WEST MIDLANDS

PENSION FUND

LGPS ISSUES

SEPTEMBER 2009

A number of issues have been raised about public sector pension provision. These comments provide a factual position statement in respect of the West Midlands Pension Fund (WMPF) and the LGPS.

LOCAL GOVERNMENT PENSION SCHEME (LGPS)

1. Background

The LGPS is a national scheme for public sector workers not in the other main public sector schemes, such as the teachers and the uniformed police/fire schemes. It is a funded scheme; in other words, the contributions paid by employers and employees are put aside and invested for when resources are needed to meet pension payments.

The LGPS has been reviewed as recently as 2008 by Government in consultation with employers and employee representatives. The objective is to produce a scheme that is affordable, viable and fair to all interested parties. The outcome has been a new defined benefit scheme operating from 1 April 2008, with tiered contribution rates for employees and costsharing arrangements that will share future cost increases between employees and employers. Costsharing arrangements will limit and cap future increases for employers. The scheme retirement age remains at 65 and the arrangements for ill health retirement have changed, introducing strict criteria.

2. Issues raised or being raised

i) Do all public sector pensions funds have large deficits?

The LGPS is different to other public sector pension schemes in that it has a fund set aside to meet its pension liabilities. There are a number of ways the fund can be valued. There is the standard actuarial valuation which is a regulatory requirement and is undertaken every three years. A number of assumptions are made in order to calculate over the very long-term what level of contributions are required to ensure the Fund is sufficient to meet all pension liabilities.

At the 2007 valuation, the actuary calculated that at that point in time the funding level for the WMPF was 82% and that, in order to ensure the Fund grew sufficiently to meet the projected liabilities, employing body contribution rates would need to average 16.5% and employee contributions 6.5% of pensionable pay. The next valuation is due in 2010.

The problem with the actuarial valuation is that it is based upon assumptions that are linked to factors that can be volatile, such as gilt and bond prices. This means that actuarial valuations can vary with market movements.

Another way of looking at the funding level is to analyse cash flows, and for the WMPF there is a positive cash flow for the next 20 plus years; in other words, the current inflow from contributions and investments will meet pension payments well into 2030 already and probably beyond.

Therefore, current funding is robust.

ii) Investment strategies are said to be too risky

The Fund is in a cash 'surplus' for 20 plus years and can, therefore, implement an investment strategy that spans a number of economic cycles and 'ride out' periods when markets are offering poor value and wait for the upturn in the cycle. This enables the Fund to seek the higher returning assets such as equities, compared with the less risky but lower return assets.

The Fund has been advised by experts in this field and follows the advice given.

The investment strategy is accepted by the actuary and is key in holding contribution rates.
The actuary is estimating an investment return of 6.5% compared to inflation of 2.75% over the very long-term.

iii) What has been the investment return for the WMPF?

Prior to the bear market of 2008, the Fund's returns over medium/long-term were:
+ 13.7% (3yr), + 13.8% (5yr), + 6.8% (10yr) per annum.

Obviously, pension funds with a high allocation to quoted equities and some areas of fixed interest were negatively impacted by the unprecedented market conditions of 2008.

The Fund's most recent performance figures are as at the end of July 2009 and are as follows:
-1.1% (3yr), + 6.2% (5yr).

The equity markets have been particularly strong since the end of July and are expected to further improve the Fund's performance over medium to long-term.

Following the market conditions of 2008, the Fund has continued to pursue a strategy of further diversification introducing an allocation to absolute return strategies. The objective being to reduce the Fund's overall volatility and over-dependence on equities, putting it in a more robust position, while maintaining the estimated return targets.

iv) Pension funds have lost money on 'risky' investing?

The Fund recognises that in seeking higher returns there are increased risks associated with these greater returns. Higher returns are also generated by assets which require a long-term commitment, thus an investor receives a 'premium' return for not being able to access their capital for a pre-determined period. Risks are mitigated or managed by limiting exposure to any one investment and diversifying across managers and assets. The risk of a loss is minimised while capturing higher returns.

It is accepted that these investment risks can increase when there is:
i) regulatory failure
ii) fraud
iii) economic down turn

The Fund has suffered, like all investors, from these issues which are beyond its control.

The Fund did not have an exposure to Madoff or Icelandic banks, but did hold bank shares. It held Enron and Poly Peck shares, although it is almost impossible to protect a fund from fraud if it invests in a quoted company, especially when there are numerous 'buy' recommendations from investment analysts. Venture capital is often regarded as a 'risky asset'. However, since the Fund has been investing in this asset class it has added over the long-term 1% per annum to the Fund's overall returns but, like quoted companies, it will underperform in a recession and there may be some loss in value over the short-term.

2008 was a challenging year, as nearly all asset classes lost value, for example certain areas of fixed interest became particularly distressed and in addition the non-correlation between asset classes diminished. The strong cash flow position of the Fund has meant that it was not forced to sell assets and is now benefiting from their rising value.

v) Public schemes are said to be very generous

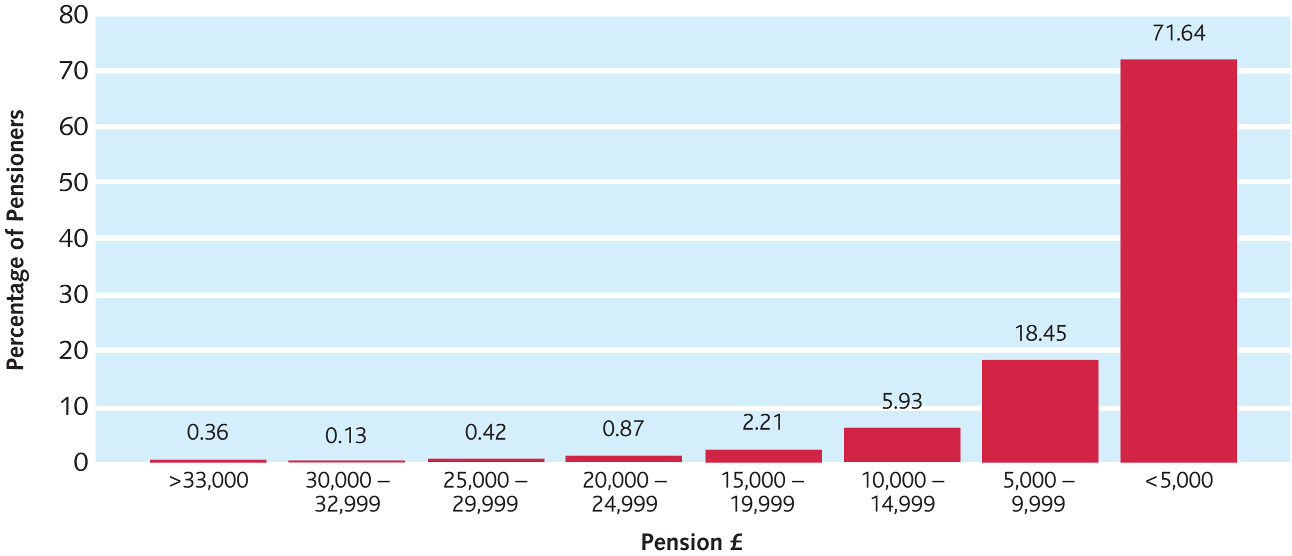
The attached analysis shows how the WMPF scheme is made up of contributors and where pensions are paid. The vast majority of beneficiaries are on small pensions with low levels of income.

PAYMENT OF PENSIONS AND ITS IMPACT ON THE LOCAL ECONOMY

SEPTEMBER 2009

INTRODUCTION

The West Midlands Pension Fund pays annually £250m in pension benefits and the average payment made to 60,056 individuals is £4,305 per annum with the following range:



The majority of payments are into households in the most deprived areas of the West Midlands. Approximately £200m is paid to beneficiaries with a postcode located within the West Midlands urban area covering the seven district councils in and around the Birmingham area.

PAYMENTS AND LOCATION OF BENEFICIARIES

Mapping the post code of those receiving the £200m paid out annually to 50,220 people living in the West Midlands urban area, to the information from 'The English Indices of Deprivation 2007' shows the following:

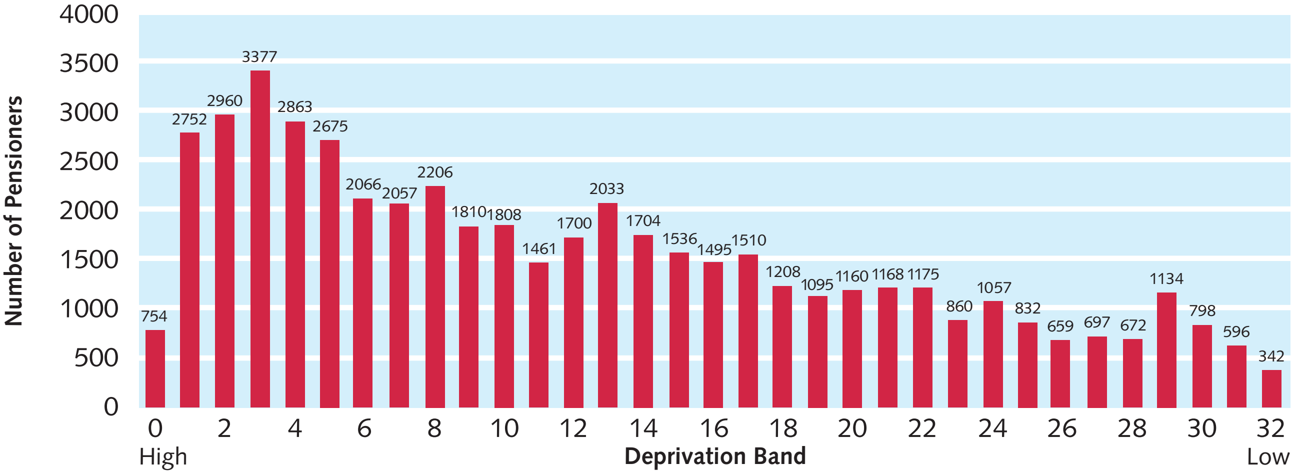
- The majority of beneficiaries live in the 30% most deprived areas.
- £85.8m per annum is paid in benefits to individuals (£3,400 per individual per annum) living in those areas giving a significant financial boost to families who have some of the lowest incomes per household.

The pensioner individuals in the most deprived wards are likely to be on the state minimum pension and having to claim a range of state benefits, finance-related such as pensions credit, housing benefits, as well as support-related such as attendance allowance or disability allowance.

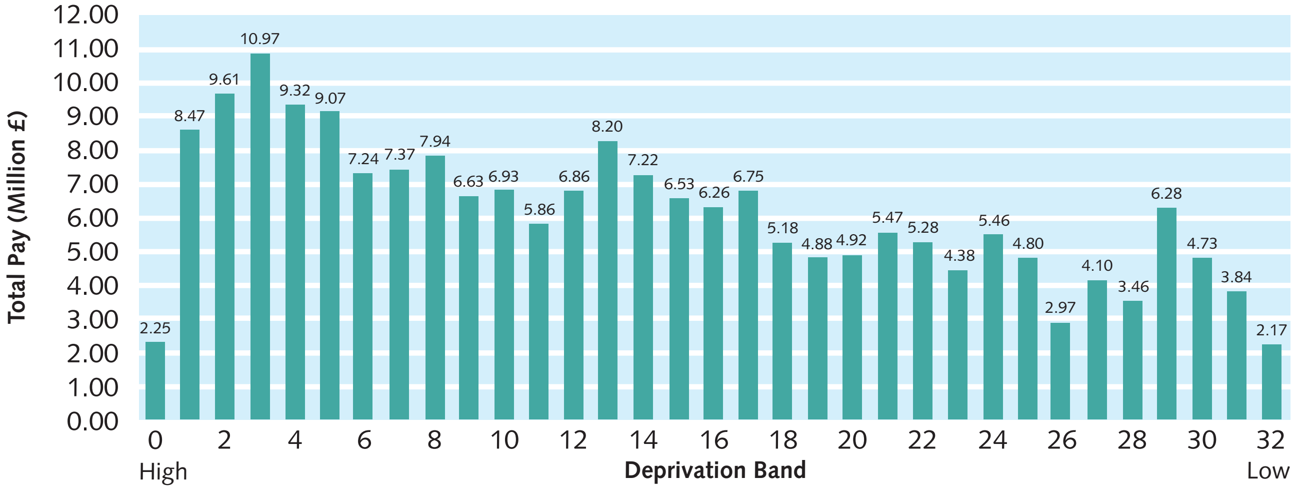
The Local Government Pension Scheme allows many to live fully or partially independently of finance-related benefits.

The charts overleaf show the distribution of payments relative to deprivation as measured by the overall index of multiple deprivation 2007.

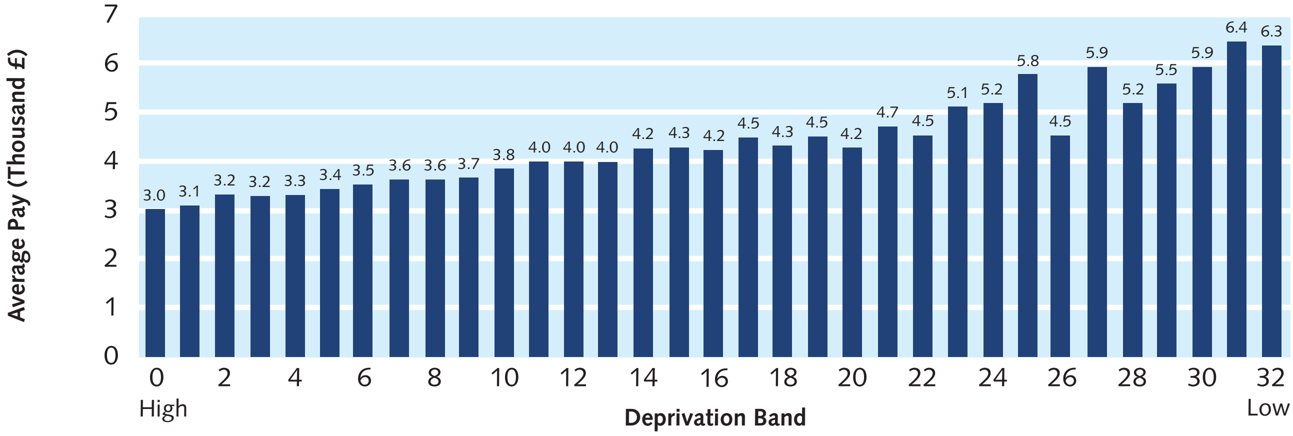
Number of Pensioners Versus Band - West Midlands



Total Pay Versus Band - West Midlands



Annual Pay Versus Band - West Midlands



Total Pay Versus Annual Pay - West Midlands