West Midlands PTA Pension Fund

Funding Strategy Statement 2008

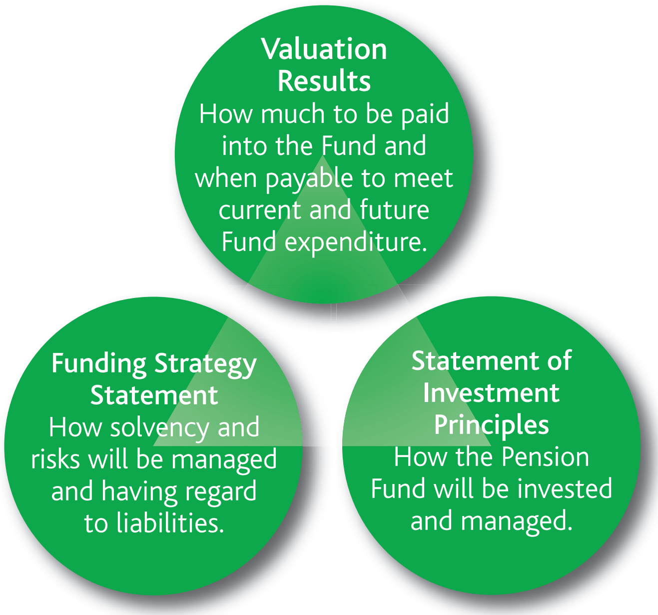
March 2008

1. Introduction

1.1. The LGPS Regulations require funds to produce a Funding Strategy Statement (FSS) having regard to the guidance produced by CIPFA.
This statement has been drawn up by the West Midlands PTA Pension Fund in accordance with the regulations and following consultation.

1.2. The FSS complements and adds to the Statement of Investment Principles (SIP). The SIP is a supporting document.

1.3. The statements relate as follows:



1.4. The Fund's actuary takes account of the FSS in his actuarial work for the Fund, most notably the actuarial valuation process. This has been done in respect of the 2007 valuation.

1.5. The FSS reflects the statutory nature of the Local Government Pension Scheme (LGPS), particularly the defined benefit nature and the benefit payable guarantee. The FSS sets out how benefits will be funded over the long-term through an accountable, transparent process with full disclosure of relevant details and assumptions.

1.6. The Fund, like all similar public and private sector funded schemes, has seen a gap open up between its assets and pension liabilities.

1.7. A number of factors have contributed to the funding gap and rise in contribution rate:

(a) investment returns relative to the movement in liabilities;

(b) liabilities are valued by reference to index-linked gilt yields. These have fallen substantially, thus raising the value of liabilities and increasing the likely fund deficit;

(c) increases in longevity of pensioners.

Against this background, the key considerations in determining the funding strategy, taking advice from the actuary, are:

(a) the appropriate time period for targeting funding recovery taking into account the closed nature of the Scheme, but also the ongoing nature of the sponsoring organisations;

(b) the strength of covenant of the sponsoring organisations, their funding sources, and any guarantee arrangements in place;

(c) changes being made to the benefit and contribution terms of the Scheme (the 'LGPS2008' proposals), including changes to retirement rules affecting some members (for example, retirement at aged 65, and no early retirements before 55).

1.8. Since the fund was established in 1989, there has been a consistent approach with the actuarial valuation process, the link to an investment strategy and balanced management of the risks. The current arrangements continue this approach. The critical element is securing investment market returns from the world markets. The Fund has a long record of achieving solid returns for all of its portfolios. The approach adopted is to ensure a priority is given to achieving at least a market return and as recommended best practice indicates, use asset allocation to deliver the overall investment target.

2. Purpose of the Funding Strategy Statement in Policy Terms

2.1. The purpose of this FSS is:

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

2.2. The Fund currently has a net cash outflow. The FSS supports the process of ensuring adequate funds are put aside on a regular basis to meet future benefit liabilities. The LGPS regulations specify the approach and requirements, the implementation of the funding strategy is the responsibility of the West Midlands PTA acting on expert advice and following consultation.

2.3. The FSS is a comprehensive strategy for the whole Fund. It balances and reconciles the many direct interests that arise from the nature of the Scheme and funding of the benefits now and in the future.

3. Aims and Purposes of the Pension Fund

3.1. The aims of the Fund are to:

- Enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the admitted bodies having regard to the liabilities.
- Manage employers' liabilities effectively through regular review of contributions and additional contributions for early retirements which lead to a strain on funding.
- Ensure that sufficient resources are available to meet all liabilities as they fall due.
- Maximise the returns from investments within reasonable risk parameters.

3.2. The purpose of the Fund is to:

- Receive monies in respect of contributions, transfer values and investment income.
- Pay out monies in respect of Scheme benefits, transfer values, costs, charges and expenses.

The Local Government Pension Scheme Regulations and in particular the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 define these purposes.

4. Responsibilities of the Key Parties

4.1. The LGPS regulations set out the responsibilities of the key parties which are summarised below.

4.2. The administering authority (West Midlands PTA):

- Collects employer and employee contributions.
- Invests surplus monies in accordance with the regulations and agreed strategy.
- Ensures that cash is available to meet liabilities as and when they fall due.
- Manages the valuation process in consultation with the Fund's actuary.
- Prepares and maintains a FSS and a SIP, both after consultation with interested parties..
- Monitors all aspects of the Fund's performance and funding. Amends the FSS and SIP as appropriate.

The administering authority discharges its responsibilities in consultation with the two employers and working through a pension fund committee.

4.3. The individual employers:

- 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 Scheme benefits and early retirement strain.
- Notify the administering authority promptly of all changes to membership, or as may be proposed, which affect future funding.
- Discharge their responsibility for compensatory added years.

4.4. The Fund's actuary:

- Prepares valuations including the setting of employers' contribution rates after agreeing assumptions with the administering authority and having regard to the FSS.
- Sets employer's contribution rates in order to secure the Fund's solvency having regard to the aims of maintaining contribution rates that are as constant as possible.
- Prepares advice and calculations in connection with bulk transfers and individual benefit-related matters.

5. Solvency Issues and Target Funding Levels

5.1. The Fund currently is mature and has a strong cash outflow and funding gap. It therefore takes an appropriate cautious view on determining employing body contribution rates to meet future liabilities through operating a fund with an investment strategy that reflects this view. It aims to allow short-term investment market volatility to be managed so as not to cause volatility in employing body contribution rates.

5.2. The LGPS Regulations require the long-term funding objectives to achieve and maintain assets sufficient to meet 100% of the projected accrued liabilities. The level of assets necessary to meet this 100% funding objective is known as the funding target. The role of the actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements. The approach to the actuarial valuation process and key assumptions used at each three yearly valuation are consulted upon and the 2007 valuation forms part of the consultation undertaken with the FSS.

Determination of the Funding Target and Recovery Period

5.3. The principle method and assumptions to be used in the calculation of the funding target are set out in Appendix A.

5.4. Underlying these assumptions are the following two tenets:

- that the Scheme is expected to continue for the foreseeable future over the run-off of the liabilities for current and former members; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

5.5 As part of each valuation, separate employer contribution rates are assessed by the actuary for each participating employer. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the 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. The general approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole.

5.6 The administering authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates:

- Deficit recovery periods of eight years will apply for WMTL and 17 years for Preston Bus.
- The deficit recovery period for WMTL will be extended to 12 years subject to a suitable financial guarantee being obtained to the satisfaction of the administering authority.
- With effect from 1 April 2008, all early retirements (including those on the grounds of ill-health) from the Fund will give rise to an additional charge to the employer, calculated on a case-by-case basis for each retirement. This change in approach reflects the very high incidence of ill-health retirements occurring.
- Employer contributions payable to the Fund include an element to cover the expected administrative costs involved, incurred by the administering authority. This expenses allowance will, from 1 April 2008, be expressed as annual £s amounts, allocated to each employer by reference to total membership.
- Deficit contributions will continue to be assessed and expressed as annual £s amounts.
- In addition to any deficit 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 are also set out in Appendix A.
- For both employers, the total annual amount of contributions over 2008/11 will not be lower than the annual level of contributions payable under the 2004 valuation certificate.

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 administering authority's views on the strength of the participating employers' covenants in achieving the objective.

6. Links to Investment Policy Set Out in the Statement of Investment Principles (SIP)

6.1. The Fund has, for many years after each actuarial valuation, used an asset study or some other form of stochastic modelling in order to assist the process of formulating a strategic asset allocation. The outcome from the last exercise is reflected in the SIP. The exercise has been repeated as part of the 2007 valuation exercise and has been part of the consultation on its and the FSS. A revised SIP has been produced to reflect the FSS and Investment Strategy Review.

7. The Identification of Risks and Countermeasures

7.1. Evaluating risks that may impact on the funding strategy and expectations of future solvency is crucial to determining the appropriate measures to mitigate those risks. The FSS identifies those key risks specific to the Fund and the measures being taken or assumptions made to counter those risks.

7.2. Some of the key risks taken into account and responses are:

Financial

- Unexpected market-driven events.
- 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 reallocations in volatile markets may lock in past losses.
- Pay and price inflation significantly more or less than anticipated.
- The effect of a possible increase in employer's contribution rate on service delivery and employers in general.

The Fund undertakes a three yearly review of its investment strategy taking into account investment risk and future benefit payments to determine a bespoke investment strategy that for a variety of future economic outcomes gives a high degree of certainty that the investment objectives will be achieved. Short-term investment management decision to reflect anticipated market changes are strictly controlled against the investment strategy or benchmark. Investment management briefs reflect the importance of capturing at least a market rate of return and minimising the risk of significantly underperforming an investment market.

Further information is available in the SIP and on the Fund's website.

Demographic

- The longevity horizon of beneficiaries continues to expand.
- Cost of early retirements.

The Fund has in place policies and procedures to identify for employing bodies the impact of these factors and agrees how they will be managed in terms of annual contribution rates and/or as special additional contributions.

Regulatory

- Changes to regulations, for example, more favourable benefits package, potential new entrants to Scheme.
- Changes to national pension requirements and/or Inland Revenue.

These changes agreed and proposed are evaluated and taken into account in the actuarial valuation and closely monitored between valuations in case any action is required.

Employing bodies are required to make contributions to the Fund as cases are approved for early retirement and other employing body discretions that when exercised alter future liabilities.

Governance

- Administering authority unaware of structural changes in an employer's membership (for example, large fall in employee members, large number of retirements).
- An employer ceasing to exist with insufficient funding or adequacy of a bond.
- Changes in the level of covenant or guarantee arrangements provided by the employers to the Fund.

The Fund has established inter-valuation monitoring and working relations with its two employers to ensure changes are detected, discussed, evaluated and appropriate action agreed. This includes regular reviews of funding levels, and the assessment of the financial standing of employers and any guarantee arrangements in place.

The Fund's approach to the outcome of the 2007 valuation has had regard to balancing the needs of funding the liabilities and the cost to the employers.

- provision of any financial guarantees
- financial standing of the body
- known activities and working activities
- term of the admission agreement
- maturity of workforce

This analysis indicates the risk to the Fund's solvency and ability to meet prior liabilities to be low. It will, however, continue to be monitored.

Appendix A

Actuarial Valuation as at 31 March 2007

Method and Assumptions Used in Calculating the Funding Target

1. Method

The actuarial method to be used in the calculation of the funding target is the 'attained age' 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 makes advance allowance for the anticipated future ageing and decline of the current closed membership group.

2. Financial Assumptions

2.1. Investment Return (Discount Rate)

A yield based on market returns on 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 outperformance assumption (AOA) of 2.0% pa for the period pre-retirement and 1.0% pa post-retirement.

The AOAs 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 outperformance is based on the liability profile of the Scheme, with a higher assumption in respect of the 'pre-retirement' (ie. active and deferred pensioner) liabilities than for the 'post-retirement' (ie. 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.

2.2. Inflation (Retail Prices Index)

The inflation assumption will be taken to 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.

2.3. Salary Increases

The assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% pa over the inflation assumption as described above.
This excludes allowance for any promotional increases.

2.4. Pension Increases

Increases to pensions are assumed to be in line with the inflation (RPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the RPI (for example, guaranteed minimum pensions in respect of service prior to April 1997).

Full details of the assumptions adopted are set out in the actuary's formal valuation report.

3. 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.

4. Summary of Key Whole Fund Assumptions Used for Calculating Funding Target and Cost of Future Accrual (the 'normal cost') for the 2007 Actuarial Valuation

Long-term gilt yields

Fixed interest	4.4% p.a.
Index-linked	1.3% p.a.
Implied RPI price inflation	3.1% p.a.

Financial assumptions

Investment return pre-retirement	6.4% p.a.
Investment return post-retirement	5.4% p.a.
Salary increases	4.6% p.a.
Pension increases	3.1% p.a.

Principal demographic assumptions

Non-retired members' mortality	PA92 MC YoB tables + 1 year
Retired members' mortality	PA92 MC YoB tables + 1 year (+6 years for retirements in ill-health)
Commutation	One half of members take maximum lump-sum, others take 3/80ths
Ill-health and other early retirements	No allowance made on the basis that additional charges will apply

5. Assumptions Used in Calculating Contributions Payable Under the Recovery Plan

The contributions payable under the recovery plan are calculated using a discount rate based on the liability weighted average of the pre- and post-investment return assumptions.

Your notes

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