

London Borough of Newham Pension Fund

Actuarial Valuation as at 31 March 2010
Valuation Report

Barnett Waddingham
Public Sector Consulting

30 March 2011

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Dear Sirs

Actuarial Valuation as at 31 March 2010

We have carried out an actuarial valuation of the London Borough of Newham Pension Fund ("the Fund") as at 31 March 2010. The Fund is part of the Local Government Pension Scheme ("LGPS").

The valuation is being carried out in accordance with Regulation 36 of The Local Government Pension Scheme (Administration) Regulations 2008 ("the Regulations") as amended.

The purpose of this report is to set out the results of the actuarial valuation of the Fund.

This report is addressed to London Borough of Newham as administering authority to the Fund. It is not intended to assist any user other than London Borough of Newham in making decisions. Neither we nor Barnett Waddingham LLP accepts any liability to third parties in respect of this report.

This report has been written in accordance with "Technical Accounting Standard R: Reporting Actuarial Information" and "Technical Actuarial Standard D: Data" issued by the Board for Actuarial Standards and actuarial guidance note "GN9: Funding Defined Benefits – presentation of actuarial advice", insofar as they apply to the LGPS.

Our report is set out in the following sections.

1	Introduction	2
2	Valuation Data	3
3	Actuarial Methods and Assumptions	4
4	Financial Assumptions and Experience	6
5	Demographic Experience and Assumptions	10
6	Valuation Results.....	12
7	Comments and Conclusions	15
	Appendix 1. Valuation Method.....	16
	Appendix 2. Valuation Data	17
	Appendix 3. Actuarial Assumptions	19
	Appendix 4. Individual Employer Data as at 31 March 2010.....	26
	Appendix 5. Rates and Adjustments Certificate	27
	Appendix 6. LGPS Benefits	29

1 Introduction

1.1 Purpose of the Valuation

- 1.1.1 The main purpose of the valuation is to review the financial position of the Fund and to determine the rate at which the employing bodies participating in the Fund should contribute in the future to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the Fund.
- 1.1.2 The figures in this report count as part of a “planning exercise” for the purposes of the Board for Actuarial Standards’ Technical Actuarial Standard R. This means the primary purpose of the figures is for “budgeting” or “target setting” – in this case setting the future levels of employer contributions payable to the Fund.

1.2 Previous Valuation

- 1.2.1 The last formal actuarial valuation of the Fund was carried out as at 31 March 2007 by C R Hull FIA of Mercer and the results of that valuation were set out in the formal valuation report dated March 2008.
- 1.2.2 The results of the previous valuation indicated that the assets of the Fund represented 72% of the accrued liabilities of the Fund. The Total Required Contribution Rate was certified as 22.7% of payroll which assumed that the past service funding level would be restored over a period of 17 years.

1.3 Changes to the LGPS

- 1.3.1 The 2010 Emergency Budget announced that in future, the pension increase orders will be linked to the Consumer Price Index or CPI rather than RPI.
- 1.3.2 Also, it was announced that State Pension Age will be increased to age 66 for both men and women from 2020 which is likely to influence future retirement patterns.
- 1.3.3 A report has recently been issued by an independent pensions commission led by Lord Hutton to investigate pension reform across the public sector. His report contains a number of recommendations which are likely to lead to some changes to the LGPS in future although at this stage it is difficult to assess the detail of what they might be. The Chancellor has also indicated that the level of member contribution should be expected to increase at some point in future. We anticipate that these changes will be closer to being finalised by the date of the next valuation.
- 1.3.4 Full current details of the current benefits and contribution structure are set out in Appendix 6.

2 Valuation Data

2.1 Data Sources

2.1.1 We have used the following items of data as provided by the London Borough of Newham:

- Membership extract as at 31 March 2010. The membership data has been checked for reasonableness and any missing or inconsistent data has been estimated where necessary. Whilst this should not be seen as a full audit of the data, we are happy that the data is sufficiently accurate for the purposes of the valuation.
- Fund accounts for the 3 years to 31 March 2010.

2.1.2 A summary of the data is set out in Appendix 2 - Valuation Data.

2.2 Assets

2.2.1 The asset allocation of the Fund as at 31 March 2010 was as follows:

Assets at This Valuation	31 March 2010	
	£(000)	%
UK Equities	155,510	23%
Overseas Equities	291,555	44%
Corporate Bonds	-	-
Cash	6,388	1%
UK Gilts	25,041	4%
Overseas Bonds	55,294	8%
Property	68,648	10%
Alternative assets	59,481	9%
Total	661,916	100%

2.2.2 We estimate that the annual return on the assets in market value terms for the 3 years to 31 March 2010 was approximately -0.8% per annum.

2.3 Benefits

2.3.1 Since the previous valuation changes to the benefits have been introduced with effect from 1 April 2008.

2.3.2 The benefits being valued including these changes are as set out in the Regulations governing the Local Government Pension Scheme ("the LGPS") and are summarised in Appendix 6 - LGPS Benefits.

3 Actuarial Methods and Assumptions

3.1 Valuation Method

3.1.1 For the purposes of this valuation we have, as in the past, adopted an approach which separately considers the benefits in respect of service completed before the valuation date (“past service”) and benefits in respect of service expected to be completed after the valuation date (“future service”). This approach enables us to focus on:-

3.1.2 The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service after making allowance for future increases to members’ pay and pensions in payment. A funding level in excess of 100% indicates a surplus of assets over liabilities; a funding level of less than 100% indicates a deficit.

3.1.3 The future service funding rate i.e. the level of contributions required from the employing bodies to support the cost of benefits building up in future.

3.1.4 There are various “funding methods” that can be used to determine the cost of providing benefits. The method we have adopted for employers open to new staff at this valuation is known as the “Projected Unit Method”. The key feature of this method is that in assessing the future service cost we calculate the contribution rate which meets the cost of one year of benefit accrual.

3.1.5 For employers that are closed to new staff we have used the Attained Age Method. The key feature of this method is that we assess the average contribution required to fund the benefits earned until retirement.

3.1.6 This is the same approach as adopted at the previous valuation.

3.2 Valuation Assumptions

3.2.1 The next step is to formulate assumptions about the factors affecting the Fund's future finances such as inflation, pay increases, investment returns, rates of mortality, early retirement and staff turnover etc.

3.2.2 Future levels of pay increases will determine the level of benefits to be paid in future in respect of active members as well as the contributions that will be received by the Fund. Once in payment, pension benefits in excess of Guaranteed Minimum Pensions (“GMPs”) are linked to the Retail Prices Index through increases granted in line with the Pensions (Increase) Act 1971. Pension benefits in future will be linked to the CPI rather than RPI.

3.2.3 The cost of providing for benefits, however, depends not only upon the amount but also the incidence of benefits paid i.e. at what point in the future benefits begin to be paid and, for pension benefits, for how long they continue to be paid.

3.2.4 As money is being set aside now to provide for benefits payable in the future i.e. the benefits are being prefunded, then part of the cost of providing the benefits can be met from investment returns achieved by the Fund's assets. These assets build up from contributions paid by scheme members and participating employers to the Fund.

3.2.5 The assumptions adopted at the valuation can therefore be considered as:-

- The statistical assumptions which generally provide estimates of the likelihood of benefits and contributions being paid, and,
- The financial assumptions which determine the estimates of the amount of benefits and contributions payable as well as their current or present value.

3.2.6 We examine the assumptions in more detail in the next two sections of our report.

3.3 Funding Model

3.3.1 At this valuation we have used a market related funding model. The key features of the model are as follows:

3.3.2 Assumed future levels of retail price inflation are derived by considering the difference between index-linked gilt and fixed-interest gilt yields at the valuation date, as published by the Bank of England. At this valuation we have also included an adjustment known as an inflation premium. This inflation premium is deducted from the market implied inflation assumption to reflect the expectation that market implied inflation tends to overstate actual retail price inflation.

3.3.3 Pay increases are assumed to exceed future retail price inflation based on past experience and expectations of future experience.

3.3.4 Pension increases are assumed to be in line with CPI rather than RPI. It is assumed that CPI will be 0.5% per annum less than RPI, consistent with the historical average.

3.3.5 The expected future return from equities is based on dividend yields at the valuation date in addition to an allowance for real capital growth in asset values.

3.3.6 Rather than take "spot" yields and market values of assets at the valuation date we have used smoothed yields and asset values spanning the 6 month period around the valuation date.

3.3.7 The discount rate used to discount future payments to and from the Fund and so determine the value placed on the liabilities reflects the risk adjusted expected return that will be earned by the actual investment strategy adopted by the Fund.

3.3.8 Under TAS R a "funding model" is referred to as a "measure".

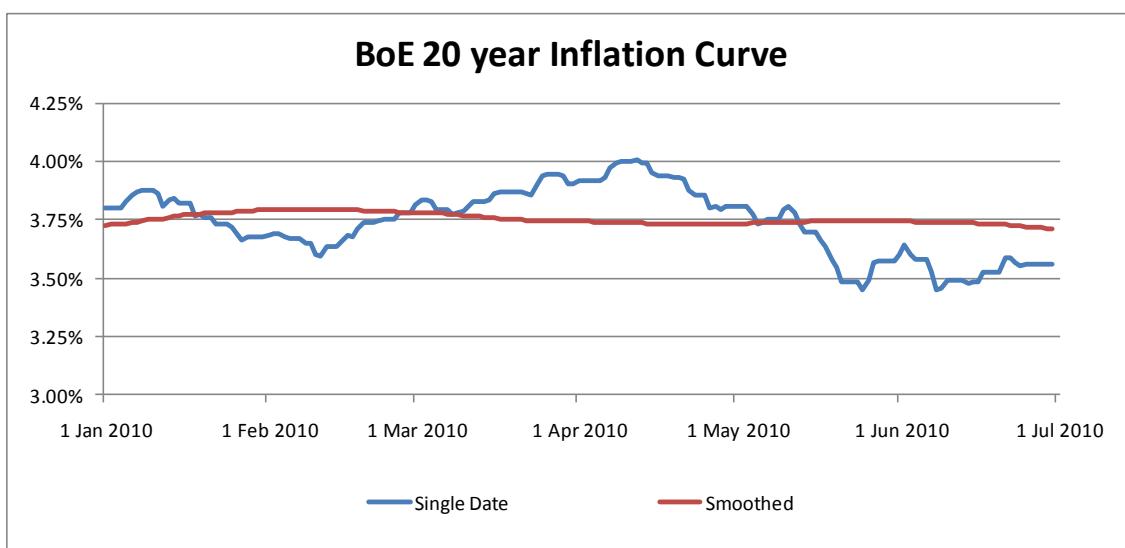
4 Financial Assumptions and Experience

4.1.1 The derivation of the key financial assumptions adopted at this valuation and how they compared as at the previous valuation are set out below. Further details are set out in Appendix 3.

4.2 Future Retail Price Inflation

4.2.1 The base assumption is the future level of retail price inflation. This is derived by considering the difference in yields from conventional and index linked gilts using the Bank of England Inflation Curve and then adjusting by an inflation premium.

4.2.2 The following chart plots the Inflation Curve over the 6 month period spanning the valuation date.



4.2.3 As at the valuation date the spot inflation projection was 3.90% and the average or smoothed level over the 6 months spanning the valuation date was 3.75%. We have used the smoothed level but then reduced by a 0.25% inflation premium adjustment to end up with an RPI assumption of 3.5% per annum.

4.3 Future Pension Increases

4.3.1 Previously, pension increases were assumed to be in line with retail price increases. The 2010 Emergency Budget announced that in future, the pension increase orders will be linked to the CPI rather than RPI. We have therefore assumed that pension increases will be 0.5% less than the price inflation assumption. i.e. 3.0% per annum.

4.4 Future Pay Inflation

4.4.1 As benefits are currently linked to pay levels at retirement, an assumption has to be made about future levels of pay inflation. Historically there has been a close link between price and pay inflation

with pay increases in excess of price inflation averaging out at between 1% and 3% per annum depending on economic conditions.

- 4.4.2 The assumption adopted at the previous valuation was that pay increases, including increases due to promotion and other increments (or “salary scales”), would exceed price inflation by 1.75% per annum in the longer term.
- 4.4.3 At this valuation we have adopted a lower salary increase assumption, at 1.5% per annum above price inflation.
- 4.4.4 In addition, in anticipation of Government policy we have completed calculations assuming a short term “pay freeze” for 2 years for those earning over £21,000 per annum.
- 4.4.5 At this valuation we have adopted salary scales that are used over and above the real salary increase assumption. These scales can be seen in Appendix 3 - Actuarial Assumptions.

4.5 Future Investment Returns/Discount Rate

- 4.5.1 To determine the value of accrued liabilities and future contribution requirements at any given point in time it is necessary to discount future payments to and from the Fund. There are a number of different approaches which can be adopted in deriving the discount rate to be used. FRS 17 for example requires that the discount rate is related only to yields from corporate bonds.
- 4.5.2 In our view the discount rate adopted should depend on the purpose of the valuation and the overall funding objectives. The regulations require the actuary to adopt methods and assumptions which produce stable levels of employer contributions. In our view therefore, to help achieve this objective, the discount rate should reflect the expected investment return to be achieved from the underlying investment strategy.
- 4.5.3 In determining the assumption to be made in relation to future investment returns it is necessary to consider the investment strategy of the Fund and the resulting expected future return earned by the assets held.
- 4.5.4 The investment strategy of the Fund is to invest the assets in a mix of equities, bonds and alternative assets.
- 4.5.5 Redemption yields from gilts give an indication of the future rates of return from these asset classes. Redemption yields from corporate bonds are also readily available. There is however no comparable market indicator to derive the market expected future return from investing in equities, property or other alternative assets.
- 4.5.6 It is however possible to model future returns from equities by considering current dividend yields and making an assumptions regarding future growth in capital values.
- 4.5.7 The following table sets out the derivation of the expected return from equities at the valuation date.

Smoothed Equity Returns	March 2010
	% p.a.

Net equity yield	3.3%
Inflation	3.5%
plus assumed real capital return	0.6%
Equity Return	7.4%

4.5.8 It would also be possible to derive the expected future return from other asset classes such as property and alternative asset classes. Intuitively we might expect that returns from asset classes other than equities and gilts might be expected to return somewhere between gilts and equities.

4.5.9 Accordingly we have assumed that the return from other alternative asset classes is the same as the expected return from equities.

4.5.10 We then derive the discount rate as firstly, the weighted average of future expected returns from the various asset classes based on the actual asset allocation as at the valuation date.

4.5.11 We then include a risk adjustment to the discount rate to reflect the amount of equity risk being taken relative to gilts. For a Fund with 75% or less exposure to equity type investments the risk adjustment is nil. For a Fund with more than 75% in equity type investments the reduction in discount rate is 50% of the extra return expected from the actual strategy compared to one invested 75% in equity type investments.

4.5.12 Finally to accommodate any extreme market conditions at the valuation date the resulting real discount rate is constrained to 4% per annum.

4.5.13 In summary therefore we have adopted the following assumptions.

Financial Assumptions	March 2010		March 2007	
	% p.a.	Real % p.a.	% p.a.	Real % p.a.
Investment Return				
Equities/absolute return funds	7.4%	3.9%		
Gilts	4.5%	1.0%		
Bonds & Property	5.6%	2.1%		
Risk Adjusted Discount Rate	6.7%	3.2%	6.0%	2.9%
Pay Increases	4.7%	1.5%	4.9%	1.8%
Price Inflation	3.5%	-	3.1%	
Pension Increases	3.0%	(0.5%)	3.1%	

4.5.14 Note that the pay increase assumption is zero for 2 years for those earning over £21,000.

4.6 Intervaluation Experience - Financial

4.6.1 The following table sets out the financial experience of the Fund during the intervaluation period compared to the assumptions adopted at the previous valuation.

Financial Experience	Actual	Assumed	Difference
	% p.a.	% p.a.	% p.a.
Investment Return	-0.8%	6.0%	(6.8%)
Estimated Pay Increases	4.9%	4.9%	0.0%
Price Inflation/Pension Increases	2.9%	3.1%	(0.2%)

4.6.2 The principal conclusions are:

- Investment returns were less than assumed.
- Pay increases were as expected.
- Pension increases were slightly less than expected.

4.6.3 Overall the financial experience of the Fund during the intervaluation period compared to the assumptions adopted at the previous valuation was a negative factor.

5 Demographic Experience and Assumptions

5.1 Statistical Experience – Active Members

5.1.1 The following table sets out the actual number of membership movements amongst active members during the intervaluation period compared to the assumptions adopted at the previous valuation.

Active Membership Movements	Actual	Assumed	Difference %
Early Leavers	2,031	2,266.9	(10%)
Deaths in Service	33	31	6%
Retirements			
Ill health	40	64.9	(38%)
Age	584		
Voluntary	12		
Redundancy	187		
Efficiency	1		
Total	824		

5.1.2 There were less early leavers than expected and fewer ill-health retirements than expected.

5.1.3 Overall the demographic experience of the Fund during the intervaluation period compared to the assumptions adopted at the previous valuation was a negative factor during the intervaluation period.

5.1.4 We have adjusted our pre retirement assumptions to better reflect recent actual experience.

5.2 Pensioner Mortality

5.2.1 Mortality investigations over the last few years have concluded that the population across the UK is living longer and that this improvement will continue at a faster rate than seen in the past. Our analysis of LGPS pensioner longevity over the course of the last 20 years or so confirms that pensioners are living longer although experience does vary across the country and from Fund to Fund.

5.2.2 The following table sets out the actual and expected mortality of pensioners during the intervaluation period.

Pensioner Deaths	Pensioners	Dependants	Total
By Number			
Actual	399	190	589
Assumed	311	130	441
% Difference	28%	46%	34%
By Amount of Pension	£(000)	£(000)	£(000)
Actual	1,811	420	2,231
Assumed	1,517	320	1,837
% Difference	19%	31%	21%

- 5.2.3 The number of pensioners dying during the intervaluation period was higher than expected. In terms of the amount of pension ceasing then this was also more than expected.
- 5.2.4 Overall the mortality experience over the intervaluation period had a positive impact on the financial position of the Fund in that the amount of pension ceasing was more than expected.
- 5.2.5 We have reviewed the mortality assumptions adopted at this valuation which bring the assumptions closer to recent experience but also allow for improvements in mortality over the next 20 years.

5.3 Retirement Ages – Active Members

- 5.3.1 At the previous valuation it was assumed that active members will retire as soon as they are able to on unreduced benefits without requiring employer consent – typically satisfying the Rule of 85 but no earlier than age 60 nor later than age 65.
- 5.3.2 Experience suggests that whilst the Rule of 85 is an influencing factor on when active members choose to retire, State Pension Age is also a major factor, as for many active members, they need the additional income payable from the State before they can afford to retire.
- 5.3.3 There are existing plans in place to increase State Pension Age albeit very slowly. The new Government have however indicated that State Pension Age will be 66 from 2020.
- 5.3.4 It is difficult to assess what the impact will be but we have completed calculations assuming that active members will retire 1 year later than the date they would be entitled to retire and receive unreduced benefits.

6 Valuation Results

6.1 Past Service Funding Position and Contribution Rates

6.1.1 The following table sets out the valuation results for the Fund. We show

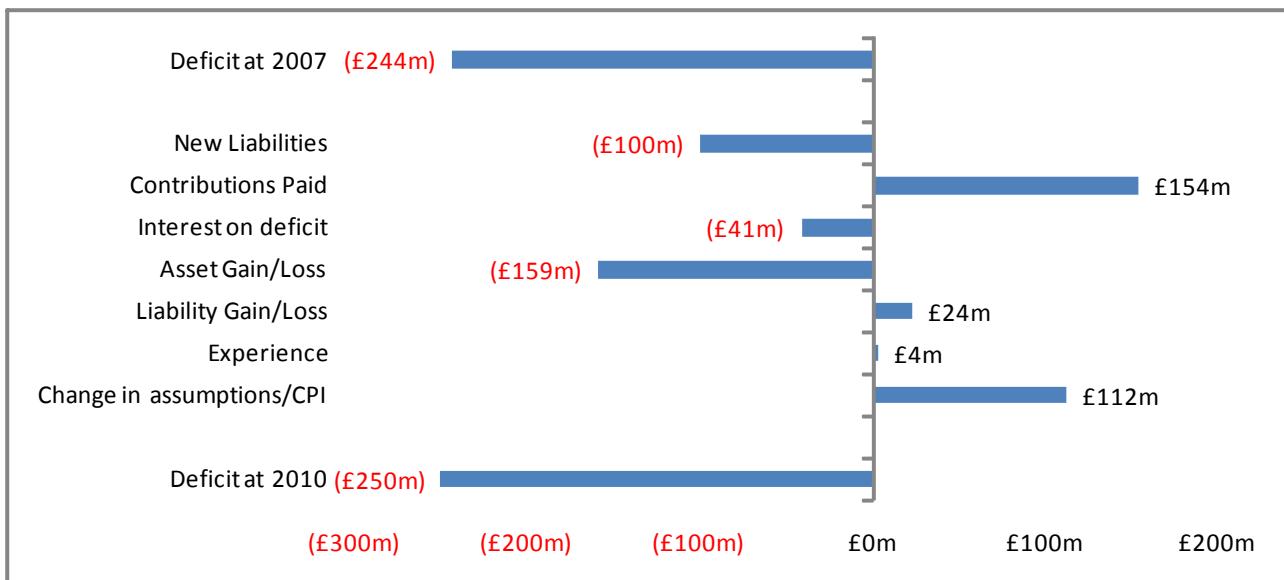
- The past service funding position
- The required average ongoing employer contribution rate for future service benefits
- The required total employer contribution rate to restore the funding position to 100% over the agreed 20 year period following the valuation date.

Past Service Funding Position		£(000)
Smoothed Asset Value		636,745
Past Service Liabilities		
Active Members		385,344
Deferred Pensioners		142,269
Pensioners		359,204
Value of Scheme Liabilities		886,817
Surplus (Deficit)		(250,072)
Funding Level		72%
Employer Contribution Rates		% pay
Future Service Contribution Rate		13.7%
Deficit recovery (20 years)		9.0%
Total Contribution Rate		22.7%

6.1.2 As we see, the funding level was 72% and the average required employer contribution to restore the funding position to 100% over the next 20 years is 22.7% of pensionable pay.

6.2 Reconciliation of Past Service Position

6.2.1 A reconciliation of the intervaluation experience on the past service position in the 3 years to the valuation date is set out in the following chart.



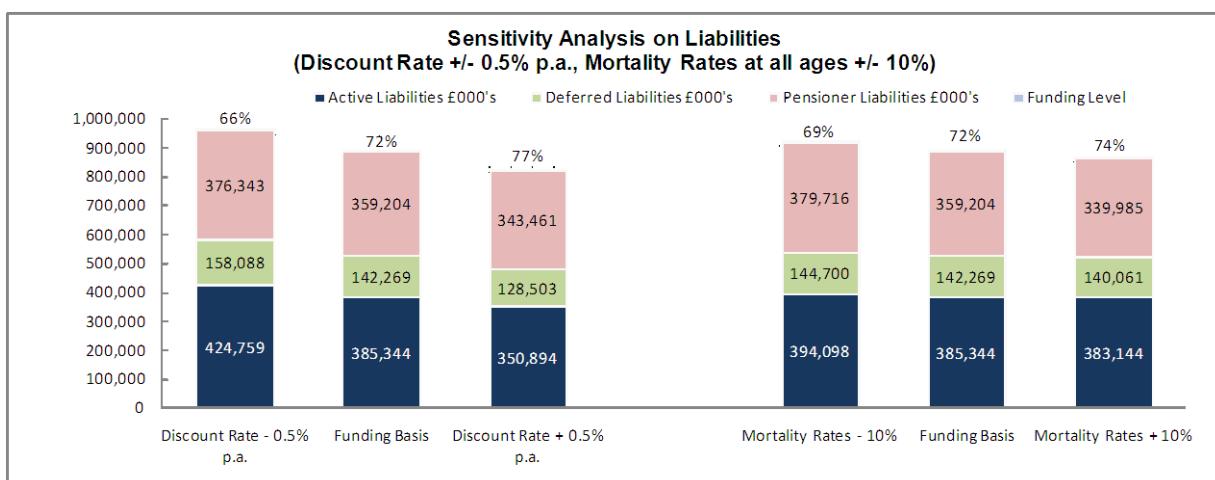
6.2.2 As we can see, overall the deficit was largely unchanged during the intervaluation period.

6.3 Sensitivity Analysis

6.3.1 It is important that it is understood that the valuation results for the Fund are based on the assumptions used to determine the liabilities. Changes to the adopted assumptions will affect the funding position of the Fund.

6.3.2 In order to illustrate this, a number of calculations have been carried out to highlight the sensitivity of the funding position to the assumptions adopted, focusing on the assumptions to which the funding position is most sensitive.

6.3.3 To highlight the sensitivity of the funding position to changes in the discount rate, we have considered the impact of changing this assumption by 0.5% p.a. in either direction. We have also considered the impact of mortality rates at all ages being either 10% higher or lower than assumed. The results of this analysis is shown in the chart below:



7 Comments and Conclusions

7.1 Financial Position

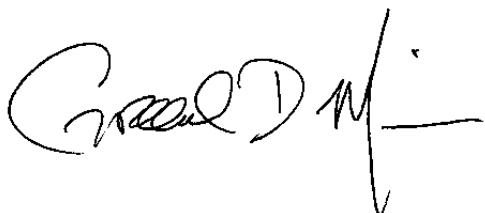
- 7.1.1 The funding level is unchanged since the 2007 valuation.
- 7.1.2 Whilst investment returns were less than assumed this was offset by the CPI changes and other assumption changes.

7.2 Employer Contribution Rates

- 7.2.1 The contribution rates that we have certified have been set to fund each employer's share of the deficiency in the Fund over the next 20 years or the employers' future service working lifetime as detailed in the Funding Strategy Statement.
- 7.2.2 The certified contribution rates for each employer are set out in our certificate in Appendix 5.

7.3 New Employers joining the Fund

- 7.3.1 We would recommend that any new employers or admitted bodies joining the Fund with no previous interest in the Fund should be referred to us for individual calculation as to the required level of contribution.
- 7.3.2 Any employer who ceases to participate in the Fund should be referred to us in accordance with Regulation 38.
- 7.3.3 We would be pleased to answer any questions arising from this report.



Graeme D Muir FFA



Alison Hamilton FFA

Appendix 1. Valuation Method

Valuation of Liabilities

Using our assumptions we estimate the payments which will be made from the Fund throughout the future lifetime of existing active members, deferred benefit members, pensioners and their dependants. We then calculate the amount of money which, if invested now would be sufficient together with the income and growth in the accumulating assets to make these payments in future, using our assumption about investment returns.

This amount is called “the present value” (or, more simply, “the value”) of members benefits. Separate calculations are made in respect of benefits arising in relation to service before the valuation date (“past service”) and for service after the valuation date (“future service”).

Past Service Funding Level

A comparison is made of the value of the existing assets with the value of benefits in relation to past service (allowing for future pay and pension increases). If there is an excess of assets over past service liabilities then there is a past service surplus. If the converse applies there is a past service deficiency.

Future Service Funding Rate

The first stage is to calculate the value of benefits accruing to existing active members in the future, by reference to projected pay as at the date of retirement or earlier exit.

For employers that are still open to new staff we have used the Projected Unit Method which considers the benefits accruing in the year following the valuation date. The value of benefits accruing in the year following the valuation date is then expressed as a percentage of payroll over the same period having first deducted the equivalent contribution paid by the active members.

The method described above results in a stable, long term contribution rate over time, if the assumptions adopted are borne out in practice and there is a steady flow of new entrants to the Fund. If the admission of new entrants is such that the average age of the membership profile increases then the contribution rate calculated at future valuations would be expected to increase.

For employers that are closed to new staff we have used the Attained Age Method. The key feature of this method is that we assess the average contribution required to fund the benefits earned until retirement.

Valuation of Assets

Assets have been valued at a 6 month smoothed market value straddling the valuation date.

Appendix 2. Valuation Data

A summary of the membership records submitted for the valuation is as follows.

Active Members		Actual Pensionable Pay				Average	
	Number	£ (000)				£	2007
Full Time	2010	2007	2010	2007	2010	2007	
Males	1,886	-	63,466	-	33,651	-	
Females	1,971	-	61,421	-	31,163	-	
Part Time							
Males	354	-	4,843	-	13,682	-	
Females	2,675	-	34,466	-	12,884	-	
Total	6,886	6,584	164,197	151,611	23,845	23,027	
Pensioners		Annual Pensions				Average	
	Number	£ (000)				£	2007
	2010	2007	2010	2007	2010	2007	
Males	2,170	4,501	15,043	20,015	6,932	4,447	
Females	2,757	-	10,190	-	3,696	-	
Dependants	1,187	1,042	2,684	2,300	2,261	2,201	
Total	6,114	5,543	27,918	22,315	4,566	4,026	
Deferred Pensioners (incl "undecideds")		Annual Pensions				Average	
	Number	£ (000)				£	2007
	2010	2007	2010	2007	2010	2007	
Males	2,634	-	5,793	-	2,199	-	
Females	4,772	-	6,485	-	1,359	-	
Total	7,406	6,175	12,278	9,456	1,658	1,531	

Notes

- The numbers relate to the number of records and so will include members in receipt of or potentially in receipt of more than one benefit.
- Annual pensions are funded items only and include pension increases up to and including the 2010 PI Order.
- Pensionable pay is actual earnings.

A summary of the assets held by the Fund at the valuation date is as shown below.

Assets at This Valuation	31 March 2010	
	£(000)	%
UK Equities	155,510	23%
Overseas Equities	291,555	44%
Corporate Bonds	-	-
Cash	6,388	1%
UK Gilts	25,041	4%
Overseas Bonds	55,294	8%
Property	68,648	10%
Alternative assets	59,481	9%
Total	661,916	100%

Revenue Accounts	Year to	March 2010	March 2009	March 2008	TOTAL £ (000)
		£ (000)	£ (000)	£ (000)	
EXPENDITURE	Retirement Pensions	27,264	24,630	22,873	74,767
	Retirement Lump Sum	10,567	8,485	6,196	25,248
	Death Benefits	1,178	488	436	2,102
	Leavers benefits	8,392	4,465	4,085	16,942
	Expenses	793	899	1,140	2,832
	Other Expenditure	197	285	476	958
		48,391	39,252	35,206	122,849
TOTAL					
INCOME	Employees Ctns	11,299	11,035	9,908	32,242
	Employers Ctns	42,150	39,995	39,975	122,120
	Transfer Values	10,209	6,182	6,215	22,606
	Investment Income	3,606	4,834	5,954	14,394
	Other Income	-	-	-	-
TOTAL		67,263	62,046	62,052	191,361
Fund Value					
		£ (000)	£ (000)	£ (000)	£ (000)
Assets at Start of Year		501,678	622,133	618,580	618,580
Cashflow		18,872	22,794	26,846	68,512
Change in value		141,366	(143,249)	(23,293)	(25,176)
Assets at End of Year		661,916	501,678	622,133	661,916
Annual Returns					
Approx Rate of Return		28.5%	-21.9%	-2.8%	-0.8%

Appendix 3. Actuarial Assumptions

The valuation process is essentially a projection of future cashflows into and out of the Fund. The amount of future cashflows out of the Fund i.e. benefits provided will depend on rates of future pay increases and price inflation. The timing or incidence of the cashflows will depend upon future rates of retirement, mortality etc.

As money is being set aside now to provide for benefits payable in the future then part of the cost of providing the benefits can be met from investment returns achieved by the Fund's assets which then build up. The higher the rate of return achieved by the assets the lower the contribution requirement that has to be paid in future to meet the cost of the benefits.

Financial Assumptions

The principal financial assumptions adopted in the valuation are therefore as follows:-

Price Inflation

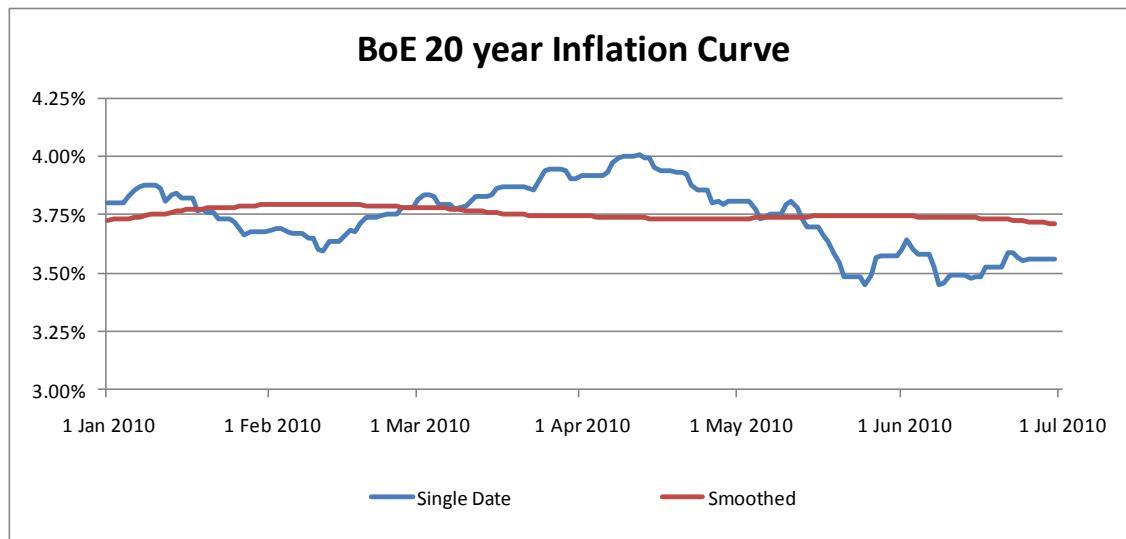
There are number of ways to try to estimate what future levels of inflation might be.

One approach would be to look at the long term trend in the past although much depends on the measurement period.

In these days of "marked to market" valuations, the usual approach is to look at the difference between yields from fixed-interest and index-linked gilts.

At this valuation we have looked at 20 year Bank of England Inflation curve which is the level of future RPI over the next 20 years as implied by the gilt market.

The following chart shows this on a daily basis during the 6 month period straddling the valuation date. We have also shown the smoothed or rolling average observation over that period.

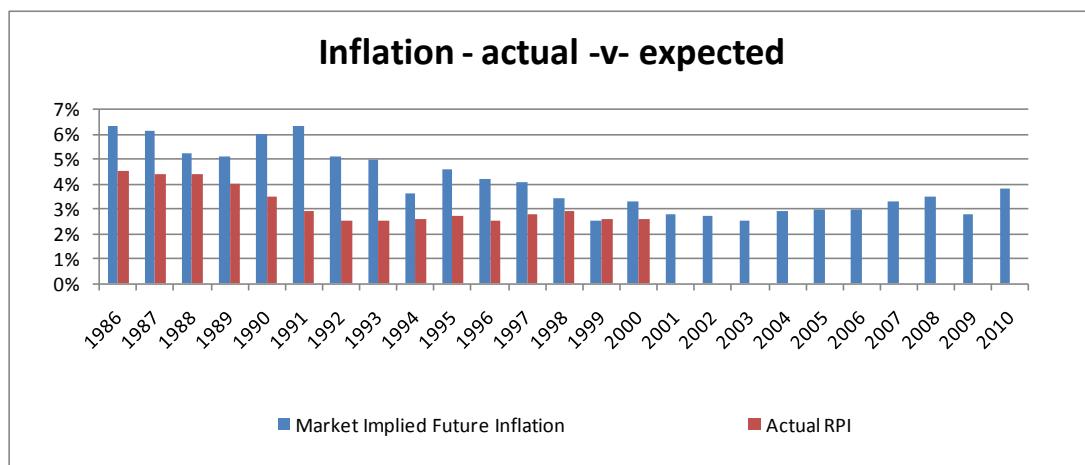


However, one of the issues in adopting such an approach is the arguably imperfect nature of the gilt market. The supplier of gilts (the Government) is a reluctant supplier, especially for long-dated gilts (which are the ones which are most useful for estimating future inflation for pension schemes).

On the demand side, there are certain institutions (insurance companies for example) who are essentially “forced holders” of gilts to meet various solvency requirements. Accordingly, the pricing of gilts is not perfect.

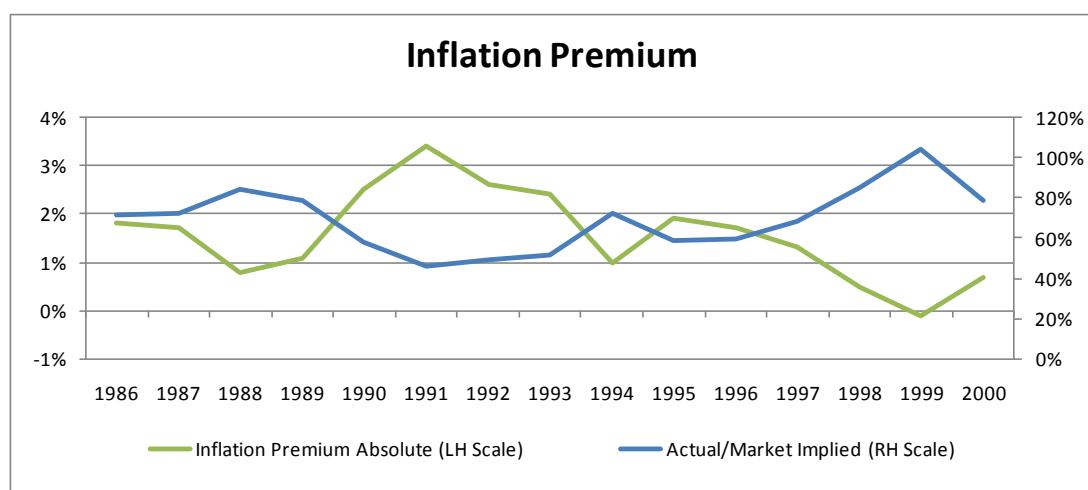
There is also the issue of what is known as the “inflation premium”. The argument is that investors will pay a premium for inflation protection and so arguably index-linked gilts are “more expensive” than fixed-interest gilts or equivalently index-linked gilt yields are lower than they might otherwise be.

The following chart shows how the gilt market implied 10 year inflation level at the beginning of each year has compared with the resulting 10 year actual level of inflation.



As we see the market implied level of inflation has consistently over-estimated the actual level of inflation.

The following chart shows the inflation premium both at an absolute level – the difference between actual and expected inflation and in relative terms (actual/expected).



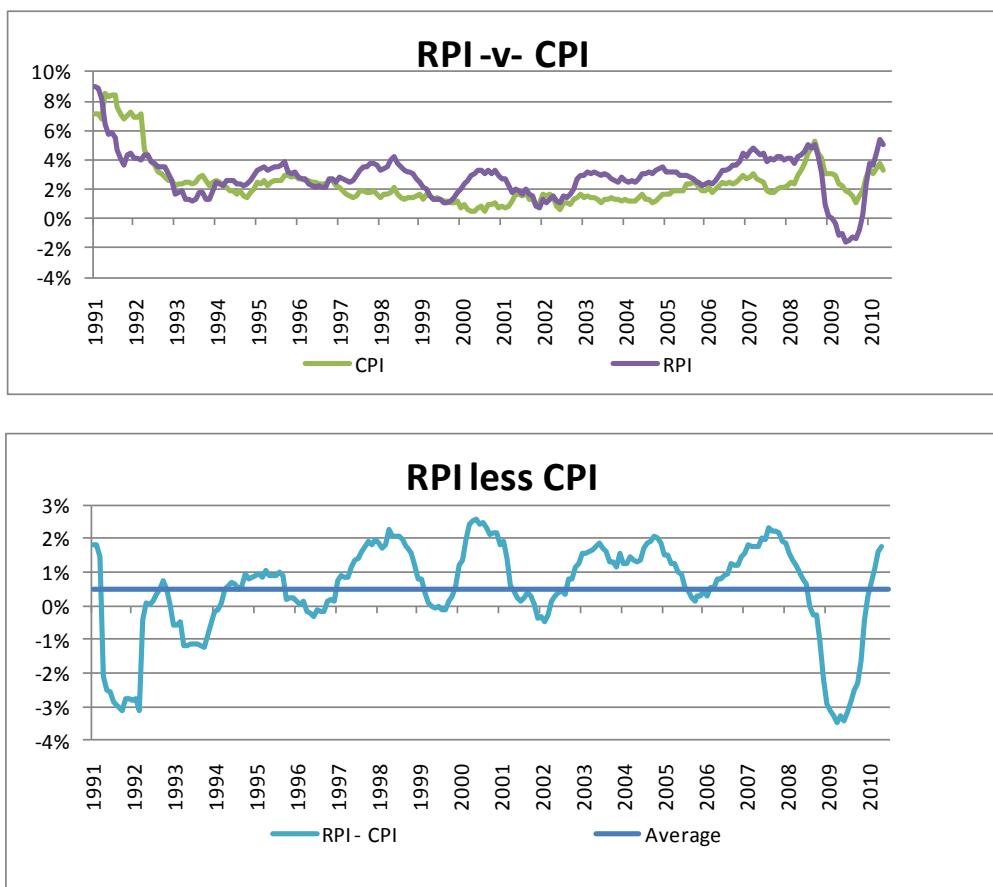
Pension Increases

The Retail Price Index has long been the established measure of inflation in the UK. It measures the change in prices of a number of things including housing costs such as mortgage interest payments.

However, in the 1990's the Government introduced the Consumer Price Index which is based on the prices of a range of consumer goods – similar to the RPI but it specifically excludes housing costs. The CPI is now the favoured measure the Government uses for measuring inflation in the economy.

The 2010 Emergency Budget delivered by George Osborne announced that in future, the pension increase orders will be linked to the CPI rather than RPI. This was expected to save some pennies implying that the Government expects CPI to be below RPI.

The following chart show how the 2 have compared since 1990.



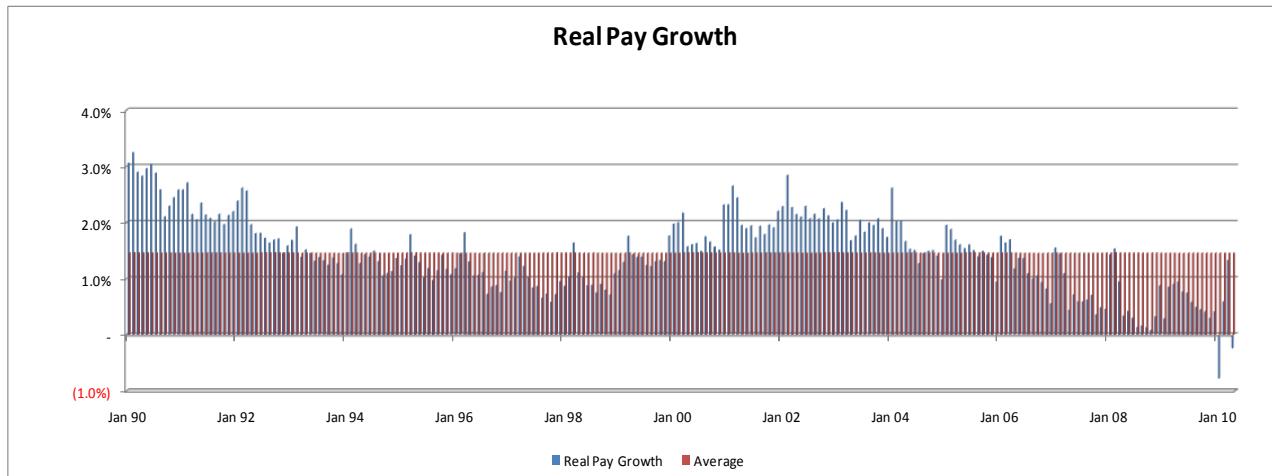
As we see RPI has indeed generally been higher the CPI and the average “gap” over the last 20 years has been around 0.5% per annum.

Thus, if this past trend continues then we would expect future pension increases to be 0.5% less than previously projected.

Pay Increases

Having determined our assumption about future levels of price inflation, the next stage is to assess future levels of pay increases relative to price inflation.

Historically there is, not surprisingly, a strong correlation between pay and price inflation as we see in the following charts.



The trend has been that real pay increases have been around 1% to 3% per annum although as overall levels of inflation have reduced so too has the level of real pay growth. The long term average is 1.5% more than RPI although there is evidence of a declining trend.

At this valuation we have assumed that future long term salary growth will be 1.5% more than RPI.

Investment Returns

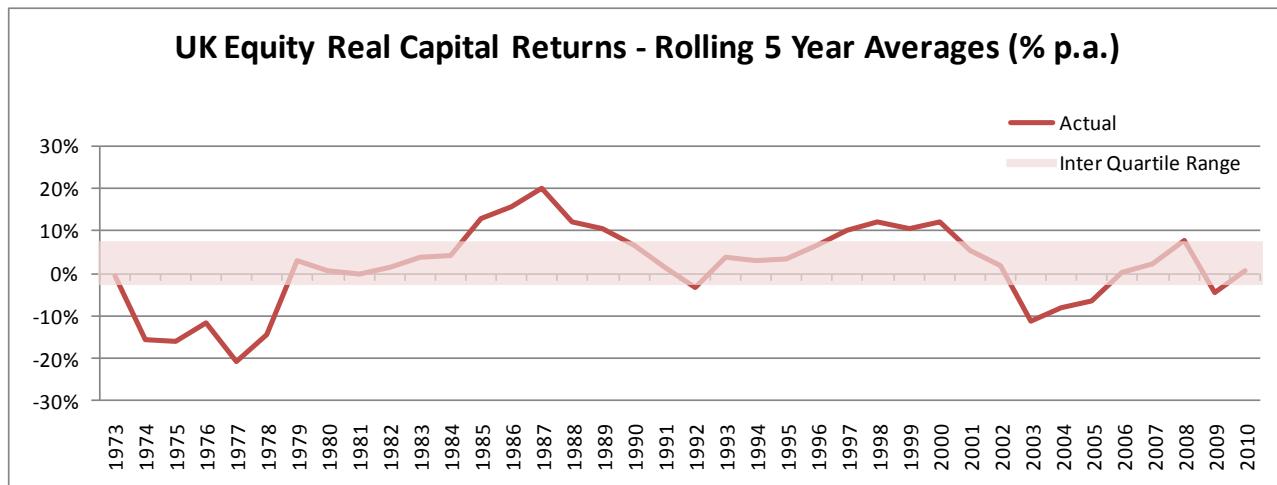
In a market-related valuation it is necessary to assess future average levels of return in current market conditions.

Redemption yields from gilts give an indication of the market's expectations of long term interest rates and so some indication about future risk free rates of return. There is however no comparable market indicator to derive the market's expected future return from investing in equities at any particular point in time.

We have assumed that the real return to be earned in future from equities from current market levels will be the current net dividend yield plus future real growth in share values.

The next chart shows the long term capital return from UK equities in real terms over the last 35 years or so together with the "inter quartile range" – the range of observations that account for 50% of all observations around the median.

As we see the actual return has averaged out at around 2% per annum although there have been prolonged periods when the real capital returns have been significantly different to this average.



For the purposes of the valuation therefore we have assumed that real capital returns will be 0.6% per annum.

The derivation of the equity return is therefore as follows:-

Smoothed Equity Returns		March 2010
		% p.a.
Net equity yield		3.3%
Inflation		3.5%
plus assumed real capital return		0.6%
Equity Return		7.4%

It would also be possible to derive the expected future return from other asset classes such as property and alternative asset classes. Intuitively we might expect that returns from asset classes other than equities and gilts might be expected to return somewhere between gilts and equities – what we usually see from corporate bonds.

Accordingly we have assumed that the return from other alternative asset classes is the same as the expected return from equities.

We then derive the discount rate as the weighted average of future expected returns from the various asset classes based on the actual investment strategy.

We then include a risk adjustment to the discount rate to reflect the amount of equity risk being taken relative to gilts. For a Fund with 75% or less exposure to equity type investments the risk adjustment is nil. For a Fund with 100% in equity type investments the reduction in discount rate is 50% of the extra return expected from a Fund invested 100% in equity type investments compared to one invested 75% in equity type investments.

Finally to accommodate any extreme market conditions at the valuation date the resulting real discount rate is constrained to 4%.

In summary therefore we have adopted the following assumptions.

Financial Assumptions	March 2010		March 2007	
	% p.a.	Real % p.a.	% p.a.	Real % p.a.
Investment Return				
Equities/absolute return funds	7.4%	3.9%		
Gilts	4.5%	1.0%		
Bonds & Property	5.6%	2.1%		
Risk Adjusted Discount Rate	6.7%	3.2%	6.0%	2.9%
Pay Increases	4.7%	1.5%	4.9%	1.8%
Price Inflation	3.5%	-	3.1%	
Pension Increases	3.0%	(0.5%)	3.1%	

Statistical Assumptions

The statistical assumptions we have adopted are based on our analysis of the incidence of retirement and withdrawal of our Local Authority client funds.

Sample rates are shown in the following tables: -

Age	Incidence per 1000 active members per annum								Salary Scales			
	Males				Females				Males	Femal	Males	Femal
	Death	III Health	Wdls	Death	III Health	Wdls	FT	PT				
20	0.2	0.0	0.0	400.0	0.2	0.1	0.1	400.0	100.0	100.0	100.0	100.0
25	0.3	0.1	0.1	360.0	0.3	0.1	0.1	360.0	122.8	100.0	114.2	100.0
30	0.5	0.1	0.1	264.0	0.4	0.3	0.3	264.0	145.5	100.0	125.8	100.0
35	0.8	0.3	0.3	184.0	0.6	0.5	0.5	184.0	166.3	100.0	133.6	100.0
40	1.2	0.5	0.5	108.0	0.9	0.8	0.8	108.0	183.1	100.0	136.6	100.0
45	1.7	0.9	0.9	48.0	1.2	1.2	1.2	48.0	194.4	100.0	136.6	100.0
50	2.6	1.6	1.6	-	1.8	2.2	2.2	-	198.8	100.0	136.6	100.0
55	3.9	3.5	3.5	-	2.6	4.2	4.2	-	198.8	100.0	136.6	100.0
60	5.8	7.4	7.4	-	3.8	8.5	8.5	-	198.8	100.0	136.6	100.0
64	8.7	13.2	13.2	-	5.5	11.5	11.5	-	198.8	100.0	136.6	100.0

Other assumptions

Age Retirements	It is assumed that active members will retire at age 60 or when they would first satisfy the rule of 85 if later, no later than 65, plus 1 year.	
Mortality	All members	Club Vita Lite tables with mortality improvements in line with the CMI Medium Cohort projections.
III Health Retirement	As above but with a +4 age rating	
Probability of partners pension coming into payment (including a loading for dependants benefits)	90%	
Partner Age Difference	Males are assumed to be 3 years older than their partners	
Commutation	It is assumed that at retirement, 50% of members will opt to increase their lump sums to the maximum allowed.	
III health tiers	It is assumed that 30% of ill health retirements will be eligible for benefits based on full prospective service and 70% will qualify for a service enhancement of 25% of prospective service.	

Appendix 4. Individual Employer Data as at 31 March 2010

Employer	Code	Number	Active Members			Pensioners			Deferred Pensioners		
			Actual Pay		Number	Annual Pensions	Number	Annual Pensions	Number	Annual Pensions	Average
			£ (000)	£ (000)		£ (000)	£ (000)		£ (000)	£ (000)	
London Borough of Newham	70	6,020	139,864	23.2	5,895	26,800	4.5	6,834	11,031	1.6	
North College of Further Education	71	205	5,578	27.2	103	437	4.2	258	342	1.3	
NEWVIC	72	69	1,630	23.6	8	29	3.6	105	124	1.2	
Stratford School	73	20	482	24.1	8	45	5.6	10	14	1.4	
ELWA (Newham)	74	-	-	-	19	89	4.7	24	70	2.9	
Magistrates Court (Newham)	75	-	-	-	19	142	7.5	21	44	2.1	
Greenwich Leisure Ltd	76	19	365	19.2	2	16	7.9	42	73	1.7	
David Webster Ltd	77	-	-	-	1	13	13.2	-	-	-	
Carpenter TMO	78	6	147	24.5	3	8	2.6	4	17	4.3	
F M Conway Ltd	79	3	88	29.3	-	-	-	-	-	-	
Arc in the Park Com Links Trust	790	12	326	27.2	1	5	4.7	2	7	3.3	
Newham Homes ALMO	791	525	15,521	29.6	55	334	6.1	104	514	4.9	
Stratford Regeneration Partner	792	2	79	39.5	-	-	-	2	42	21.2	
MITIE	793	5	117	23.5	-	-	-	-	-	-	
Total		6,886	164,197	23.8	6,114	27,918	4.6	7,406	12,278	1.7	

Appendix 5. Rates and Adjustments Certificate

John Turnbull
Divisional Director for Finance
Newham Dockside
1000 Dockside Road
London
E16 2QU

Dear Sirs

On your instruction, we have made an actuarial valuation of the London Borough of Newham Pension Fund ("the Fund") as at 31 March 2010.

In accordance with Regulation 36 of The Local Government Pension Scheme (Administration) Regulations 2008 we have made an assessment of the contributions which should be paid to the Fund by the employing authorities as from 1 April 2011 in order to maintain the solvency of the Fund.

The required contribution rates are set out in the following Contribution Schedule.

Yours faithfully



Graeme D Muir FFA



Alison Hamilton FFA

Contribution Schedule

The Common Rate of Contribution payable by each employing authority under Regulation 36 for the period 1 April 2011 to 31 March 2014 is 22.7% of pensionable payroll.

Individual Adjustments payable by each employing authority under Regulation 36 for the period 1 April 2011 to 31 March 2014 resulting in Minimum Total Contribution Rates are as set out below: -

Code	Employer	2010 Funding Pool	Minimum Level of Contributions		
			2011/12 % Pay	2012/13 % Pay	2013/14 % Pay
70	London Borough of Newham	London Borough of Newham	22.7%	22.7%	22.7%
71	North College of Further Education	NCFE	18.3%	18.3%	18.3%
72	NEWVIC	NEWVIC	12.1%	12.1%	12.1%
76	Greenwich Leisure Ltd	Greenwich Leisure Ltd	15.2%	15.2%	15.2%
78	Carpenter TMO	Carpenter TMO	14.2%	14.2%	14.2%
79	F M Conway Ltd	F M Conway Ltd	15.3%	15.3%	15.3%
790	Arc in the Park Com Links Trust	Arc in the Park Com Links Trust	13.4%	13.4%	13.4%
791	Newham Homes ALMO	Newham Homes ALMO	19.8%	19.8%	19.8%
793	MITIE	MITIE	17.4%	17.4%	17.4%

London Borough of Newham Funding Pool

73	Stratford School	London Borough of Newham	22.7%	22.7%	22.7%
792	Stratford Regeneration Partner	London Borough of Newham	22.7%	22.7%	22.7%
795	Thames Gateway (London Partnership)	London Borough of Newham	22.7%	22.7%	22.7%

New Employers

794	RM Education	RM Education	12.2%	12.2%	12.2%
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Academies

Brampton Manor Academy	Brampton Manor Academy	32.4%	32.4%	32.4%	
70791	LB Newham including Homes	London Borough of Newham	22.5%	22.5%	22.5%

Notes

1. Newham College of Further Education and Arc in the Park Com Links Trust are paying their deficit over their future service working lifetime which is 10 years.
2. Brampton Manor Academy has been set a deficit recovery period of 10 years.
3. Further sums should be paid to the Fund to meet the costs of any early retirements using methods and assumption issued by us from time to time.
4. The certified contribution rates represent the minimum level of contributions to be paid. Employing authorities may pay further amounts at any time and future periodic contributions may be adjusted on a basis approved by ourselves.

Appendix 6. LGPS Benefits

	LGPS 1997	LGPS 2008
General Features		
Type of Scheme	Final salary	
Relationship with S2P	Contracted-out	
Member Contributions	6%	Banded Contributions based on full time pay as at 1 st April 2011
	Range	Cont Rate
5% for manual workers in scheme prior to 01/04/1998	£0 - £12,900	5.50%
	£12,901 - £15,100	5.80%
	£15,101 - £19,400	5.90%
	£19,401 - £32,400	6.50%
	£32,401 - £43,300	6.80%
	£43,301 - £81,100	7.20%
	More than £81,100	7.50%
	Bands to be increased annually with Pension Increase Orders.	
	Transitional protection for members currently paying 5% until 2011/2012.	
Final Pay	In general, best of the last 3 years pensionable pay	
Pensionable Pay	Normal salary plus any shift allowance, bonuses, contractual overtime, Maternity Pay, Paternity Pay, Adoption Pay and any other taxable benefit specified as being pensionable.	
Retirement Benefits		
Normal Retiring Age	Age 65	
Early Retirement	<p>Age 55+ (existing members remains at age 50+ for retirements up to 31 March 2010. Employer consent required if below age 60.)</p> <p>Minimum 3 months membership or transfer in</p> <p>Benefits reduced unless Rule of 85 applies (member of the scheme as at 30th September 2006)</p> <p>Rule of 85 does not apply for service from 1 April 2008, subject to transitional protections.</p> <p>Employer's discretion to waive any actuarial reduction. No reductions applied for redundancy retirements.</p>	
Transitional Protections	<p>If born before 1 April 1960 and an existing member of the Scheme as at 30 September 2006 then 85 year rule stays for service up to 1 April 2016 with tapered protection to 1 April 2020.</p>	

	LGPS 1997	LGPS 2008												
General Features														
Flexible Retirement	<p>Age 55+</p> <p>(existing members remains at age 50+ for retirements up to 31/03/2010)</p> <p>Minimum 3 months membership or transfer in</p> <p>Reduce hours or move to a lower graded post</p> <p>Draw pension and salary</p> <p>Employers discretion to waive any actuarial reduction</p>													
Late Retirement	<p>Continue to day before eve of 75th birthday</p> <p>Benefits accrue to date of retirement</p>													
III Health Retirement	<p>Permanently unable to undertake own job or any comparable job with employer. Benefits are enhanced as per the table below with a maximum enhancement of potential membership to age 65</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left; padding: 2px;">Accrued Membership</th> <th style="text-align: left; padding: 2px;">Benefit Payable</th> </tr> </thead> <tbody> <tr> <td style="text-align: left; padding: 2px;">Less than 3 months</td> <td style="text-align: left; padding: 2px;">Refund of contributions</td> </tr> <tr> <td style="text-align: left; padding: 2px;">3 months to 5 yrs</td> <td style="text-align: left; padding: 2px;">Accrued Membership</td> </tr> <tr> <td style="text-align: left; padding: 2px;">5 but less than 10 yrs</td> <td style="text-align: left; padding: 2px;">Membership Doubled</td> </tr> <tr> <td style="text-align: left; padding: 2px;">10 yrs to 13 yrs 122 days</td> <td style="text-align: left; padding: 2px;">Membership Enhanced to 20 yrs</td> </tr> <tr> <td style="text-align: left; padding: 2px;">13 yrs 123 days or more</td> <td style="text-align: left; padding: 2px;">Membership Enhanced by 6 2/3 yrs</td> </tr> </tbody> </table>	Accrued Membership	Benefit Payable	Less than 3 months	Refund of contributions	3 months to 5 yrs	Accrued Membership	5 but less than 10 yrs	Membership Doubled	10 yrs to 13 yrs 122 days	Membership Enhanced to 20 yrs	13 yrs 123 days or more	Membership Enhanced by 6 2/3 yrs	<p>Permanently unable to undertake own job or any comparable job with employer. Benefits are graded based on how likely you are to be capable of gainful employment after you leave.</p> <p>First Tier - No reasonable prospect of alternative employment ever again then service enhanced by 100% of prospective service to age 65.</p> <p>Second Tier - No prospect of obtaining gainful employment within a reasonable period of leaving local government employment, but likely to be able to obtain gainful employment before 65 then service enhanced by 25% of prospective service.</p> <p>Third Tier - Reduced likelihood of obtaining gainful employment within 3 years of leaving, or before age 65 if earlier then no service enhancement. Payment of these benefits will be stopped after 3 years, or earlier if the member is in gainful employment or becomes capable of such employment, provided they are not age 65 by then.</p>
Accrued Membership	Benefit Payable													
Less than 3 months	Refund of contributions													
3 months to 5 yrs	Accrued Membership													
5 but less than 10 yrs	Membership Doubled													
10 yrs to 13 yrs 122 days	Membership Enhanced to 20 yrs													
13 yrs 123 days or more	Membership Enhanced by 6 2/3 yrs													
Benefit Accrual	<p>Pension = 1/80th</p> <p>Lump Sum = 3/80th plus increased lump sum by commutation 12:1 up to a maximum of 25% of lifetime allowance</p> <p>Spouse's Pension = 1/160th</p>	<p>Pension = 1/60th</p> <p>Lump Sum = By commutation 12:1 up to a maximum of 25% of lifetime allowance</p> <p>Spouse's Pension = 1/160th</p>												
Death and Survivor Benefits														
Lump Sum Death Benefit	<p>Active = 2 x Pensionable Pay</p> <p>Deferred = Current value of deferred lump sum</p> <p>Pensioner = 5 year guarantee less pension paid</p>	<p>Active = 3 x Pensionable Pay</p> <p>Deferred = 5 x Current value of deferred annual pension</p> <p>Pensioner = 10 year guarantee less pension paid</p>												

	LGPS 1997	LGPS 2008
General Features		(for death before age 75)
Dependants' Provision	Widow(er)s Registered civil partners	Widow(er)s Registered civil partners Nominated cohabiting partners
Dependants' Pension (Death in Service)	If membership > 3 months 50% x notional ill health pension Otherwise 1/160 th x accrued membership	1/160th x full prospective service to age 65
Spouse's Short Term Pension	Active = 3 months x salary (increased to 6 months if dependent children) Deferred = none Pensioner = 3 months x member's pension (increased to 6 months if dependent children)	None
Children's Pensions	Surviving Parent 1 child = 1/4 x notional pension 2+ children = 1/2 x notional pension divided by number of children Orphans 1 child = 1/3 x notional pension 2+ children = 2/3 x notional pension divided by number of children For death in service the notional pension is the ill health pension or a pension based on the lesser of 10 years and full service to age 65 where this is higher.	Surviving Parent 1 child = 1/2 x dependant's pension 2+ children = 1 x dependant's pension divided by number of children Orphans 1 child = 2/3 x dependant's pension 2+ children = 1 1/3 x dependant's pension divided by number of children
Increasing Benefits		
AVCs	Maximum contributions – 50% of taxable earnings Options available: Open market annuity LGPS Top Up Pension Tax Free Lump Sum (100% of fund up to max of 25% of Lifetime Allowance) LGPS Service Credit (if commenced AVCs prior to 13/11/2001)	
Added Years/Pension	Maximum purchase 6 2/3 years	Maximum purchase £5,000 extra pension (in

	LGPS 1997	LGPS 2008
General Features		
	Payable from next birthday to age 65 (contracts taken out before 01/10/2006 may have an earlier date than age 65)	multiples of £250).
Leaving the Scheme		
Benefits on Leaving	Less than 3 months membership and no transfer in Refund of contributions CETV Defer decision More than 3 months membership or transfer in CETV Defer Benefits until NRA	