Authority must have regard to the guidance issued by CIPFA for this purpose; and the revised **Statement of Investment Principles (SIP)** for the Fund dated 16 November **2010** published under **Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended)**;

- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the SIP.

Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.

The Fund is a defined benefit scheme under which the benefits are specified in the governing legislation -

- The LGPS (Benefits, Contributions & Membership) Regulations 2007 (as amended), “the BMC Regulations”

The required levels of employee contributions are also specified in the Regulations. Employer contributions are determined in accordance with the Regulations (currently principally Administration Regulation 36) which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate.

Contributions to the Fund should be set so as to “secure its solvency”, whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

## Purpose of the FSS in policy terms

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made.

Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

### The purpose of this Funding Strategy Statement is:

- To establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- To support the regulatory requirement to maintain as nearly constant employer contribution rates as possible; and
- To take a prudent longer-term view of funding those liabilities.

The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled.

Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the Administering Authority to implement and maintain.

## Aims and Purposes of the Fund

### The aims of the Fund are to:

- Enable employer contribution rates to be kept as nearly constant as possible and at a reasonable and affordable cost to the taxpayers, scheduled, resolution and admitted bodies
- Manage employers' liabilities effectively
- Ensure that sufficient resources are available to meet all liabilities as they fall due, and
- Maximise the returns from investments within reasonable risk parameters.

### The purpose of the Fund is to:

- Receive monies in respect of contributions, transfer values and investment income, and
- Pay out monies in respect of Fund benefits, transfer values, costs, charges and expenses, as defined in the various Local Government Pension Scheme Regulations:

- The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended)
- The Local Government Pension Scheme (Administration) Regulations 2008 (as amended), and
- The Local Government Pension Scheme (Benefits, Contributions & Membership) Regulations 2007 (as amended)

## Responsibilities of the Key Parties

These are as set out in the relevant regulations as amended from time to time:

- The LGPS (Administration) Regulations,
- The LGPS (Benefits, Contributions & Membership) Regulations and
- The LGPS (Transitional Provisions) Regulations 2007, “the Regulations”.

### The Administering Authority should:

- Collect employer and employee contributions
- Invest surplus monies in accordance with the underlying legislation
- Ensure that cash is available to meet liabilities as and when they fall due
- Manage the valuation process in consultation with the actuary
- Prepare and maintain an FSS and a SIP, both after due consultation with interested parties, and
- Monitor all aspects of the Fund’s performance and funding and amend FSS/SIP.

### The Individual Employer should:

- Deduct contributions from employees’ pay correctly
- Pay all contributions, including their own as determined by the actuary, promptly by the due date
- Exercise discretions within the regulatory framework
- Make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain, and
- Notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding.

### The Fund Actuary should:

- Prepare valuations including the setting of employers’ contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS
- Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters, and

Advise on funding strategy, the preparation of the FSS, and the inter-relationship between the FSS and the SIP.

# Solvency issues and target funding levels

## The funding objective:

To meet the requirements of the Administration Regulations the Administering Authority's long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the "**funding target**") assessed on an ongoing basis including allowance for projected final pay.

Determination of the funding target and recovery period:

The principal method and assumptions to be used in the calculation of the **funding target** are set out in the Appendix. Underlying these assumptions are the following two tenets:

- That the Scheme is expected to continue for the foreseeable future; and
- Favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer (or employer grouping), following a principle of no cross-subsidy between the various employers in the Scheme. In attributing the overall investment performance obtained on the assets of the Scheme to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole unless agreed otherwise between the employer and the Fund at the sole discretion of the Administering Authority.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates:

- LEA Schools and certain other employers within the Fund have been grouped with the respective Council.

A maximum deficit recovery period of [25] years will apply for scheme employers and a [15] year maximum period will apply to admitted bodies. For employers who do not admit new members, the recovery period will be limited to the future working lifetime of the membership or 15 years if shorter . Shorter periods will also be applied for employers who have a limited participation in the Fund. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may also be applied in respect of particular employers where the Administering Authority considers this to be warranted (see **Deficit Recovery Plan** on page 8).

In current circumstances, as a general rule, the Fund does not believe it appropriate for contribution reductions to apply where substantial deficits apply. As a result in addition to the maximum deficit recovery period of 25 years, the Fund will operate a default deficit recovery period, set at [20] years for scheduled and resolution bodies and [10] years for non-Transferee admission bodies at the 2010 valuation. All employers in deficit will be required to adopt a deficit recovery period in line with the default period (or shorter) before any reduction in overall contributions would be allowed.

• With effect from April 2011 employer contributions will be expressed and certified as two separate elements:

- a percentage of pensionable payroll in respect of future accrual of benefits

- a schedule of fixed £s amounts over 2011/14, building in an allowance for increases annually in line with the valuation funding assumption for long term pay growth, in respect of the past service deficit or surplus subject to review from April 2014 based on the results of the 2013 actuarial valuation.

  Where an employer is in a surplus position the fixed amount deduction from the future service rate will be subject to a threshold of £1,000 below which no deduction will be made.

- Unless agreed otherwise by the relevant Scheme Employer any Transferee admission bodies will be treated in the same way as the original Scheme Employer.

- Where the employer contributions required from 1 April 2011 increase significantly in terms of the employer's pay following completion of the 2010 actuarial valuation, the increase from the rates of contribution payable in the year 2010/11 may be phased in over a maximum period of 3 years.

- On the cessation of an employer's participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer will be due to the Scheme as a termination contribution, unless it is agreed by the Administering Authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Scheme to another participating employer.

Depending on the circumstances of the termination event this assessment and in particular whether another Fund employer is prepared to act as guarantor to the residual liabilities will incorporate a more cautious basis of assessment of the final liabilities for the employer. Where it may be appropriate to use a more cautious basis the financial assumptions used will be derived to be consistent with the equivalent assumptions adopted for the FRS17 accounting standard for current employers in the Fund. This is subject to the financial assumptions used being no less cautious than the equivalent valuation assumptions updated appropriately based on the advice of the actuary. Full details of the approach to be adopted for such an assessment on termination are set out in the separate termination policy report dated 28 January 2008 [to be updated].

- For new Community Admission Body (CAB) admissions only from 1 April 2011, who do not have a guarantor of sufficient financial standing based on the assessment of the Administering Authority, the basis of assessment for both the contributions and termination will be on a gilts or "least risk" basis. The employer's assets will then be deemed to be invested in government bonds of the appropriate duration to the liabilities and be credited with the returns derived from such assets based on the advice of the Actuary. Where a guarantor is available the assessment will be on the normal valuation basis if the guarantor agrees to underwrite the obligations of the employer in the long term.

- From 1 April 2011 all existing admitted bodies up to that date will have the option of adopting a funding basis in line with the existing termination approach based on corporate bond yields. The employer's assets will then be deemed to be invested in corporate bonds of the appropriate duration to the liabilities and be credited with the returns derived from such assets on the advice of the Actuary.

- In all cases the Administering authority reserves the right to apply a different approach at its sole discretion taking into account the risk associated with an employer in proportion to the Fund as a whole. Any employer affected will be notified separately.

In determining the above objectives the Administering Authority has had regard to:

- the responses made to the consultation with employers on the FSS principles

- relevant guidance issued by the CIPFA Pensions Panel

- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose, and the Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.
- The need to minimise the risks to the Fund from its admission arrangements by strengthening its admission arrangements and pursuing a policy of positive engagement.

## Deficit recovery plan

If the assets of the scheme relating to an employer are less than the **funding target** at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall.

Additional contributions will be expressed as a monetary lump sum.

In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:

- The size of the funding shortfall;
- The business plans of the employer;
- The assessment of the financial covenant of the Employer, and security of future income streams;
- Any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.
- Length of expected period of participation in the Fund.

For those employers with no guarantor or bond arrangements in place, a higher **funding target** will be adopted. The contribution rate for these employers will be determined to target a funding position of [120]% for the liabilities of the current active membership. The **funding target** for the non-active liabilities will be as defined earlier. The principles around the recovery period will be as noted earlier after the change in funding target has been applied.

The Administering Authority has the discretion to vary the recovery periods to a maximum period of [25] years and **funding target** in the FSS subject to satisfactory assurances over the financial covenant of an employer.

## The normal cost of the scheme (future service contribution rate)

In addition to any contributions required to rectify a shortfall of assets below the **funding target** contributions will be required to meet the cost of future accrual of benefits for members after the valuation date (the “normal cost”). The method and assumptions for assessing these contributions on the normal valuation basis are also set out in the Appendix.

## Funding For Non-Ill Health Early Retirement Costs

Employers are required to meet all costs of early retirement strain either by immediate capital payments into the Fund or in certain circumstances by agreement with the Fund, by instalments over a period not exceeding 5 years or if less the remaining period of the body’s membership of the Fund.

## Link to Investment Policy in the SIP

The results of the 2010 valuation show the liabilities to be 78% (compared to 80% at 31 March 2007) covered by the current assets, with the funding deficit of 22% being covered by future deficit contributions.

In assessing the value of the Fund's liabilities in the valuation, allowance has been made for asset out-performance as described in the Appendix on page 14, taking into account the investment strategy adopted by the Fund, as set out in the SIP.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

Investment of the Fund's assets in line with the least risk portfolio would minimise fluctuations in the Fund's ongoing funding level between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out the valuation it would not be appropriate to make any allowance for out-performance of the investments or any adjustment to the market implied inflation assumption due to supply / demand distortions in the bond markets. On this basis of assessment, the assessed value of the Fund's liabilities at the 31 March 2010 valuation would have been significantly higher and the declared funding level would be correspondingly lower at 58%.

Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

## Proposed Benchmark Investment Strategy and Asset Allocation

The proposed benchmark investment strategy and asset allocation to be set out in the SIP is shown in *Table 1*

| **Asset** | **Benchmark** | | **Benchmark Index** |
|---|---|---|---|
| **UK Equities** | **25** | | FTSE ALL SHARE INDEX |
| **Overseas Equities** | **30** | | |
| US Equities | | 8 | FTSE AW NORTH AMERICA UK |
| European Equities | | 8 | FTSE WORLD EUROPE EX UK |
| Japan | | 4 | FTSE AW JAPAN |
| Pacific | | 4 | FTSE AW DEV ASIA PAC EX JAPAN |
| Emerging Markets | | 6 | MSCI EMERGING MARKETS FREE |
| **Fixed Interest** | **20** | | |
| UK Gilts | | 4 | FTSE A ALL STOCKS |
| Overseas Gilts | | 0 | JPM GLOBAL GOVT EX UK |
| UK Index Linked | | 12 | FTSE UK GILTS INDEXED ALL STKS |
| Corporate Bonds | | 4 | ML 3 NON GILTS |
| **Property** | **10** | | IPD ALL PROPERTIES INDEX |
| **Venture Capital/Other Investments** | **14** | | GBP 7 DAY LIBID |
| **Cash** | **1** | | GBP 3 MONTH LIBID |
| **Total** | **100** | | **SPECIFIC BENCHMARK** |

*(Table 1: MPF Multi Asset Portfolio)*

The funding strategy adopted for the 2010 valuation was based on an assumed asset out-performance of [2%] in respect of liabilities pre-retirement, and [1%] in respect of post-retirement liabilities. Based on the liability profile of the Fund at the valuation, this equated to a long term overall asset out-performance allowance of [1.4%] p.a.

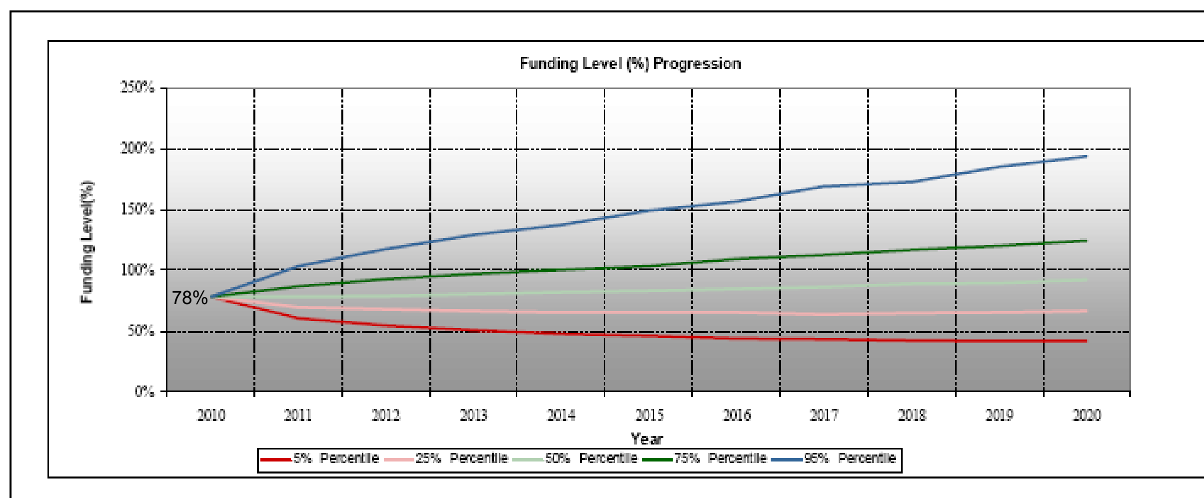
The Administering Authority believes that this is a reasonable and prudent allowance for asset out-performance, based on the investment strategy adopted as set out in the SIP.

## Identification of risks and counter-measures

The funding of defined benefits is by its nature uncertain. Funding of the Fund is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the actuary that the greatest risk to the Fund's funding is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the overall 1.4% per annum assumed in the long term.

The chart below shows a "funnel of doubt" funding level graph, which illustrates the probability of exceeding a certain funding level over a 10 year period from the valuation date. For example, the top line shows the 95th percentile level (i.e. there is a 5% chance of the projected funding level at each point in time being better than the funding level shown and a 95% chance of the funding level being lower). The graph adopts the 2010 actuarial valuation results as a starting point, and allows for the expected contributions into the Fund assuming a [25] year recovery period. An overall out-performance over and above gilts yields has been assumed in line with best estimate market expectations, together with a continuation of the current investment strategy as outlined above.




### The following key risks have been identified:

#### Financial

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- Effect of possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies

### Demographic

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)

### Regulatory

- Changes to Regulations, e.g. more favourable benefits package, potential new entrants to Fund, e.g. part-time employees
- Changes to national pension requirements and/or Inland Revenue rules

## Governance

Wirral Borough Council as the administering authority for Merseyside Pension Fund has delegated responsibility and accountability for overseeing the Fund to the Pensions Committee.

The Pensions Committee is made up of ten Members nominated by Wirral, one nominated from each of the other four metropolitan authorities and a representative of the other admitted and scheduled bodies elected by ballot. There are three members drawn from trade unions representing all actives, deferred members and pensioners. Aside from the representative Member, changes to Committee membership are subject to the political leadership of the Councils, although efforts are made to limit rotation where possible.

The Committee meets 4 to 5 times a year and has set up an Investment Monitoring Working Party which meets at least 6 times a year to monitor investment performance and developments. The Committee has delegated powers to the Director of Finance for the day to day running of the Fund.

There is a clear decision making process for the operations of the Fund, major decisions are taken and minuted at monthly Fund Operating Group meetings attended by the Director and Deputy Director of Finance and senior MPF managers.

There is a significant resource dedicated on an annual basis for Member training which is provided both internally and externally.

The Pensions Administration Strategy (PAS) sets out clear standards of service to members by defining employer and Fund responsibilities in administering the Scheme and sets out the requirements for the two way flow of information. The employer should notify the administering authority of the following events.

- Structural change in employer's membership e.g. large fall in employee numbers or large number of retirements.
- A closure in accessibility of the scheme to new entrants.
- An employer ceasing to exist.

## Monitoring and Review

The Administering Authority has taken advice from the actuary in preparing this Statement, and has also consulted with the employers participating in the Fund.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of then current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- If there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- If there have been significant changes to the Fund membership, or LGPS benefits
- If there have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy
- If there have been any significant special contributions paid into the Fund.

# Appendix

## Actuarial Valuation as at 31 March 2010

### Method

The actuarial method to be used in the calculation of the funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, unless specifically agreed otherwise, an alternative method is adopted (the Attained Age method), which makes advance allowance for the anticipated future aging and decline of the current closed membership group.

## Financial assumptions

### Investment Return (Discount Rate)

A yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") of [2%] p.a. for the period pre-retirement and [1%] p.a. post-retirement.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date. The allowance for this out-performance is based on the liability profile of the Scheme, with a higher assumption in respect of the "pre-retirement" (i.e. active and deferred pensioner) liabilities than for the "post-retirement" (i.e. pensioner) liabilities.
This approach thereby allows for a gradual shift in the overall equity/bond weighting of the Fund as the liability profile of the membership matures over time.

### Individual Employers

Having determined the AOAs as above for the Fund overall, it is important to consider how the financial assumptions in particular impact on individual participating employers. As employers in the Fund will have different mixes of active, deferred and pensioner members, adopting a different pre/post retirement investment return approach is equivalent to hypothecating a different equity/bond mix investment strategy for each employer. Such an approach would be inconsistent with the Fund practice, as set out in the FSS, of allocating investment performance pro rata across all employers based on a "mirror image" investment strategy to the whole Fund except where agreed between the employer and Fund at the sole discretion of the Administering Authority. In completing the calculations for individual employers therefore, a single, composite, pre and post retirement asset out-performance assumption of [1.4%] p.a. has been calculated which, for the Fund as a whole, gives the same value of the funding target as the separate pre and post retirement AOAs.

### Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities. An adjustment to allow for supply/demand distortions in the bond market is incorporated. The Chancellor announced, in his Emergency Budget in June 2010, that retirement pensions would be increased annually by the change in the Consumer Price Index rather than the Retail Price Index. This change will apply from April 2011 and the assumptions make due allowance for this revision as advised by the Actuary.

### Salary increases

The assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of [1.5%] p.a. over the inflation assumption as described above. This includes allowance for promotional increases. This has been modified from the previous adopted assumption (of 1.25% above the RPI inflation assumption) to reflect the change in inflation assumption from RPI to CPI. This change reasonably incorporates the effect of the recent announcements on pay restraint in the public sector.

### Pension increases

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

### Mortality

The mortality assumptions will be based on the most up-to-date information published by the Continuous Mortality Investigation Bureau, making allowance for future improvements in longevity and the experience of the scheme. The mortality tables used are set out below, with a loading reflecting Scheme specific experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. Members who retire on the grounds of ill heath are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 3 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 1% per annum.

### Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up.

### Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the ill health and proportions married assumptions have been modified from the 2007 valuation. Other assumptions are as per the 2007 valuation.

**Method and assumptions used in calculating the cost of future accrual**

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target except that the financial assumptions adopted will be as described below. The financial assumptions for assessing the future service contribution rate should take account of the following points:

- Contributions will be invested in market conditions applying at future dates, which are unknown at the effective date of the valuation, and which are not directly linked to market conditions at the valuation date; and
- The future service liabilities for which these contributions will be paid have a longer average duration than the past service liabilities.

The financial assumptions In relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real return (i.e. return in excess of price inflation) of [3.75]% per annum, with a long term average assumption for price inflation of [3.0]% per annum. These two assumptions give rise to an overall discount rate of [6.75]% p.a.

Adopting this approach the future service rate is not subject to variation solely due to different market conditions applying at each successive valuation, which reflects the requirement in the Regulations for stability in the "Common Rate" of contributions. In market conditions at the effective date of the 2010 valuation this approach gives rise to a slightly more optimistic stance in relation to the cost of accrual of future benefits compared to the market related basis used for the assessment of the funding target.

At each valuation the cost of the benefits accrued since the previous valuation will become a past service liability. At that time any mismatch against gilt yields and the asset out-performance assumptions used for the funding target is fully taken into account in assessing the funding position.

## Summary of key whole Fund assumptions used for calculating funding target and cost of future accrual (the "normal cost") for the 2010 actuarial valuation

| **Long-term gilt yields** | |
|---|---|
| Fixed Interest | 4.5% p.a. |
| | |
| Index-Linked | 0.7% p.a. |

| **Past service Funding Target financial assumptions** | |
|---|---|
| Investment return pre-retirement | [6.50]% p.a. |
| Investment return post-retirement | [5.50]% p.a. |
| CPI price inflation | [3.00]% p.a. |
| Salary increases | [4.50]% p.a. |
| Pension increases | [3.00]% p.a. |

| **Future service accrual financial assumptions** | |
|---|---|
| Investment return | [6.75]% p.a. |
| CPI price inflation | [3.00]% p.a. |
| Salary increases | [4.50]% p.a. |
| Pension increases | [3.00]% p.a. |

*Demographic assumptions*

The mortality tables adopted for this valuation are as follows:

| | Table | Adjustment |
|---|---|---|
| Males normal health pensioners | S1PMA CMI_2009_M [1%] | 106% |
| Female normal health pensioners | S1PFA CMI_2009_F [1%] | 97% |
| Males ill health pensioners | As for male normal health pensioners +3 years | |
| Female ill health pensioners | As for female normal health pensioners +3 years | |
| Male dependants | S1PMA CMI_2009_M [1%] | 127% |
| Female dependants | S1DFA CMI_2009_F [1%] | 109% |
| Male future dependants | S1PMA CMI_2009_M [1%] | 111% |
| Female future dependants | S1DFA CMI_2009_F [1%] | 103% |

**Other demographic assumptions are noted below:**

| | |
|---|---|
| Commutation | One half of members take maximum lump sum, others take 3/80ths |
| Withdrawal | As for 2007 valuation |
| Other demographics | Based on LG scheme specific experience. |

**(Version updated 25/10/2010 by Mercer)**

**WIRRAL COUNCIL**

**PENSIONS COMMITTEE**

**16 NOVEMBER 2010**

**REPORT OF THE DIRECTOR OF FINANCE**

**ACTUARIAL VALUATION AS AT 31 MARCH 2010**

## 1. EXECUTIVE SUMMARY

1.1 This report summarises for Members the results of the 2010 Actuarial Valuation of the Fund.

## 2. BACKGROUND

2.1 Members will be aware that valuations are carried out every three years. The information from the previous valuation is updated to take into account the movements of the assets of the Fund compared to the present and future liabilities, which are recalculated.

2.2 At the start of the three year period the Actuary, Mercer will have made a number of assumptions to try to forecast the key factors affecting the assets and liabilities over the period. Financially these are the assumed rates of:

- Investment return
- Future increases in pensionable pay
- Future pension increases
- Future increases in index linked stock proceeds.

In addition to the financial assumptions other factors estimated include:

- Average age of retirement
- Rates of ill-health retirement
- Rates of mortality
- Withdrawals from active membership
- Proportions married and age differences between spouses.

2.3 The actual experience over the period is then substituted for the assumptions and the revised value of the assets compared to the aggregate estimated liabilities of every individual member whether active, deferred, or pensioner. A separate calculation is made for each employer so that its share of the assets is compared to the liabilities of its employees.

2.4 Any other factors affecting the finances of the Fund are also taken into account. In the current valuation these include national changes such as the decision to index future cost of living increases to the Consumer Price Index (CPI) rather than the Retail Price Index (RPI).

2.5 The Actuary has also taken into consideration the draft revised Funding Strategy Statement (FSS) which is the subject of a separate report to this meeting of the Pensions Committee and the proposed changes to the Statement of Investment Principles reflecting recommended changes to the Asset Allocation policy following the recent valuation outlined in a further separate report to this Committee.

## 3. THE VALUATION RESULTS – FINANCIAL IMPLICATIONS

3.1 The market value of the Fund has increased from £4.301 billion as at 31 March 2007 to £4.690 billion at 31 March 2010.

3.2 The past service liabilities have been assessed as follows:

| | £million |
|---|---|
| Active members' accrued benefits | £2,725 |
| Deferred pensioners | £ 703 |
| Pensioners (including dependents) | £2,588 |
| Total | £6,016 |

3.3 This gives a deficit of £1,326 million and a funding level of 78% compared to a deficit of £1,063 million and a funding level of 80%, at the previous valuation as at 31 March 2007.

3.4 The deficit is in respect of benefits for service to date of current active members and has to be recovered from employers.

The total average contribution rate will therefore be 18.1% (25 year deficit recovery) or 21.7% (15 year deficit recovery, excluding any allowance for the risk premium loading for certain admission bodies).

3.5 This is compared to 17.8% (25 years) and 20.9% (15 years) at 31 March 2007. The actual rates vary however according to the individual experiences of employers. This is best shown by the following table for the major employers:

| | Actual | Notional | | Recovered from 1 April 2011 as: | | | |
|---|---|---|---|---|---|---|---|
| Employer | Old Rate % of pay | New Rate % of pay | Change % of pay | Future Service Rate % of pay | Plus Deficit Repayments 2011-12 | 2012-13 | 2013-14 |
| Knowsley | 18 | 18.5 | 0.5 | 10.9 | £ 7,541,900 | £ 7,541,900 | £ 7,541,900 |
| Liverpool | 21.5 | 21.8 | 0.3 | 12 | £22,636,600 | £ 22,636,600 | £ 22,636,600 |
| St Helens | 18.2 | 18.2 | 0 | 11.6 | £ 6,326,000 | £ 6,326,000 | £ 6,326,000 |
| Sefton | 17.1 | 19.6 | 2.5 | 11.9 | £ 9,082,300 | £ 9,082,300 | £ 9,082,300 |
| Wirral | 17.6 | 18.3 | 0.7 | 12 | £10,705,000 | £ 10,705,000 | £ 10,705,000 |

3.6 It is intended that the increases resulting from the revised rates will be able to be phased in over three years if the increase in the notional contribution rate is greater than 1%.

3.7 The differences in the above rates will mainly reflect the individual practices and costs to each employer of early and ill-health retirements over past years.

3.8 Details of rates for other employers for the period 1 April 2011 to 31 March 2014 should be available at the meeting.

3.9 All employers will continue to be required to meet costs arising from early retirements over either a period of up to five years or by an immediate lump sum payment. Requests from employers to fund the cost of Augmentation awards made under Regulation 12 in this way will also be considered.

3.10 The Actuary has updated the mortality assumptions. The allowance made takes account of recent improving national trends but modified to reflect local experience. This is an area which will need to be kept under review and it might be necessary to adjust these mortality assumptions again at the next actuarial valuation in 2013.

3.11 The deficit recovery periods used are in line with the policy set out in the proposed revised Funding Strategy Statement; with a 25 year maximum period being used for scheduled bodies and subject to any special agreement, the recovery maximum period for other employers continuing to be set at the present period of up to 15 years. The recovery period for those organisations with a limited lifespan may be less than 15 years.

3.12. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may also be applied in respect of particular employers where the Administering Authority considers this to be warranted.

3.13. The revised FSS reflects the recommendations of the Actuary that in current circumstances, as a general rule, it would not be appropriate for contribution reductions to apply where substantial deficits apply. As a result in addition to the maximum deficit recovery period of 25 years, MPF will operate a default deficit recovery period, set at 20 years for scheduled and resolution bodies and 10 years for non -Transferee admission bodies at the 2010 valuation. All employers in deficit will be required to adopt a deficit recovery period in line with the default period (or shorter) before any reduction in overall contributions would be allowed

3.14 **Method of expressing and payment of employer contributions**

With effect from 1 April 2011 employer contributions will be expressed and certified as two separate elements:

(1) a percentage of pensionable payroll in respect of future accrual of benefits, and

(2) a schedule of fixed amounts over 2011/14, building in an allowance for increases annually in line with the valuation funding assumption for long term pay growth, in respect of the past service deficit or surplus subject to review from April 2014 based on the results of the 2013 actuarial valuation.

## 4. STAFFING IMPLICATIONS

4.1 There are no staffing implications in this report.

## 5. EQUAL OPPORTUNITY IMPLICATIONS

5.1 There are none arising directly from this report.

## 6. HUMAN RIGHTS IMPLICATIONS

6.1 There are none arising directly from this report.

## 7. COMMUNITY SAFETY IMPLICATIONS

7.1 There are no specific implications arising from this report.

## 8. LOCAL MEMBER SUPPORT IMPLICATIONS

8.1 There are no specific implications for any Member or Ward.

## 9. LOCAL AGENDA 21 IMPLICATIONS

9.1 There are no specific implications arising from this report.

## 10. PLANNING IMPLICATIONS

10.1 There are no specific implications arising from this report.

## 11. BACKGROUND PAPERS

11.1 Merseyside Pension Fund 2010 Actuarial Valuation – Mercer.

## 12. RECOMMENDATION

12.1. That the revised contribution rates be agreed.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/218/10

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

# Agenda Item 11

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# Agenda Item 12

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