Finance and Resources Committee Meeting – 17 November 2008

CAPITA HARTSHEAD FLEXIPLAN SCHEME PAPER

Executive summary and recommendations

Introduction
This paper gives an update on progress in closing the Capita Flexiplan scheme.

Decision
The Committee is requested to note the document.

Background information
The Capita Flexiplan pension scheme was the pension scheme for the HPC until the Finance & Resources Committee approved its replacement by the Friends Provident pension scheme.

Entrust Pension Recovery Ltd ("Entrust"), the sole professional trustee for the Flexiplan scheme was appointed in May 2007, taking over from Capita Pension Trustees Ltd. Entrust's duties include the duty to act in the best interests of members of the Scheme. At a meeting on 6 March 2008, Entrust resolved to wind up the Flexiplan scheme. At that same meeting, the scheme rules were amended to formally recognise the Employers Consultative Group ("ECG"), whose aims include:
- to give or withhold agreement on behalf of the employers in relation to scheme funding matters,
- liaise with the professional trustee,
- set an effective date to wind up the scheme,
- discuss distribution of any surplus on winding up.

Entrust recently confirmed that there are approximately 75 remaining active employers in the Flexiplan scheme and confirmed that the ECG have the power to choose the termination date of the scheme.

Entrust with the assistance of ECG market tested the scheme administration, actuarial, consultancy and investment advisory services, historically provided by Capita Hartshead. In early October, KPMG was appointed to replace Capita Hartshead to provide those services, and a new scheme actuary appointed.

Following investment advice received in July from KPMG, various changes were made to the scheme investment portfolio, essentially moving investments out of equities and into long-dated corporate bonds – see Appendix One details.

KPMG are also liaising with various providers of pensions, such as insurance companies, in order that quotations of the costs of these benefits can be obtained and assessed. Entrust advised that KPMG are expecting quotes from up to 6 buy out providers and it hopes to receive advice including a recommendation on which provider to take on responsibility for payment of pensioner benefits, by early November 2008.

The ECG recently indicated that their estimate of the earliest time the scheme could be wound up is the end of March 2009, "but there are still uncertainties". The ECG advised that we could expect an update by the end of November. Entrust indicated more generally that "we would anticipate completing the major stages of the winding up the scheme within two years of the termination date, as suggested in Pensions Regulator guidance."

The HPC received a letter from Entrust back in early June, advising that they are in the process of obtaining an updated actuarial valuation of the Flexiplan scheme. The last actuarial valuation had an effective date of 31 March 2006, with a range of net valuations from -£2.9M to £15.8M, depending on assumptions used. This paper went to the Finance & Resources Committee to note in July 2007. At the time of writing, a more recent valuation is still a work in progress. Given the uncertainties, the HPC continues to pay a small monthly amount to keep notional members in the Flexiplan scheme.

What is the benefit to the HPC of keeping notional members in the scheme? Until there is a further actuarial valuation of the Flexiplan scheme, its financial status (in surplus or in deficit) is not known. Since the valuation may fluctuate with changes e.g. in actuarial assumptions, in pensions legislation and/or changes in investment value, it is considered prudent for the HPC to leave notional members in the scheme, to avoid potentially triggering a section 75 liability (should a fund deficit is determined). This liability could arise as the HPC employer's deemed share of any fund shortfall (pension fund liabilities exceeding fund assets).

Potentially, if the HPC cancelled its notional member contributions, a subsequent actuarial valuation may highlight a deficit, of which the HPC may be asked to pay our share of the deficit. However, if it took a further period to wind up the scheme, by then the scheme might be in surplus again, good news for any remaining employers in the scheme at that point.

Since we have no reliable information at present to suggest withdrawing notional members in the near future will give the best result for HPC, we continue to rely on Entrust & ECG to obtain an actuarial valuation and progress winding up the scheme.

Sacker and Partners recently commented on the above rationale: "I agree with your analysis that until such time as it is clear that there is no potential section 75 liability, the safest approach is to retain notional members in the Capita Scheme."

Finally, is it likely that the active employers in the scheme would receive a share of any residual scheme surplus, on wind up?

Entrust advised recently that "all the indications are that there will not be sufficient funds in the scheme to return any funds to employers. Members who retied after 10 July 2006 are already receiving a substantially reduced pension. I anticipate therefore that any surplus on pensions capital which may be available, will be distributed amongst members to increase their benefits above the pensions capital level. Recent indications from the scheme actuary suggest that the level of surplus on pensions capital, if any, is likely to be only modest."

Resource implications
Nil

Financial implications
Employer contributions for 6 notional scheme members @ £10 per head per month = £720 per annum.

Appendices
Appendix One – Flexiplan Statement of Investment Principles

Date of paper
5 November 2008

The Federated Flexiplan No1

Statement of Investment Principles

August 2008

The Trustee of the Federated Flexiplan No1. ("the Plan"), complies with the relevant requirements of the Pensions Act 1995, the Pensions Act 2004 and the Occupational Pension Schemes (Investment) Regulations 2005 ("the SIP Requirements") as follows:

1. Introduction

The Plan is likely to be wound up in late 2008 or early 2009. The Plan therefore has a short investment time horizon. This means that the Trustee is reluctant to hold substantial investments in riskier assets, such as equities, as there will only be a short time period for these investments to come good following any further downturn in equity markets.

Since June 2007 the Plan has gradually been switching out of equities and into bonds. Between June 2007 and June 2008 £33.1m of equities were sold off in six separate transactions. The Trustee has now decided to sell off the Plan's remaining equity exposure, and expects this to happen during August 2008.

The Plan will therefore be switching from a strategy of 26% equities and 74% bonds to a 100% bond based strategy during August 2008.

2. Decision making structure

The Trustee is responsible for setting the Plan's investment objectives, asset allocation and appointing the investment managers. The Trustee feels that it has the skills to perform this role and receives advice from its actuary and investment consultant (KPMG LLP) before making decisions.

The Trustee recognises that setting investment policy involves striking a balance between risk and potential future return. Risk must be considered in terms of the Plan's liabilities to its members and the capacity to take risk depends heavily upon the position of the sponsoring Employers and the time horizon to the potential wind up of the Plan.

The Trustee's investment powers are set out within the Plan's governing documentation and relevant legislation. Where and if necessary, the Trustee will take legal advice regarding the interpretation of these. The Trustee notes that, according to the law, it has ultimate power and responsibility for the Plan's investment arrangements.

3. The Kinds of Investment Held

- All day to day investment decisions for the assets of the Plan are delegated to qualified and authorised investment managers of pooled pension fund portfolios. The Trustee reviews them regularly to ensure the manner in which they make investments on the Trustee's behalf is suitable for the Plan and is appropriately diversified.
- Appropriate written advice will always be taken from a properly qualified and authorised investment consultant, currently KPMG LLP, before the appointment or review of any such investment manager, or before any alteration in the underlying mix of investments.

- The Trustee will select investment managers who will hold only the kind of investments which are deemed suitable for the Plan. The Trustee's investment consultant, KPMG LLP advises the Trustee on this as appropriate.

4. Investment objective

- The Trustee's immediate investment objective is to invest the assets of the Plan to reduce volatility of the Plan's assets relative to the price an insurance company would charge for taking on the Plan's liabilities.
- An investment strategy that satisfies this immediate objective is also likely to satisfy the ultimate objective of ensuring the Plan's assets are sufficient to meet the liabilities and payments as and when these are required.
- To satisfy this objective the Trustee will be switching from a 26% equity and 74% bonds strategy to a 100% bond based investment strategy during August 2008.

5. Investment mandates

The Trustee has appointed the following managers who are regulated by the Financial Services Authority (the "FSA"):

- Barclays Global Investors Limited (BGI) – as passive/index manager.
- Frank Russell Company Limited (Frank Russell) – as the core active manager. All equity assets are expected to be moved away from Frank Russell during the restructuring exercise in August 2008, leaving only a small amount of bond assets with Frank Russell.
- Scottish Equitable – as manager for part of the fixed interest investment.
- RNPFN – as annuity provider, for pension benefits at a time when the Plan purchased pensions. This purchased element is fixed until such a time as the Trustee considers it appropriate to purchase further annuities from a suitable provider, RNPFN annuities have been excluded from the strategic benchmark allocation.

The investment managers have full discretion to buy and sell investments on behalf of the Plan, subject to agreed constraints. The mandate includes performance objectives, risk parameters and timescales over which their performance will be measured. The Trustee has signed agreements with the investment managers.

The Plan's investment managers have appointed global custodians who provide full custodial services.

The Expected Return on Investments

The Plan's assets are expected to provide a return which broadly matches the return on the Plan's liabilities.

Risk

- There are various risks to which any pension scheme is exposed. The Trustee has considered the following risks:
  - The risk of deterioration in the Plan's ongoing funding level.
  - The risk of a shortfall of assets relative to the liabilities as determined when the Plan is wound up.
  - The risk that the day to day management of the assets will not achieve the rate of investment return expected by the Trustee.

- The Trustee considers the investment managers to be competent investment managers who can be expected to manage their funds in a prudent manner whilst aiming to achieve returns in line with their investment targets.
- The Trustee, in consultation with its advisers, considers the revised diversification of assets held by the investment managers to be suitable with regard to the liability profile of the Plan and that this diversification is achieved without undue concentration in a particular asset.
- The Trustee recognises that there are other risks that also affect the Plan's funding level in addition to investment returns.
- The Trustee considers that it would be prudent on its part to monitor the progress of the investment managers and therefore will review their status and appointment on a regular basis.

The realisation of investments

The Trustee may realise investments from its portfolio in order to pay benefits and cover the costs of the Plan. The selection of individual investments to be realised is at the discretion of the Trustee's investment managers. They also have discretion to realise investments within the portfolio for the purpose of making new investments, subject to reporting to the Trustee.

Social, environmental and ethical policies

The Trustee takes no account of social, environmental, or ethical considerations in the Trustee's selection, retention, or realisation of investments. The Trustee's investment managers have discretion to buy, hold, or sell investments purely on their financial merits as suitable investments for the Plan.

The exercise of shareholder rights

The Trustee's investment managers have discretion to exercise the Trustee's shareholder rights in the best financial interests of the portfolio.

6. Asset Allocation Strategy

The revised asset allocation has been set to provide a broad match for the Plan's liabilities.

Asset Class	Strategic Benchmark Allocation (%)	Benchmark
UK Corporate Bonds (BGI)	44%	iBoxx £ Non Gilt
UK Long Dated Corporate Bonds (BGI)	26%	iBoxx Over 15 Years £ Non-Gilts Index
UK Corporate Bonds (Scottish Equitable Aegon)	8%	Lipper Hindsight Sector Average
UK Long Gilts (Scottish Equitable Aegon)	8%	Lipper Hindsight Sector Average
UK Govt Index Linked (Frank Russell)	4%	FTSE A Index Linked Govt All Stock

Sterling Corporate Bonds (Frank Russell)	4%	Merrill Lynch Non Gilts +10
Sterling Bonds (Frank Russell)	4%	Merrill Lynch Sterling Broad Market
UK Cash (Frank Russell)	2%	UK one Month T Bill

7. Other issues

- All investment decisions for the Plan are under the Trustee's control, with no constraint from the Employers.
- The Trustee has taken appropriate written advice in preparing this statement, as required by the SIP Requirements.
- Also, as required by the SIP Requirements, the Trustee has consulted the Employers during the preparation of this statement.
- The Trustee monitors regularly all investment decisions affecting the Plan, and the overall investment performance of its investment managers, with the assistance of its investment consultant.
- The Trustee will keep this statement under review to ensure that these principles remain appropriate to the Plan, and to ensure that the reviews mentioned in the statement are carried out.
- The Trustee has appointed a variety of agents and advisers to assist the Trustee in carrying out its duties. All such parties are remunerated on the basis of agreed set fees.

Signed on behalf of the Trustee of the Federated Flexiplan No1.

Patrick Kennedy ....(signed) 7th August 2008 ....(date)

Director (Entrust Pension Recovery Limited)

..........(signed) 8th August 2008 ....(date)

Director (Entrust Pension Recovery Limited)