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Dear Julie

Buckinghamshire County Council Pension Fund
Admission Bodies – Bond Review

Further to recent discussions and correspondence in respect of the above, we have now completed our calculations in relation to the review of the level of bond in respect of admission bodies within the Buckinghamshire County Council Pension Fund.

Data

The membership as at 31 March 2007 is summarised below (note the numbers relate to the number of employments rather than individuals).

Active Members	Number at 31/3/2007	Actual Salary	FTE Salary	Average Age	Average Service (years)
ASM Metal Recycling Ltd	2	£11,782	£33,801	53.0	3.11
Catermasters	81	£1,157,816	£1,611,631	49.6	9.61
Connaught	27	£436,898	£516,126	49.9	11.55
Cressex School (Superclean)	6	£89,887	£150,384	50.8	11.78
Excelcare	17	£200,181	£256,891	55.3	7.40
HBS	363	£8,251,970	£9,048,350	46.9	12.10
Heritage Care	1	£15,319	£17,872	47.0	11.90
Penn School	4	£116,249	£116,249	52.5	22.01
Serco	1	£22,412	£22,412	54.0	7.23
Total	**502**	**10,302,514**	**11,773,717**	**47.9**	**11.54**

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Calculation Basis

For consistency with the other employers in the Fund our calculations have been based on consistent methods and assumptions underlying the valuation of the Fund as at 31 March 2007.

Indemnity

In deciding upon the level of bond or indemnity it is first of all necessary to decide what the bond or indemnity is intended to cover. In the past the approach that has been adopted is that the bond/indemnity should cover the potential early retirement costs.

However for the purposes of this review of the required level of bond we have also considered the potential shortfall of assets to liabilities should the admission body cease to participate in the Fund, leaving behind less than fully funded pension liabilities.

Should the admission body cease to participate in the Fund then it is almost certain that the (ongoing) funding position will be different to 100% at the date of cessation as the actual investment returns etc earned by the Fund will be different to the assumptions used in the calculation of the ongoing funding position. However the deviation from the fully funded position is rectified at each triennial valuation via an adjustment to the required level of employer's contribution.

In an ongoing valuation we also take some advance credit for the expected outperformance of equities over bonds on the basis that there is an employer available to underwrite any shortfall in actual equity returns compared to what was anticipated.

With no employer available to underwrite the equity risks then we would generally assess the deficit without assuming any equity outperformance to minimise the likelihood of the other employers in the Fund having to fund any shortfall in future.

Essentially ongoing employers "self insure" the equity risk. If an employer leaves the Fund then we need to charge them an "insurance premium" up front unless another employer takes on the equity risk going forward.

The risks to the Fund therefore at the date that the admission body ceases to participate in the Fund are therefore:

- The ongoing funding position is less than 100% and the additional funding that is required cannot be met by the admission body.
- No other employer picks up the future equity risk.
- Employees are made redundant and become entitled to early retirement benefits.

The latter two scenarios can be measured to some extent in that it is possible to forecast future early retirement costs and the difference in ongoing liabilities and what might be described as "minimum risk" liabilities – i.e. the amount required to fund the liabilities without taking any future equity risk.

Ongoing Funding Deficits

However trying to forecast future ongoing funding deficits is more tricky as it requires trying to predict future stock market volatility. However it is possible to model future valuation results based on what has been experienced in the past.

Of course the "best estimate" of future ongoing funding deficits is zero (assuming fully funded at outset) in that we "expect" the assumptions to be borne out in practice. However we know that whilst they might be borne out in practice in the longer term (with some variability in the short term) there is a significant chance that at any future point in time the ongoing funding level will be different to 100%.

If it is therefore deemed appropriate to include an allowance for future ongoing deficits then we would suggest that an approximate approach and take a reserve equal the deficit as at 31 March 2007 plus 5% of the liabilities – effectively what we are saying is that in the normal course of events we might see funding levels fluctuate by 5% per annum.

Projections, averaged over the next 3 years, of the potential early retirement costs, the current deficit and 5% of ongoing liabilities and the "equity risk" are set out below

			Potential Risks			
Employer	**Strain Costs**	**5% Ongoing**	**Deficit**	**Min Bond**	**Equity Risk**	**Max Bond**
ASM Metal Recycling Ltd	£62k	£1k	£1k	£65k	£10k	£75k
Catermasters	£1,224k	£274k	£0k	£1,498k	£2,483k	£3,980k
Connaught	£261k	£83k	£114k	£458k	£752k	£1,211k
Cressex School (Superclean)	£142k	£28k	£33k	£203k	£250k	£452k
Excelcare	£246k	£55k	£67k	£368k	£498k	£866k
HBS	£5,433k	£1,686k	£0k	£7,119k	£15,308k	£22,427k
Heritage Care	£0k	£3k	£3k	£6k	£22k	£28k
Penn School	£144k	£27k	£27k	£198k	£244k	£442k
Serco	£22k	£2k	£2k	£26k	£16k	£42k

The key issues in determining the level of bond are what risks should be included.

If it is decided to proceed as before with only the Strain Costs included then the amounts would as set out in the above table in the Strain Cost column. If however it is decided that the bond should include an element of the current deficit or a potential future deficit then the relevant amount would as set out in the Min Bond column.

If all of the above risks were to be included then what could be considered a maximum level would be numbers in the Max Bond column.

In our experience then the bond would usually either be the Strain Cost amount or the Min Bond amount. The approach may also depend on the contractual agreement between the contractor and the letting authority.

Commentary

If allowance is only made for the indemnity to cover the potential early retirement strain costs then it is effectively assuming that the original letting authority and/or the new service provider would take on the equity risk and any ongoing funding deficits.

In reality, should the admission body fail then any unfunded pension liabilities within the Fund would ultimately be allocated to the original letting authority and as such, the level of bond is really an issue for them to consider. The higher the level of bond the greater the level of "insurance".

In addition the post cessation equity risk and the risk of ongoing funding deficiencies would continue to be underwritten by the original letting authority if the service was to remain in-house.

We would recommend that the bond levels are reviewed at least every 3 years and more often towards the end of the contract.

We trust that this is helpful and would be pleased to answer any questions you may have.

Kind regards

Yours sincerely

GRAEME D Muir FFA
PARTNER

For and on behalf of Barnett Waddingham LLP