

Dear Colleagues,

Earlier this week local council pensions were covered by the *Daily Mail* and *Channel 4 News*. The particular focus of both features was on investment policy and fund deficits as stock markets have fallen. Both reports noted the extent of our commitment to the long term equity market - which is relatively high and contrasted it with private sector schemes. We believe the opinions expressed in the reports are misguided and displayed a superficial knowledge of the Local Government Pension Scheme.

Towards the end of 2007 the value of the Worcestershire Pension Fund reached its high point of £1,300 million. We have seen the value of stock market holdings fall substantially during the credit crunch. Our current holdings are summarised in the following table.

### **Worcestershire County Council Pension Fund**

#### **Holdings Analysis**

**6th March 2009**

<b><u>Investment category</u></b>	<b><u>Value of assets managed</u></b>	<b><u>% of total holdings</u></b>
	<b>£m</b>	
UK Active Equities	184,145.4	22.1
Americas Active Equities	72,658.8	8.7
Far East Active Equities	140,276.8	16.9
Europe (ex-UK) Active Equities	16,876.6	2.0
Passive North America Equities	44,888.3	5.4
Passive Europe (ex-UK) Equities	114,736.4	13.8
Passive UK Equities	139,990.1	16.8
Active Bonds	119,282.6	14.3
	<b>832,855.0</b>	<b>100.0</b>

From the table it can be seen that just over 14% of our portfolio of assets is held in the form of bonds - mostly government securities. This week's media coverage suggested that this proportion was too low and our various holdings in global stocks and shares was too high. We disagree. Our view is supported by our independent financial adviser and independent actuary. The external auditors appointed by the Audit Commission have always issued unqualified audit opinions on the Pension Fund Accounts.

Our equity portfolio is diverse across both active and passive (market tracking) activity. Our equity portfolio is also spread globally and across a variety of industries so that we are not dependent upon a single stock market. Our individual share holdings cover many companies. Our current highest holding of around £15 million is with BP. Eggs are placed in very many baskets to spread risk.

We have no money in Icelandic banks. As a matter of principle we do not place money in hedge funds. We do not trade in currencies or commodities. We invest in companies. We do not speculate.

The Council undertook a restructuring of its Pension Fund in the first quarter of 2003 and from then until 31 December 2008 the rate of return on its equity portfolio has exceeded that on its bond portfolio by 4.2% per year

Over the long term, equities provide higher returns than other assets. According to the UBS Global Asset Management report Pension Fund Indicators 2008, between 1963 and 2007, the average annual return (based on real values) in the following asset areas was:-

- UK equities – 6.6%
- Gilts – 2.6%
- Cash – 2.3%

Therefore, a high exposure to equities, over time, can be expected to reduce the cost of providing a given level of pension. In addition, a recent analysis of the stock market carried out by Fidelity International of the Barclays Equity-Gilt Study found that every rolling decade of negative equity returns has been followed by a decade of positive average annual returns.

Past performance is no guarantee to future returns. However, we can and should learn from history.

We have to look to the very long term. Our youngest contributor to the pension fund is aged 17. Our oldest pensioner is 102. We have over 20,000 staff contributing around 6% of their pay to the scheme. Over 50 employers make very significant contributions to the Fund that are minimised by investment returns. We have over 12,000 pensioners being paid benefits. Contributions from staff and employers plus interest and dividends receivable out weighed benefit entitlements paid in 2007-08 by around £40 million. An operating surplus will exist for many years to come.

Benefit entitlement is protected by law and is independent of individual pension fund surplus or deficits. The average value of benefit entitlement currently being paid is £74 per week or £3,848 per year.

The value of the pension fund promise has to be seen as part of the overall staff remuneration package. Quantifying the value of this promise for decades ahead is extremely difficult and heavily dependent upon actuarial assumptions. Valuing the long term liability is more art than science. Quite small changes in assumptions can have a dramatic effect on the long term notional actuarial surplus or deficit declared by the actuary - who it should be remembered has statutory independence. It is vital that reasonable and sensible assumptions are made that recognise a margin of error which can be either positive or negative.

Finally it should be remembered that the local government pension scheme is backed in part by real assets - always recognising that their value can and does fluctuate. The pension schemes for teachers, police officers, fire fighters, health service staff, the judiciary and civil servants have no assets that can yield a return to offset the cost of their schemes to the taxpayer.

Yours sincerely

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