

Section Two - Pension Fund Accounts

Introduction

The Pension Fund accounts, and accompanying notes, summarise the financial transactions and net assets related to the provision of pensions and other benefits payable to former employees of the Council, Essex district, borough and unitary councils, and for other scheduled and admitted bodies. The Pension Fund accounts are set out in the following pages, as detailed below.

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Fund Account for the year ended 31 March 2012

2010/11 £000	Note		2011/12 £000	£000
		Contributions and Benefits		
		Income		
		Contributions receivable		
(50,353)	5	Member contributions	(48,558)	
(173,106)	5	Employers' contributions	(161,588)	
(27,683)	5	Transfers in from other Pension Funds	(14,192)	
(169)		Other income	(152)	
<u>(251,311)</u>		Total income		(224,490)
		Expenditure		
		Benefits payable		
130,775	5	Pensions	141,174	
43,229		Commutation of pensions & lump sum retirement benefits	33,883	
3,338		Lump sum death benefits	4,752	
		Payments to and on account of Leavers		
15		Refunds of contributions	10	
-		State scheme premiums	1	
17,246	5	Transfers out to other schemes	9,946	
1,816	7	Administration expenses	1,922	
<u>196,419</u>		Total expenditure		191,688
(54,892)		Net additions from dealings with members		(32,802)
		Returns on investments		
(48,977)	6	Investment income	(61,108)	
(240,963)	9	Profit and losses on disposal of investments and changes in market value of investments	(30,811)	
2,134	12	Taxes on income	2,463	
13,560	8	Investment management expenses	16,502	
<u>(274,246)</u>		Net returns on investments		(72,954)
(329,138)		Net (increase)/decrease in the assets available for benefits during the year		(105,756)
(3,084,874)		Net assets as at 1 April		(3,414,012)
<u>(3,414,012)</u>		Net assets as at 31 March		<u>(3,519,768)</u>

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Net Assets Statement as at 31 March 2012

31 March 2011 £000 Restated	Note		31 March 2012 £000	£000
	9	Investments at market value		
		Investment assets		
226,019		Fixed interest securities	170,600	
2,118,859		Equities	2,185,607	
171,839		Index linked securities	127,446	
234,688		Property unit trusts	237,865	
126,264		Private Equity	154,545	
65,914		Infrastructure	103,002	
-		Timber	28,181	
58,341		Active currency	25,676	
156,301		Other managed funds	163,410	
22		Derivative contracts	21,653	
147,520		Property	196,040	
76,737		Cash/deposits	68,868	
13,347		Other investment balances	8,085	
3,395,851				3,490,978
		Investment liabilities		
(3,060)		Derivative contracts	(45)	
(9,429)		Other investment balances	(4,611)	
(12,489)				(4,656)
3,383,362		Total Investments		3,486,322
		Long term assets		
12,428		Contributions due from employers		11,081
	11	Current assets and liabilities		
		Current Assets		
13,150		Cash	10,085	
18,746		Contributions due from employers and other current assets	19,151	
3,427,686				3,526,639
		Current liabilities		
(13,674)		Unpaid benefits and other current liabilities		(6,871)
3,414,012		Net assets of the scheme available to fund benefits		3,519,768

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Notes to the Pension Fund Accounts

1. Background

Under the Local Government Pension Scheme (LGPS) (Administration) Regulations 2008, Essex County Council is required to maintain a pension fund (the Fund) for its employees and those of other scheduled Bodies within its area. The Fund is also empowered to admit the employees of certain other bodies, town and parish councils, educational establishments, contractors providing services transferred from scheduled bodies and community interest bodies. As a result the Fund now contains around 420 employing bodies. A complete list of the employers participating in the Fund is contained in the Pension Fund Annual Report & Accounts. The Fund does not provide pensions for teachers, for whom separate arrangements exist. Uniformed police and fire staff are also subject to separate pension arrangements.

Independent investment managers have been appointed to manage the investments of the Fund. The Fund also invests in private equity, infrastructure and timber through the use of limited partnerships. The Investment Steering Committee (ISC) oversees the management of these investments and meets regularly with the investment managers to monitor their performance against agreed benchmarks. The ISC in turn reports to the Essex Pension Fund Board. The Fund's Statement of Investment Principles is contained in the Pension Fund Annual Report & Accounts.

2. Basis of preparation

The financial statements have been prepared in accordance with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008, the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 issued by CIPFA which is based upon International Financial Reporting Standards (IFRS) as amended for UK public sector and with the guidelines set out in the Statement of Recommended Practice 2011/12(SORP) and the Financial Reports of Pension Schemes Statement of Recommended Practice (revised May 2007).

The Pension Fund publishes a number of statutory documents, including a Statement of Investment Principles, a Funding Strategy Statement and Statements of Compliance. Copies can be obtained by contacting the Council's Investments team or alternatively are available from www.essexpensionfund.co.uk.

The Pension Fund Financial Statement of Accounts summarises the transactions for the 2011/12 financial year and its position as at 31 March 2012. The accounts do not reflect obligations to pay pensions and benefits that fall due after the financial year. However, a statement calculating the Fund's actuarial present value of promised retirement benefits as at 31 March 2012 using IAS19 methodology is included in the notes to the accounts and can be found at Note 3.2.

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3. Actuarial valuation

The contributions payable for 2011/12 were determined by the 2010 Actuarial Valuation.

3.1 Actuarial Valuation 2010

An actuarial valuation of the Essex Pension Fund was carried out as at 31 March 2010 to determine the contribution rates with effect from 1 April 2011 to 31 March 2014. The results of the valuation are contained within the Statement by the Consulting Actuary of the Pension Fund Report and Accounts.

On the basis of the assumptions adopted, the valuation revealed that the value of the Fund's assets of **£3,085m** represented **71%** of the Funding Target liabilities of **£4,319m** at the valuation date. The valuation also showed that a common rate of contribution of **12.2%** of Pensionable Pay per annum was required from employers. The common rate is calculated as being sufficient, together with contributions paid by members, to meet all liabilities arising in respect of service after the valuation date.

Adopting the same method and assumptions as used for assessing the Funding Target the deficit could be eliminated by an average additional contribution rate of **9.2%** of Pensionable Pay for 20 years. This would imply an average employer contribution rate of **21.4%** of Pensionable Pay in total.

In practice, each individual employer's position is assessed separately and the contributions required are set out in the Actuary's statement. In addition to the certified contributions, payments to cover additional liabilities arising from early retirements (other than ill-health retirements) will be made to the Fund by the employers.

The funding plan adopted in assessing the contributions for each individual employer is in accordance with the Funding Strategy Statement (FSS). Different approaches adopted in implementing contribution increases and deficit recovery periods are as determined through the FSS consultation process.

The valuation was carried out using the projected unit actuarial method. Full details of the actuarial assumptions are contained within the full valuation report that is available from www.essexpensionfund.co.uk.

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The main financial assumptions used for assessing the Funding Target and the common contribution rate were as follows:

	Past service liabilities (funding target) <i>Rate per annum</i>	Future service liabilities (common contribution rate) <i>Rate per annum</i>
Rate of discount		
Pre retirement	7.00%	6.75%
Post retirement	5.50%	6.75%
Rate of pay increases	4.50%	4.50%
Rate of increase to pensions in payment (in excess of guaranteed minimum pension)	3.00%	3.00%

The assets were assessed at market value.

The next triennial actuarial valuation of the Fund is due as at 31 March 2013. Based on the results of this valuation, the contributions payable by the individual employers will be revised with effect from 1 April 2014.

3.2 Actuarial present value of promised retirement benefits

IAS 26 requires the present value of the Fund's promised retirement benefits to be disclosed, and for this purpose the actuarial assumptions and methodology used should be based on IAS 19 rather than the assumptions and methodology used for funding purposes.

In order to assess the present value of the Fund's obligation on this basis, the Actuary, allowing for the different financial assumptions required under IAS 19 has used a roll forward approach in valuing the Fund's liabilities which were last calculated at the triennial actuarial valuation as at 31 March 2010. The discount rate of 4.6% per annum for both before and after retirement has been used (5.5% as at 31 March 2011), rather than the rates as outlined above. The value of the Fund's promised retirement benefits as at 31 March 2012 was **£5,918m** (£5,009m as at 31 March 2011).

Similar calculations were carried out as per the last actuarial valuation date of 31 March 2010, using the same actuarial assumptions as those used for funding purposes at that date, other than the discount rate where a rate of 5.6% per annum both before and after retirement was used. On this basis, the value, for IAS 26 purposes, of the Fund's promised retirement benefits at that date was **£4,720m**.

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4. Accounting conventions

4.1 Fund Account – revenue recognition

4.1.1 Contribution income

Normal contributions, both from the members and from the employer, are accounted for on an accruals basis at the percentage rate recommended by the Fund Actuary in the payroll period to which it relates.

Employers' augmentation contributions and financial strain contributions are accounted for in the period in which the liability arises. Any amounts due in the year but unpaid will be classed as a current financial asset. Amounts not due until future years are classed as long-term assets.

4.1.2 Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Fund during the financial year and are calculated in accordance with the Local Government Scheme Regulations (see Note 5 which commences on page 146).

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and included in Transfers in (see Note 5 which commences on page 146).

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

4.1.3 Investment Income

Dividend income

Dividend income is recognised in the Fund Account on the date the shares are quoted ex-dividend. Any amounts not received by 31 March are disclosed in the Net Asset Statement as other investment balances due. Investment income also includes withholding tax where this cannot be recovered. The amount of irrecoverable withholding tax is disclosed as a separate line item on the face of the Fund Account, and a more detailed breakdown can be found in Note 12 of the accounting notes that accompany these financial statements.

Income from fixed interest, index linked securities, cash and short term deposits

Income from fixed interest, index linked securities, cash and short-term deposits is recognised in the Fund Account on an accruals basis, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction cost or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

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Income from other investments

Income from other investments is accounted for on an accruals basis. Any amount not received by the end of the reporting period is disclosed in the Net Asset Statement under other investment balances.

Property related income

Property related income consists primarily of rental income. Rental income from operating leases on properties owned by the Fund is recognised on a straight line basis over the term of the lease.

Change in market value of investments

The change in market value of investments is recognised as income during the year and comprises all increases and decreases in market value of investments held at any time during the year, including profits and losses realised on sales of investments and unrealised changes in market value.

4.2 Fund Account – Expense recognition

4.2.1 Benefits Payable

Under the regulations, retirees can receive a lump sum retirement grant in addition to their annual pension. Pensions and lump sum retirement grants are accounted for from the date of retirement. When a member chooses to take a greater retirement grant in return for reduced pension these lump sums are accounted for on an accruals basis from the date that the option is exercised. Any amounts due but not paid are disclosed in the Net Asset Statement as current liabilities.

Other benefits are accounted for on the date the member leaves the Fund or upon death.

4.2.2 Taxation

The Fund is a registered public service scheme under section 1 (1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax accounted for as a fund expense as it arises (see note 12).

As Essex County Council is the administering authority for the Fund, VAT input tax is recoverable on all fund activities including expenditure on investments and property expenses.

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4.2.3 Administration expenses

Administration expenses are accounted for on an accruals basis. All expenses are recognised net of any recoverable VAT. All relevant staff costs including management, accommodation and other overhead costs has been charged direct to the Fund on the basis of time spent on investment related matters and pension administration. In 2011/12 this totalled **£1.299m** (2010/11 £1.182m).

4.2.4 Investment management expenses

All investment management expenses are accounted for on an accruals basis. Fees of the external investment managers and custodian are agreed in their mandates governing their appointments. Broadly these are based on the market value of investments under their management and therefore increase or reduce as the value of investments change. In addition the Fund has negotiated with the following managers that an element of their fee be performance related subject to them reaching a trigger point:

- First State Investments (UK) Limited
- Marathon Asset Management Limited
- FIL Pensions Management

Performance related fees totalled **£0.520m** in 2011/12 (£0.651m in 2010/11).

When an investment manager's fee invoice has not been received by the balance sheet date a creditor has been raised and the actual invoice amount and is shown in current liabilities.

The cost of obtaining investment advice from external consultants is included in investment management charges.

4.3 Net Asset Statement – Financial Asset

Financial assets are included in the Net Asset Statement on a fair value basis as at the financial year end date of 31 March. The financial asset is recognised in the Net Assets Statement on the date the Fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes in fair value of the asset are recognised by the Fund in the Fund Account. Acquisition costs are included in the purchase cost of investments.

The value of investments as shown in the Net Asset Statement has been determined as follows:

▪ Market Quoted Investments

In the majority of cases, market quoted equity investments for which there is a readily available market price is determined by the bid market price ruling on the final day of the accounting period.

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▪ **Unquoted Investments**

The fair value of investments for which market quotations are not readily available is determined as follows:

- For unquoted equity and private equity limited partnerships investments are valued based on the Fund's share of the net assets in the private equity fund or limited partnership using the latest financial statements published by the respective fund managers. There is usually a time delay in receiving information from the private equity fund managers. In general these are valued as at 31 March 2012 and are compiled in accordance with the guidelines issued by the British Venture Capital Association or an equivalent body. In a few cases an estimate of the valuation at 31 March 2012 has been made. The Fund amends the 31 December 2011 valuation for payments made to and payments received from the private equity managers in the period 1 January 2012 to 31 March 2012.
- Investments in unquoted property, timber and infrastructure pooled funds are valued at the net asset value or a single price advised by the fund manager.

▪ **Directly held investments**

Directly held investments include investments in limited partnerships, shares in unlisted companies, trust and bonds. Other unquoted securities typically include pooled investments in property, infrastructure, debt securities and private equity. The valuation of these pooled or directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The valuation standards followed in these valuations adhere to industry guidelines or standards set by the constituent documents of the pool or the management agreement.

▪ **Unit trusts and managed funds**

Unit trusts and managed funds are valued at bid prices provided by the relevant fund managers, which reflect the market value of the underlying investments. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income which is reinvested in the Fund, net of applicable withholding tax.

▪ **Value of fixed interest investments**

The value of fixed interest investments in the Fund's investment portfolio are recorded at net market value based on their current yield i.e. excludes interest earned but not paid over at the Fund year-end, which is included separately within accrued investment income and disclosed within note 9.

▪ **Derivatives**

- The Fund uses derivative financial instruments to manage its exposure to specific risks arising from its investments activities. The Fund does not hold derivatives for speculative purposes.
- Derivative contracts assets are held at fair value bid price and liabilities are fair valued at offer prices. Changes in the fair value of derivatives are included in the change in market value (Note 9).

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- The value of futures contracts is determined using exchange prices published by the relevant futures exchange e.g.: LIFFE – London International Financial Futures Exchange at the reporting date. Amounts due from or owed to the broker are amounts outstanding in respect of the initial margin and variation margin.
- Forward foreign exchange contracts outstanding at year end are stated at fair value, which is determined as the loss or gain that would arise if the outstanding contract was required to be settled on 31 March.

- **Dividends, Interest and Foreign Currencies**

Dividend, interest, purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of transaction. End of year spot market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchases and sales outstanding at the end of the reporting period.

- **Direct Property Investments**

Direct property investments have been valued, at open market value as at 31 March 2012, by Jones Lang LaSalle, Chartered Surveyors. The valuers opinion of market value and existing use value was primarily derived using comparable recent market transactions on arm's-length terms.

- **Cash and Cash Equivalents**

Cash comprises of cash in hand and demand deposits.

Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

4.4 Financial Liabilities

The Fund recognises financial liabilities at fair value as at the financial year end date of 31 March. A financial liability is recognised in the Net Asset Statement on the date the Fund becomes party to the liability. From this date, any gains or losses arising from changes in the fair value of the liability are recognised by the Fund.

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5. Membership activities

5.1 Membership

31 March 2011 <i>Restated</i>		31 March 2012 (Provisional)
43,351	Contributors	42,315
34,723	Deferred pensioners	38,101
30,612	Pensioners	32,269

Deferred pensioners are former employees who have chosen not to transfer their pension rights.

5.2 Pension benefits payable

2010/11 £000 <i>Restated</i>		2011/12 £000
49,311	Administering Authority	52,888
67,784	Scheduled Bodies	74,591
6,519	Admitted Bodies	6,729
4,468	Community Admission Bodies	3,684
2,348	Transferee Admission Bodies	2,872
345	Resolution Bodies	410
<u>130,775</u>		<u>141,174</u>

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5.3 Contributions receivable

5.3.1 By category

Contributions receivable from employers are set out below:

2010/11 £000		2011/12 £000
96,103	Normal	86,582
16	Augmentation	2
71,482	Deficit	66,288
5,505	Other	8,716
173,106		161,588

Other employers' contributions relate to payments for the cost of early retirements.

5.3.2 By type

2010/11 (<i>restated</i>)			2011/12	
Member £000	Employer £000		Member £000	Employer £000
17,448	55,855	Administering Authority	16,646	53,947
23,546	89,573	Scheduled Bodies	24,421	84,230
1,478	5,097	Admitted Bodies	1,352	6,322
4,912	15,545	Community Admission Bodies	3,509	10,579
2,740	6,371	Transferee Admission Bodies	2,416	5,869
229	665	Resolution Bodies	214	641
50,353	173,106		48,558	161,588

During 2011/12 no lump sum contributions in respect of the Actuarial deficiency were received. During 2010/11 lump sum contributions in respect of Actuarial deficiency were received from the Essex Probation of **£0.1m** and an accrual in respect of the Essex Magistrates Court Committee of **£12.556m**.

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5.4 Transfers in from other pension funds

2010/11 £000		2011/12 £000
705	Group transfers	-
26,978	Individual transfers	14,192
27,683	Total	14,192

No amounts were receivable in respect of group transfers from other schemes in 2011/12. During 2010/11 **£0.7m** was received from Suffolk County Council, Ipswich Museum and **£5,000** was received from Metropolitan Police Superannuation Scheme.

5.5 Transfers out to other schemes

2010/11 £000		2011/12 £000
-	Group transfers	-
17,246	Individual transfers	9,946
17,246	Total	9,946

No amounts were payable in respect of group transfers to other schemes during 2011/12 and 2010/11.

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6. Investment income

6.1 By Type

2010/11 <i>Restated</i> £000		2011/12 £000
23,873	Dividends from equities	35,173
3,156	Income from index linked securities	2,978
6,265	Income from pooled property investments	8,469
8,173	Net rent from properties	10,884
5,728	Interest from cash deposits	677
720	Other	951
47,915	Total	59,132

In line with best practice guidelines, net rental income for 2010/11 has been restated to take account of all property expenses and income relating to the Fund's direct property portfolio.

6.2 Investment property net rental

2010/11 £000		2011/12 £000
8,969	Rental Income from investment property	12,093
(796)	Direct operating expenses arising from investment property	(1,209)
8,173	Total	10,884

6.3 Movement in the fair value of investment properties

2010/11			2011/12		
Freehold £000	Leasehold £000	Total £000	Freehold £000	Leasehold £000	Total £000
90,050	27,650	117,700	120,075	27,445	147,520
24,069	3	24,072	36,885	16,401	53,286
-	-	-	(5,958)	-	(5,958)
5,956	(208)	5,748	2,258	(1,066)	1,192
120,075	27,445	147,520	153,260	42,780	196,040

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7. Administrative expenses

2010/11 £000 Restated		2011/12 £000
1,182	Administration and Processing	1,299
413	Actuarial Fees	253
63	Audit fees	64
150	Legal fees	301
8	Other professional fees	5
<u>1,816</u>		<u>1,922</u>

The administration and processing expenses represent a proportion of relevant officers' salaries on the basis of time spent on pensions' administration and investment matters.

8. Investment management expenses

2010/11 £000		2011/12 £000
11,742	Management fees	13,779
391	Custody fees	471
54	Performance monitoring services	58
379	Advisory fees	464
994	Other	1,730
<u>13,560</u>	Total	<u>16,502</u>

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9. Investments

9.1 Value of investments held by managers

The value of investments held by each manager together with investments in private equity, infrastructure, financing and shareholder activism partnerships on 31 March was as follows:

2011			2012		
£m	%		£m	%	
234	6.9	Alliance Bernstein	213	6.1	
396	11.7	Aviva Investors	463	13.3	
293	8.7	Baillie Gifford and Co	290	8.3	
244	7.2	FIL Pensions Management	241	6.9	
180	5.3	First State Investments (UK) Ltd	192	5.5	
169	5.0	Goldman Sachs Asset Management International	171	4.9	
1,137	33.6	Legal and General Investment Management	1,142	32.8	
282	8.3	Marathon Asset Management Ltd	283	8.1	
30	0.9	Mellon Capital Management	26	0.7	
144	4.3	M&G Investments Alpha Opportunities	147	4.2	
54	1.6	M&G Investments Infracapital	67	1.9	
7	0.2	M&G Investments Financing Fund	14	0.4	
12	0.4	Partners Group Management II S.à r.l	36	1.1	
168	5.0	Private Equity/Other	171	4.9	
28	0.8	Record Currency Management	-	-	
5	0.1	Shareholder activism	2	0.1	
-	-	Stafford Timberland Limited	28	0.8	
3,383	100.0		3,486	100.0	

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9.2 Movement in the market value of investments

9.2.1 Reconciliation of movements in investments and derivatives for the year ended 31 March 2012

The table below shows the movement in the market value of the investments held during the financial year, including profits and losses realised on the sales of investments since 1 April 2011.

	Value at 1 April 2011	2011/12 Movement					Value at 31 March 2012
		Purchases	Net Transfers	Sale Proceeds	Change in Market Value	Cash Movement	
	£000	£000	£000	£000	£000	£000	£000
Fixed interest securities							
UK government	57,344	-	(31,718)	(30,000)	4,374	-	-
UK corporate	168,675	-	-	-	1,925	-	170,600
Equities							
UK	343,945	59,515	1,402	(39,127)	3,006	-	368,741
Overseas	1,774,914	462,777	(2,132)	(385,838)	(32,855)	-	1,816,866
Index linked securities	171,839	49,596	(30,898)	(94,797)	31,706	-	127,446
Properties							
Direct property							
UK properties freehold	120,075	36,885	-	(5,958)	2,258	-	153,260
UK properties leasehold	27,445	16,401	-	-	(1,066)	-	42,780
Property unit trusts	234,688	8,496	-	(4,967)	(352)	-	237,865
Private equity							
UK	629	65	-	(283)	(160)	-	251
Overseas	125,635	51,131	-	(32,157)	9,685	-	154,294
Infrastructure							
UK	53,913	10,234	-	(2,358)	4,973	-	66,762
Overseas	12,001	27,126	-	(2,592)	(295)	-	36,240
Timber	-	23,526	-	-	4,655	-	28,181
Active currency	58,341	-	(22,935)	-	(9,730)	-	25,676
Other managed funds							
UK	151,913	12,291	-	(1,205)	(312)	-	162,687
Overseas	4,388	-	-	(2,728)	(937)	-	723
Derivative future contracts	22	-	-	-	(1)	-	21
Cash							
Cash deposits held at the custodian/other							
Sterling	40,393	-	22,935	-	-	(22,377)	40,951
Foreign currency	36,179	-	-	(13,773)	13,773	(8,591)	27,588
Cash deposits held in the margin account							
Sterling	109	-	-	-	-	167	276
Foreign currency	56	-	-	(164)	164	(3)	53
	3,382,504	758,043	(63,346)	(615,947)	30,811	(30,804)	3,461,261
Other investment balances							
Assets							
Amounts receivable for sales of investments	8,082						2,591
Investment income due	5,265						5,494
Liabilities							
Amounts payable for purchase of investments	(9,281)						(4,484)
Investment withholding tax payable	(148)						(127)
Derivative pending foreign currency contracts							
Assets	-						21,632
Liabilities	(3,060)						(45)
	3,383,362						3,486,322

For 2011/12, the total transaction costs were **£1.2m** (2010/11: £1.2m and 2009/10: £2.0m).

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9.2.2 Reconciliation of movements in investments and derivatives for the year ended 31 March 2011

The table below shows the movement in the market value of the investments held during the financial year, including profits and losses realised on the sales of investments since 1 April 2010

	Value at 1 April 2010 £000	2010/11 Movement					Value at 31 March 2011 £000
		Purchases	Net Transfers	Sale Proceeds	Change in Market Value	Cash Movement	
		£000	£000	£000	£000	£000	
Fixed interest securities							
UK government	57,037	3,656	-	(6,146)	2,797	-	57,344
UK corporate	160,734	-	-	-	7,941	-	168,675
Equities							
UK	329,583	31,214	-	(43,941)	27,089	-	343,945
Overseas	1,576,166	430,103	-	(387,859)	156,504	-	1,774,914
Index linked securities	172,895	13,996	-	(24,701)	9,649	-	171,839
Properties							
Direct property							
UK properties freehold	90,050	24,069	-	-	5,956	-	120,075
UK properties leasehold	27,650	3	-	-	(208)	-	27,445
Property unit trusts	186,281	49,838	-	(9,396)	7,965	-	234,688
Private equity							
UK	704	33	-	(430)	322	-	629
Overseas	90,742	39,826	-	(15,592)	10,659	-	125,635
Infrastructure							
UK	45,633	5,479	-	(1,446)	4,247	-	53,913
Overseas	-	12,533	-	(515)	(17)	-	12,001
Timber	-	-	-	-	-	-	-
Active currency	57,357	-	-	-	984	-	58,341
Other managed funds							
UK	148,671	11,192	-	(8,143)	193	-	151,913
Overseas	38,016	-	-	(38,335)	4,707	-	4,388
Derivative future contracts	21	-	-	-	1	-	22
Cash							
Cash deposits held at the custodian/other							
Sterling	80,875	-	33,000	-	-	(73,482)	40,393
Foreign currency	11,682	-	-	(2,168)	2,168	24,497	36,179
Cash deposits held in the margin account							
Sterling	79	-	-	-	-	30	109
Foreign currency	80	-	-	(6)	6	(24)	56
	3,074,256	621,942	33,000	(538,678)	240,963	(48,979)	3,382,504
Other investment balances							
Assets							
Amounts receivable for sales of investments	18,687						8,082
Investment income due	5,721						5,265
Liabilities							
Amounts payable for purchase of investments	(4,609)						(9,281)
Investment withholding tax payable	(178)						(148)
Derivative pending foreign currency contracts							
Assets	1,610						-
Liabilities	(28,896)						(3,060)
	3,066,591						3,383,362

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9.3 Analysis of investments by asset type

An analysis of investment assets at 31 March is shown below.

2011 £000		2012 £000
	Fixed interest securities	
57,344	UK public sector quoted	-
168,675	UK quoted	170,600
	Equities	
71,609	UK quoted	77,437
1,135,418	Overseas quoted	1,114,687
272,336	UK unit trusts	291,304
639,496	Overseas unit trusts	702,179
171,839	Index linked securities: UK public sector quoted	127,446
	Property	
120,075	UK properties (freehold)	153,260
27,445	UK properties (leasehold)	42,780
234,688	Property unit trusts	237,865
	Private equity	
629	UK unquoted	251
125,635	Overseas unquoted	154,294
	Infrastructure	
53,913	UK unquoted	66,762
12,001	Overseas unquoted	36,240
-	Timber: Overseas unquoted	28,181
58,341	Active currency: UK unquoted	25,676
	Other managed funds	
151,913	UK unquoted	162,687
4,388	Overseas unquoted	723
	Derivative contracts	
22	Assets: Derivative future contracts	21
-	Assets: Derivative pending foreign currency contracts	21,632
(3,060)	Liabilities: Derivative liabilities	(45)
	Cash deposits	
	Cash deposits held at custodian/other	
40,393	Sterling	40,951
36,179	Foreign currency	27,588
	Cash deposits held in margin account at GSAM	
109	Sterling	276
56	Foreign currency	53
	Other investment balances	
	Assets	
8,082	Amounts receivable for sales of investments	2,591
5,265	Investment Income Due	5,494
	Liabilities	
(9,281)	Amounts payable for purchase of investments	(4,484)
(148)	Investment withholding tax payable	(127)
3,383,362	Value at 31 March	3,486,322

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9.4 Analysis of pooled investments representing 5% or more of net assets

The Fund holds the following investments in unit trusts/pooled vehicles at 31 March which are in excess of 5% of the value of the Fund:

2011		Unit trust / pooled vehicle	2012	
£000	%		£000	%
272,336	8.0	Legal and General - UK Equity Index	291,304	8.3
213,791	6.3	Legal and General - North America Equity Index	236,344	6.7
217,569	6.4	Legal and General - Europe (Ex UK) Equity Index	224,240	6.4

9.5 Analysis of single investments 5% or more of any asset types

The Fund holds the following single investments at 31 March which are in excess of 5% of any asset class or type of security:

2011		Asset type / Asset name	2012	
£000	%		£000	%
UK QUOTED EQUITIES				
-	-	BP Plc	11,718	15.1%
5,545	7.7%	Astrazeneca	6,354	8.2%
6,395	8.9%	Vodafone Group	5,574	7.2%
5,944	8.3%	Sabmiller plc	5,411	7.0%
5,765	8.1%	Rio Tinto	-	-
UK INDEX LINKED BONDS				
-	-	UK (Govt) Treasury IL Stock 2.5% 16 April 2020	8,156	6.4%
-	-	UK (Govt) Treasury IL Stock 1.250% 22 Nov 2027	7,976	6.3%
-	-	UK (Govt) Treasury IL Stock 1.875% 22 Nov 2022	7,870	6.2%
-	-	UK (Govt) Treasury IL Stock 2.5% 17 Jul 2024	7,545	5.9%
-	-	UK (Govt) Treasury IL Stock 1.25% 22 Nov 2055	6,740	5.3%
-	-	UK (Govt) Treasury IL Stock 1.125% 22 Nov 2037	6,644	5.2%
-	-	UK (Govt) Treasury IL Stock 1.25% 22 Nov 2032	6,621	5.2%
-	-	UK (Govt) Treasury IL Stock 2.0% 26 Jan 2035	6,541	5.1%
8,905	5.2%	UK (Govt) Treasury IL Stock 2.5% 26 July 2016	-	-
PROPERTY				
-	-	48-49 Chancery Lane, London	15,650	8.0%
13,220	9.0%	55-57 Dean Street, London	13,425	6.8%
-	-	971 Great West Road, Brentford	11,400	5.8%
-	-	734-736 Seven Sisters Road	11,200	5.7%
10,600	7.2%	74-82 Western Road	10,600	5.4%
8,350	5.7%	32-36 High Street, Guildford	-	-
8,200	5.6%	Redditch Abbey Retail Park	-	-
8,175	5.5%	Cardiff Gate Business Park, Cardiff	-	-
7,800	5.3%	121 Dunmow Road, Bishops Stortford	-	-
7,750	5.3%	Stortford Hall, Bishops Stortford	-	-

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2011		Asset type / Asset name	2012	
£000	%		£000	%
PROPERTY UNIT TRUSTS				
24,317	10.4%	Aviva Investors Property Fund	25,486	10.7%
-	-	Lothbury Property Fund	20,833	8.8%
-	-	Blackrock UK Property Fund	15,545	6.5%
-	-	Quercus Healthcare Property	14,107	5.9%
-	-	Theadneedle Investment Strategic Property Fund	12,356	5.2%
PRIVATE EQUITY				
12,851	10.2%	Warburg Pincus Private Equity VIII	12,439	8.0%
11,359	9.0%	CVC European E P Tandem Fund	12,185	7.9%
7,709	6.1%	OHA Strategic Credit Fund li (Offshore), L.P	9,954	6.4%
7,495	5.9%	Apollo Overseas Partners VII	9,868	6.4%
9,566	7.6%	Kohlberg TE Investors VI Lp	9,625	6.2%
-	-	New Mountain Partners	7,700	5.0%
14,227	11.3%	Avenue Capital Group	-	-
INFRASTRUCTURE				
53,913	81.8%	Infracapital Partners	66,762	64.8%
12,001	18.2%	Partners Group Global Infrastructure 2009 S.C.A., SICAR	32,447	31.5%
TIMBER				
-	-	Stafford Timberland	28,181	100.0%
ACTIVE CURRENCY				
30,053	51.5%	Mellon Offshore Currency Opp Enhanced UK Equitized Fund	25,676	100.0%
28,288	48.5%	Record Currency Alpha US Equitized Fund	-	-
OTHER MANAGED FUNDS				
144,375	92.4%	M&G Alpha Opportunities Fund	147,102	90.0%
-	-	M&G Financing Fund	13,861	8.5%
DERIVATIVE CONTRACTS				
-	-	S&P 500 Emini Index Futures Exp June 12	21	100.0%
22	100.0%	S&P 500 Emini Index Futures Exp June 11	-	-
CASH				
20,658	26.9%	BNP Paribas Investment Partners GBP Fund	35,060	50.9%
22,347	29.1%	BNY Mellon Euro Liquidity Fund	11,181	16.2%
-	-	BNP Paribas Investment Partners Euro Fund	5,724	8.3%
17,924	23.4%	BNY Mellon Sterling Liquidity Fund	5,535	8.0%
4,643	6.1%	BNP Paribas Investment Partners US\$ Fund	-	-

9.6 Derivative contracts

9.6.1 Objectives and policies for holding derivatives

Most of the holdings in derivatives are to hedge liabilities or hedge exposure to reduce risk in the Fund. Derivatives maybe used to gain exposure to an asset more efficiently than holding the

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underlying asset. The use of derivatives is managed in line with the investment agreement agreed between the Fund and the various investment managers.

9.6.2 Futures

A breakdown of outstanding exchange traded future contracts is as follows

31 March 2011			31 March 2012	
Economic Exposure £000	Market Value £000		Economic Exposure £000	Market Value £000
		Assets		
948	22	Overseas Equities Futures - Less than one year	1,221	21
		Liabilities		
-	-	Overseas Equities Futures - Less than one year	-	-
948	22	Net futures	1,221	21

9.6.3 Forward foreign currency

In order to maintain appropriate diversification and to take advantage of overseas investment returns, **57.9%** (56.1% as at 31 March 2011) of the Fund's portfolio is in overseas stock markets as at 31 March 2012. To reduce the volatility associated with fluctuating currency rates (currency risk) the fund has a passive currency programme in place which is managed by Legal and General Investment Management. The Fund hedges 50% of the US Dollar, Euro and Yen exposure within the portfolios managed by the growth managers.

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9.6.4 Analysis of open forward currency contracts as at 31 March 2012

Settlement	Currency Bought	Local value 000	Currency sold	Local value 000	Asset value £000	Liability value £000
Settled within one month						
Up to one month	GBP	10,375	AUD	15,796	134	
Up to one month	GBP	10,153	CAD	16,065	93	
Up to one month	GBP	13,994	CHF	20,586		(261)
Up to one month	GBP	88,451	EUR	105,658	381	
Up to one month	USD	186	EUR	140		-
Up to one month	AUD	15,796	GBP	10,335		(94)
Up to one month	CAD	16,065	GBP	10,145		(85)
Up to one month	CHF	20,586	GBP	14,324		(69)
Up to one month	EUR	65,728	GBP	55,151		(368)
Up to one month	JPY	5,878,158	GBP	44,523	182	
Up to one month	SEK	71,585	GBP	6,766		(14)
Up to one month	THB	534	GBP	11		-
Up to one month	USD	230,311	GBP	144,836		(688)
Up to one month	GBP	121	HKD	1,510		-
Up to one month	GBP	49,211	JPY	5,863,016	4,621	
Up to one month	GBP	6,676	SEK	71,585		(76)
Up to one month	GBP	149,224	USD	231,182	4,532	
Up to one month	GBP	15	KRW	27,142	15	
Settled within one to six months						
One to six months	GBP	33,115	AUD	50,017	910	
One to six months	GBP	33,584	CAD	53,174	315	
One to six months	GBP	48,998	CHF	70,164	347	
One to six months	GBP	185,092	EUR	220,197	1,407	
One to six months	CHF	2,259	GBP	1,568		(2)
One to six months	EUR	13,692	GBP	11,448		(26)
One to six months	GBP	169,190	JPY	21,466,224	5,751	
One to six months	GBP	24,025	SEK	254,232	97	
One to six months	GBP	442,244	USD	699,102	4,485	
Forward currency contracts unsettled as at 31 March 2012					23,270	(1,683)
Net forward currency contracts as at 31 March 2012						21,587

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9.6.5 Analysis of open forward currency contracts as at 31 March 2011

Settlement	Currency Bought	Local value 000	Currency sold	Local value 000	Asset value £000	Liability value £000
Settled within one month						
Up to one month	AUD	18,606	GBP	11,919	85	
Up to one month	AUD	81	USD	84	-	
Up to one month	CAD	20,884	GBP	13,406		(13)
Up to one month	CHF	20,569	GBP	13,978	48	
Up to one month	CLP	31,773	GBP	43		(2)
Up to one month	DKK	280	GBP	33	-	
Up to one month	EUR	77,234	GBP	68,064	311	
Up to one month	GBP	11,842	AUD	18,606		(161)
Up to one month	GBP	81	BRL	214		(1)
Up to one month	GBP	13,543	CAD	20,884	150	
Up to one month	GBP	13,847	CHF	20,569		(179)
Up to one month	GBP	3	DKK	26		-
Up to one month	GBP	65,830	EUR	78,290		(3,481)
Up to one month	GBP	52,841	JPY	6,808,141	1,595	
Up to one month	GBP	22	MYR	109		-
Up to one month	GBP	9,284	SEK	98,802		(487)
Up to one month	GBP	149,969	USD	232,133	5,153	
Up to one month	JPY	6,939,832	GBP	61,677		(413)
Up to one month	SGD	12	USD	10	-	
Up to one month	TWD	229,540	GBP	143,711		(526)
Settled within one to six months						
One to six months	CHF	2,191	GBP	1,463	34	
One to six months	GBP	32,128	AUD	51,626		(927)
One to six months	GBP	36,902	CAD	58,216		(411)
One to six months	GBP	39,851	CHF	59,378		(696)
One to six months	GBP	198,874	EUR	229,910		(4,577)
One to six months	GBP	146,997	JPY	19,345,174	1,175	
One to six months	GBP	21,520	SEK	221,217		(293)
One to six months	GBP	429,392	USD	686,833	492	
One to six months	USD	11,639	GBP	7,205	64	
Forward currency contracts unsettled as at 31 March 2011					9,107	(12,167)
Net forward currency contracts as at 31 March 2011						(3,060)

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10. Additional Voluntary Contributions (AVC) Investments

AVC's are not included in the accounts in accordance with section 4(2) (b) of the Local Government Pension Scheme (Management and Investments of Funds) Regulations 2009 but are disclosed as a note only.

The AVC providers to the Fund are the Equitable Life Assurance Society and Standard Life Assurance Company. The assets of these investments are held separately from the Fund. The AVC providers secure additional benefits on a money purchase basis for those members electing to pay additional voluntary contributions. Members participating in these arrangements each receive an annual statement confirming the amounts held in their account and the movements in the year.

The Fund relies on individual contributors to check that deductions made on their behalf are accurately reflected in the statements provided by the AVC providers. A summary of the information provided by Equitable Life and Standard Life to the Fund is shown in the table below.

2010/11		2011/12
£000		£000
6,050	Value of AVC fund at beginning of year	5,996
421	Employees contributions	383
361	Investment income and change in market value	307
(836)	Benefits paid and transfers out	(877)
<u>5,996</u>		<u>5,809</u>

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11. Current assets and liabilities

11.1 Analysis of current assets and liabilities

31 March 2011 £000		31 March 2012 £000
Current assets		
540	Cash at bank	1,077
12,610	Cash on short term deposit <3 months	9,008
<u>13,150</u>		<u>10,085</u>
	Debtors and payments in advance	
	Contributions due	
1,992	Contributions due – employees	3,470
15,588	Contributions due – employers	14,463
1,166	Sundry debtors	1,218
<u>18,746</u>		<u>19,151</u>
Current liabilities		
	Creditors and receipts in advance	
(7,026)	Contributions due – employers	(1,305)
(4,533)	Investment manager fees payable	(3,133)
(1,603)	Benefits payable	(2,104)
(457)	Other	(329)
<u>(13,619)</u>		<u>(6,871)</u>
(55)	Receipts in advance	-
<u>18,222</u>	Net total	<u>22,365</u>

In line with latest best practice guidelines, contributions due for 2010/11 have been restated to show the proportion due from employees and employers. In addition financial strain debtors have now been split between amounts due within 12 months and amounts due after 12 months.

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11.2 Analysis of debtors and creditors

31 March 2011 £000		31 March 2012 £000
Debtors and payments in advance		
1,618	Central Government	2,222
8,793	Other Local Authorities	13,949
-	NHS Bodies	38
1,440	Public Funded Bodies	1,681
6,895	Other	1,261
18,746		19,151
Creditors and receipts in advance		
(180)	Central Government	(333)
(489)	Other Local Authorities	(1,093)
(15)	Public Funded Bodies	(197)
(12,990)	Other	(5,248)
(13,674)		(6,871)
5,072	Net total	12,280

In line with latest best practice guidelines, contributions due for 2010/11 have been restated to show the proportion due from employees and employers. In addition financial strain debtors have now been split between amounts due within 12 months and amounts due after 12 months.

11.3 Analysis of long term debtors by duration

31 March 2011 Restated £000		31 March 2012 £000
1,128	Financial strain instaments due >12 months	1,037
11,300	Other employer contributions due >12 months	10,044
12,428	Total	11,081

Long term debtors for 2010/11 have been restated in line with new best practice. Financial strain debtors have now been split between amounts due within 12 months and amounts due after 12 months.

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11.4 Analysis of long term debtors

31 March 2011 <i>Restated</i> £000		31 March 2012 £000
11,312	Central Government	10,152
1,082	Other Local Authorities	852
28	Public Funded Bodies	77
6	Other	-
12,428	Total	11,081

Long term debtors for 2010/11 have been restated in line with new best practice. Financial strain debtors have now been split between amounts due within 12 months and amounts due after 12 months.

11.5 Contingent assets

To protect the Fund from employer default the Funding Strategy sets out safeguards to be in place on all new admission agreements. These can include a guarantee from another Fund employer with sufficient covenant strength, and a surety bond or other contingent asset.

11.6 Contingent liabilities and contractual commitments

As at 31 March 2012, the Fund had a commitment to contribute a further **£182m** to its existing partnership investments, including private equity, infrastructure, timber and financing (31 March 2011, £221m). The amounts called by these funds are irregular in both size and timing over a period of between five to ten years from the date of each original commitment.

12. Taxes on income

The table below provides a breakdown of the taxes paid by the Fund in the UK and overseas.

2010/11 £000		2011/12 £000
1,697	UK withholding tax	1,968
435	Overseas withholding tax	493
2	Payment to HMRC in respect of returned contributions	2
2,134		2,463

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13. Related party transactions

The Fund is required to disclose material transactions with bodies or individuals that have the potential to control or influence the Council, or to be controlled or influenced by the Council. The intention in making this disclosure is to make explicit the extent to which the Fund might have been constrained in its ability to operate independently, or might have secured the ability to limit another party's ability to negotiate freely with the Fund.

The Essex Pension Fund is administered by Essex County Council.

The Council incurred costs of **£1.299m** in 2011/12 (£1.182m in 2010/11) in relation to the administration of the Fund and was subsequently reimbursed by the Fund for these expenses. The Council is also the single largest employer of members of the Fund and contributed **£53.947m** to the Fund in 2011/12 (£55.855m in 2010/11). No significant amounts were owing to and due to be paid from the Fund in the year.

As at the 1 April 2010 the Fund put in place a separate bank account arrangement. Before this, the Pension Fund cash was aggregated with the County Council's balance. Surplus cash is invested by the County Council treasury management team on the sterling money market, in accordance with the Essex Pension Fund treasury management policy and strategy as agreed by the Essex Pension Fund Board on 31 March 2010. This service is provided to the Fund at a cost of **£0.025m** (£0.022m in 2010/11).

During the year to 31 March 2012, the Pension Fund had an average investment balance of **£8.174m** (£10.518m in 2010/11) earning **£0.920m** interest (£0.111m in 2010/11).

Under FRS 8 'Related Party Disclosures' it is a requirement that material transactions with related parties, not disclosed elsewhere, should be included in a note to the financial statements. During the year each member of the Essex Pension Board and Investment Steering Committee is required to declare their interests at each meeting. None of the Essex Pension Board Members, Investment Steering Committee Members or Senior Officers undertook any material transactions with the Essex Pension Fund. There were no material contributions due from the employer bodies at the end of the year that remained outstanding after the due date for payment.

14. Financial Instruments

14.1 Classification of financial instruments

The following table analyses the carrying amounts of financial assets and liabilities by category and Net Asset Statement headings. No financial assets were reclassified during the accounting period.

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31 March 2011			Asset type	31 March 2012		
Designated as fair value through profit and loss £000	Loans and receivables £000	Financial liabilities at amortised cost £000		Designated as fair value through profit and loss £000	Loans and receivables £000	Financial liabilities at amortised cost £000
			Financial assets			
226,019			Fixed interest securities	170,600		
2,118,859			Equities	2,185,607		
171,839			Index linked securities	127,446		
234,688			Pooled unit trusts	237,865		
126,264			Private equity	154,545		
65,914			Infrastructure	99,208		
-			Timber	28,181		
58,341			Active currency	25,676		
156,301			Other managed funds	163,410		
22			Derivative contracts	21,653		
	89,887		Cash		78,953	
13,347			Other investment balances	8,085		
	31,174		Debtors		30,232	
3,171,594	121,061	-		3,222,276	109,185	-
			Financial liabilities			
(3,060)			Derivative contracts	(45)		
(9,429)			Other investments balances	(4,611)		
		(13,674)	Creditors			(6,871)
		-	Borrowing			-
(12,489)	-	(13,674)		(4,656)	-	(6,871)
3,159,105	121,061	(13,674)	Balance at the end of the year	3,217,620	109,185	(6,871)
		3,266,492	Total			3,319,934

14.2 Net gains and losses on financial instruments

Asset value as at 31 Mar 2011 £000		Asset value as at 31 Mar 2012 £000
Financial assets		
233,041	Fair value through profit and loss	16,130
2,174	Loans and receivables	13,937
235,215		30,067
Financial liabilities		
-	Fair value through profit and loss	-
-	Loans and receivables	-
-		-
235,215	Total	30,067

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14.3 Fair value of financial instruments and liabilities

Carry value as at 31 Mar 2011 £000	Fair value as at 31 Mar 2011 £000		Carry value as at 31 Mar 2012 £000	Fair value as at 31 Mar 2012 £000
		Financial assets		
3,171,594	3,171,594	Fair value through profit and loss	3,222,276	3,222,276
121,061	121,061	Loans and receivables	109,185	109,185
3,292,655	3,292,655		3,331,461	3,331,461
		Financial liabilities		
(12,489)	(12,489)	Fair value through profit and loss	(4,656)	(4,656)
-	-	Loans and receivables	-	-
(13,674)	(13,674)	Financial liabilities measured at amortised cost	(6,871)	(6,871)
(26,163)	(26,163)		(11,527)	(11,527)
3,266,492	3,266,492	Total net financial assets	3,319,934	3,319,934

14.4 Valuation of financial instruments carried at fair value

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

- **Level 1** – Financial instruments at Level 1 are those where the fair value are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Assets classified as Level 1 comprise of equities, quoted fixed securities, quoted index linked securities and unit trusts. Listed investments are shown at bid prices. The bid value of the investments is based on bid market quotation of the relevant stock exchange.
- **Level 2** – Financial instruments at Level 2 are those where quoted market prices are not available, for example where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.
- **Level 3** – Financial instruments classified as Level 3 are those where at least one input that could have significant effect on the instruments valuation is not based on observable market data.

Such instruments would include unquoted equity investments which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The value of the investment in private equity is based on valuations provided by the general partners to the private equity funds in which the Essex Pension Fund has invested.

These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines, which follow the valuation principles of IRRS and US GAAP. Valuations are usually undertaken annually at the end of December with unaudited valuations provided by the general partner as at 31 March.

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The valuations of infrastructure and timber are based on net asset value provided by the fund manager.

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Level 1 to 3 based on the level at which the fair value is observable.

Carry value as at 31 Mar 2011 £000	Fair value as at 31 Mar 2011 £000		Carry value as at 31 Mar 2012 £000	Fair value as at 31 Mar 2012 £000
		Financial assets		
3,171,594	3,171,594	Fair value through profit and loss	3,222,276	3,222,276
121,061	121,061	Loans and receivables	109,185	109,185
3,292,655	3,292,655		3,331,461	3,331,461
		Financial liabilities		
(12,489)	(12,489)	Fair value through profit and loss	(4,656)	(4,656)
-	-	Loans and receivables	-	-
(13,674)	(13,674)	Financial liabilities measured at amortised cost	(6,871)	(6,871)
(26,163)	(26,163)		(11,527)	(11,527)
3,266,492	3,266,492	Total net financial assets	3,319,934	3,319,934

15. Nature and Extent of Risks arising

15.1 Risk and risk management

The Fund's primarily long term risk is that the Fund assets will fall short of its liabilities i.e. promised benefits payable to members. Therefore the aim of investment risk management is to maximise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole of the Funds investments. The Fund achieves this through asset diversification to reduce its exposure to a variety of financial risks: market risk; price risk; currency risk; interest rate risk and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows. The Council manages these investment risks as part of its overall pension fund risk management programme.

Responsibility for the Fund's risk management strategy rests with the Investment Steering Committee (ISC). Risk management policies are established to identify and analyse the risks faced by the Council's pensions operations. Policies are reviewed regularly to reflect changes in activity and in market conditions.

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15.2 Market risk

Market risk is the possibility that financial loss might occur as a result of fluctuations in equity and commodity prices, interest rates and foreign exchange. The level of risk exposure depends on market conditions, expectation of future price and yield movements and the asset mix.

Market risk is inherent in the investments that the Fund makes. To mitigate market risk the investments are made in a diversified pool of asset classes and investment approaches to ensure a risk adjusted balance between categories. The Fund takes formal advice from its institutional investment consultant, Hymans Robertson LLP along with two independent advisers and the portfolio is split between a number of managers and investment strategies with different benchmarks and performance targets. Full details can be found in the Statement of Investment Principles which is available from the website www.essexpensionfund.co.uk. Investment risk and strategy are regularly reviewed by the Investment Steering Committee (ISC).

15.3 Other price risk

Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk) whether those changes are caused by factors specific to the individual instrument, its issuer or factors affecting all such instruments in the market.

The Fund is exposed to share and derivative price risk. This arises from investments held by the Fund for which the future price is uncertain. All investments present a risk of loss of capital. The level of volatility will vary by asset class and also over time. The Fund has some diversification in the asset classes in which it invests, which seeks to reduce the correlation of price movements between different asset types, while employing specialist investment managers to best deploy capital in line with the Funds overall strategy. The LGPS investment regulations also contain prescribed limits to avoid over-concentration in specific areas.

15.4 Other price risk sensitivity analysis

In consultation with its institutional consultants, Hyman Robertson, an analysis of historical data and expected return movements during the accounting periods in question was undertaken. The table below shows the potential price movements deemed possible for the accounting period 2012/13.

The percentages shown in the following table are broadly consistent with a movement of one standard deviation in the value of the Fund's assets, and assumes that all other variables in particular foreign exchange rates and interest rates remain unchanged.

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Asset type	Potential Market movement %
UK bonds	9.9%
UK equities	18.5%
Overseas equities	22.2%
UK index linked bonds	7.8%
Pooled property unit trusts	14.5%
Private equity	29.6%
Infrastructure funds	14.5%
Timber	29.6%
Property	14.5%
Cash	0.8%
Currency active	22.2%

Had the market price of the Fund investments increased/ (decreased) in line with the above assumptions the change in the net assets available to pay benefits would have been as follows:

31 Mar 2011 £000	Percentage change %	Value increase £000	Value decrease £000	Asset type	31 Mar 2012 £000	Percentage change %	Value increase £000	Value decrease £000
76,737	0.8%	77,351	76,123	Cash and equivalents	68,868	0.8%	69,419	68,317
				Investment portfolio assets				
226,019	9.9%	248,395	203,643	UK bonds	170,600	9.9%	187,489	153,711
343,945	18.5%	407,575	280,315	UK equities	368,741	18.5%	436,958	300,524
1,774,914	22.2%	2,168,945	1,380,883	Overseas equities	1,816,866	22.2%	2,220,210	1,413,522
171,839	7.8%	185,242	158,436	UK index linked bonds	127,446	7.8%	137,387	117,505
234,688	14.5%	268,718	200,658	Pooled property unit trusts	237,865	14.5%	272,355	203,375
126,264	29.6%	163,638	88,890	Private equity	154,545	29.6%	200,290	108,800
65,914	14.5%	75,472	56,356	Infrastructure	103,002	14.5%	117,937	88,067
-	-	-	-	Timber	28,181	29.6%	36,523	19,839
58,341	22.2%	71,293	45,389	Active currency	25,676	22.2%	31,376	19,976
156,301	14.5%	178,965	133,637	Other managed funds	163,410	14.5%	187,104	139,716
147,520	14.5%	168,910	126,130	Property	196,040	14.5%	224,466	167,614
(3,038)	-	(3,038)	(3,038)	Net derivative assets	21,608	-	21,608	21,608
5,265	-	5,265	5,265	Investment income due	5,494	-	5,494	5,494
(148)	-	(148)	(148)	WHT payable	(4,484)	-	(4,484)	(4,484)
8,082	-	8,082	8,082	Amounts receivable for sales	2,591	-	2,591	2,591
(9,281)	-	(9,281)	(9,281)	Amounts payable for purchases	(127)	-	(127)	(127)
3,383,362		4,015,383	2,751,341	Total assets available to pay benefits	3,486,322		4,146,596	2,826,048

15.5 Sensitivity of funding position to market conditions and investment performance

When preparing the formal valuation the Actuary takes the assets of the Fund at market value on the valuation date. Volatility in investment performance as a result of market risk factors can have an immediate and tangible effect on the funding level and deficit.

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Less obvious is the effect of anticipated investment performance on the Fund's liability to pay future pension benefits. Here, the returns available on government bonds (gilts) are important, as the discount rate that is used to place a value on liabilities is the gilt yield at the valuation date plus a margin of 2.5% per annum (pre retirement) and 1.0% per annum (post retirement). Effectively if the gilt yield rises the discount rate will increase and all other things being equal the value placed on liabilities will fall. If the Fund was invested entirely in gilts rather than potentially higher returning assets the discount rate would be lower as no margin for performance over gilts could be assumed.

15.6 Interest rate risk

The Fund invests in financial assets for the primarily purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk primarily impacts on the valuation of the Funds' bond holdings and to a lesser degree the return it receives on cash held. The Fund has three bond mandates; one passive bond mandate with Legal & General and two bond mandates with M&G Investments (M&G) and Goldman Sachs Asset Management (GSAM) which their exposure is actively managed.

The Fund's direct exposure to interest rate movements as at 31 March 2012 and 31 March 2011 are shown below. The underlying assets are shown at their fair value.

Asset value as at 31 Mar 2011 £000	Asset type	Asset value as at 31 Mar 2012 £000
76,737	Cash and cash equivalents	68,868
13,150	Cash balances	10,085
226,019	Fixed interest securities	170,600
171,839	Index-linked securities	127,446
487,745	Total assets	376,999

15.7 Interest rate risk sensitivity analysis

Interest rates over the last 24 months have remained constant but this is not always the case and can vary as a result any variation in interest rates affects the level of income achievable and the value of the net assets of the Fund to pay benefits. The Fund's institutional consultants, Hymans Robertson, has undertaken a sensitivity analysis and advised that it is reasonable in today's climate that a movement increase/(decrease) of not more than 100 basis points on a year to year basis is possible based on past experience.

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The table below shows the effect in the year on the net assets available to pay benefits of an increase/(decrease) of 100 basis points change in interest rates assuming all other factors remain unchanged.

Asset value as at 31 Mar 2011 £000	Change in year in the net assets to pay benefits		Asset type	Asset value as at 31 Mar 2012 £000	Change in year in the net assets to pay benefits	
	+100 BPS £'000	-100 BPS £'000			+100 BPS £'000	-100 BPS £'000
76,737	767	(767)	Cash and cash equivalents	68,868	689	(689)
13,150	132	(132)	Cash balances	10,085	101	(101)
226,019	2,260	(2,260)	Fixed interest securities	170,600	1,706	(1,706)
171,839	1,718	(1,718)	Index-linked securities	127,446	1,274	(1,274)
487,745	4,877	(4,877)	Total change in assets available	376,999	3,770	(3,770)

15.8 Currency risk

Currency risk is the extent to which the fair value of future cash flows of a financial asset/liability will fluctuate due to changes in exchange rates. The Fund is exposed to currency risk on all assets that are denominated in any currency other than sterling, its reporting currency. To reduce the volatility associated with fluctuating currency rates the ISC has for the Fund put in place a passive currency overlay programme which is managed by Legal and General Investment Management. The Fund hedges 50% of the US Dollar, Euro and Yen exposure within the portfolios managed by the growth managers.

The following table summaries the Fund's currency exposure as at 31 March 2012 and prior year:

Asset value as at 31 Mar 2011 £000	Asset type	Asset value as at 31 Mar 2012 £000
1,135,418	Overseas equities quoted	1,114,687
639,496	Overseas unit trusts	702,179
125,635	Overseas private equity	154,294
12,001	Overseas Infrastructure	36,240
-	Overseas Timber	28,181
4,388	Overseas managed funds unquoted	723
1,916,938	Total overseas assets	2,036,304

15.9 Currency risk sensitivity analysis

In consultation with the Fund's institutional consultant, Hymans Robertson the Fund considers the likely volatility associated with exchange rate movements to be in the region of 12% (approximately one standard deviation) assuming other factors remain constant.

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The table below shows the effect of a 12% strengthening/weakening of the pound against the investments the Fund holds in various other currencies. The increase/ (decrease) on the net assets of the Fund are as follows:

Asset value as at 31 Mar 2011 £000	Change in year in the net assets to pay benefits		Asset type	Asset value as at 31 Mar 2012 £000	Change in year in the net assets to pay benefits	
	+12% £000	-12% £000			+12% £000	-12% £000
1,135,418	1,271,668	999,168	Overseas equities quoted	1,114,687	1,248,449	980,925
639,496	716,236	562,756	Overseas unit trusts	702,179	786,440	617,918
125,635	140,711	110,559	Overseas private equity	154,294	172,809	135,779
12,001	13,441	10,561	Overseas infrastructure	36,240	40,589	31,891
-	-	-	Overseas timber	28,181	31,563	24,799
4,388	4,915	3,861	Overseas managed funds unquoted	723	810	636
1,916,938	2,146,971	1,686,905	Total change in assets available	2,036,304	2,280,660	1,791,948

15.10 Credit Risk

Credit risk is the possibility that the counterparty to a transaction or a financial instrument might fail in its obligation to pay amounts due to the Pension Fund resulting in a financial loss. The market value of investments reflects an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial assets and liabilities.

The Fund is exposed to credit risk in all its operational activities through forward currency contracts, derivative positions (futures) and treasury management activities. However, the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

15.11 Commercial

Commercial credit risk also arises with those organisations that pay monies over to the Fund (debtors) as part of the administration function, principally contributions from employers and transfers in from other registered pension schemes.

Except in certain bulk transfer cases, the Fund does not apply service credits in respect of transfers in until cash settlement is made.

Monthly receipt of contributions is closely monitored by the Contribution's team. In addition, member records are undated throughout the year by Pensions Services with any new information provided to them. At the end of the financial year employers are required to provide Pensions Services with an annual return which is used to reconciliation both member information and the contributions paid over in the year by both the employee and the employer.

The Funding Strategy Statement requires safeguards to be in place on all new admission agreements to protect the Fund from an employer default, including through a guarantee from a

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tax backed scheme employer for any new body. An analysis of debtor balances at 31 March 2012 is provided in Note 11.

15.12 Forward currency contracts

Forward currency contracts are undertaken by Legal & General for the passive currency overlay programme and by the Funds appointed fund managers. The largest single contracts are entered into for the overseas equity passive currency overlay; the counterparties on these contracts as at 31 March 2012 are shown in the table below. The counterparty on contracts entered into by other investment managers is at the discretion of those managers. All parties entering into forward contracts on behalf of the Fund are FSA regulated and meet the requirements of the LGPS (Management & Investment of Funds) Regulations 2009. Further details of forward foreign exchange contracts are provided in note 9.

Exposure at 31 March 2011		Counterparty	Exposure at 31 March 2012	
£000	%		£000	%
49,525	3.3%	Barclays Capital	157,422	10.5%
122,149	8.2%	BNP Paribas Capital Markets	87,791	5.9%
-	-	Citigroup	137,641	9.2%
104,757	7.0%	Australian Commonwealth Bank	185,608	12.4%
164,726	11.0%	Credit Suisse AG	223,750	15.0%
132,522	8.9%	Deutsche Bank AG	143,588	9.6%
147,100	9.9%	HSBC	51,781	3.5%
251,447	16.9%	J P Morgan Securities	212,285	14.2%
100,227	6.7%	RBS	114,075	7.6%
57,722	3.9%	Royal Bank of Canada	78,739	5.3%
-	-	SEB	9,840	0.7%
205,032	13.7%	SG Securities	-	-
119,070	8.0%	UBS	87,944	5.9%
37,052	2.5%	Westpac Bank Corp	3,593	0.2%
1,491,329	100.0%	Total	1,494,057	100.0%

15.13 Futures

Futures contracts entered into by the Fund are all exchange traded. As a consequence, credit risk is minimised as counterparties are recognised financial institutions with acceptable credit ratings determined by a recognised rating agency. At the 31 March 2012 the contracts in place were all traded in the US on the Chicago Mercantile Exchange (CME). Further details of these futures contracts are provided in note 9. In these transactions the clearing broker Goldman Sachs acts as counterparty to both sides of the contract (buyer and seller). The clearing broker requires both parties to put up an initial amount of cash (variation margin). All positions are then

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marked to market daily, with margins required to be posted and maintained at all times. This minimises the risk of default by either party. In the event that a client does default, FSA rules state that the broker must make good the position to the extent that it is able, primarily through accessing the other party's variation margin. The ultimate default risk therefore lies with Goldman Sachs and their balance sheet strength but is underpinned by the contractual requirement for variation margin. Goldman Sachs is a registered deposit taking institution and therefore monies posted to it are held under banking regulation rather than in accordance with FSA client money rules.

15.14 Bonds

Credit risk will also be considered by the Fund's bond managers in their portfolio construction. A bond is a saleable debt instrument issued by a corporation, government or other entity, the instrument may be purchased direct from the issuer or in the secondary market.

In addition to the passive manager, Legal & General, the Fund has two active bond managers M&G and GSAM the former also manage a financing fund.

Both M&G and GSAM manage pooled assets against a LIBOR plus benchmark. At 31 March 2012, the average credit quality of the M&G bond mandate was A- rated (A+ rated as at 31 March 2011) and the portfolio had suffered 4 defaults since inception, none have been experienced in the financial year ended 31 March 2012. The average credit rating of the financing fund was BB rated as at 31 March 2012 (BB rated as at 31 March 2011), and the portfolio has not suffered any defaults since inception. The portfolio managed by GSAM as at 31 March 2012 had an average credit quality of AA+ (AA- rated as at 31 March 2011) and has suffered two defaults since inception both occurring 2011/12.

15.15 Cash held on deposit and current accounts

Cash managed internally – The Fund has operated a separate bank account since 1 April 2010 with Lloyd's TSB Bank plc, which is also banker to the Administering Authority. The bank holds an A (A+ in 2010/11) long term credit rating with Standard and Poors. Cash is not invested with Lloyd's TSB but is placed with institutions on the Administering Authority's approved counter-party list. The management of cash is carried out by the Treasury Management function of the Administering Authority in accordance with the treasury management policy and strategy approved by the Essex Pension Board. The Board have approved the management of cash in accordance with the policies and practices followed by the Administering Authority for its own investments as outlined in the CIPFA Code of Practice for Treasury Management in the Public Services. The Authority sets detailed credit criteria having taken independent advice and has maximum exposure limits to any single institution. Details of such are shown in the following tables. At 31 March 2012 **£10.085m** (£13.150m as at 31 March 2011) was under management by the Administering Authority's Treasury Management Team. Over the last five financial years the Pension Fund has no experience of default or uncollectible deposits.

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Cash managed externally – The majority of the cash held by the Fund’s custodian, the Bank of New York Mellon (BNY Mellon) is swept overnight to one of two AAA rated money market funds. The historical experience of default from AAA rated entities detailed in the table below is nil. As at 31 March 2012, the total balance held in the Sterling, US dollar and Euro AAA money market funds was **£58.716m** with a smaller balance of **£9.761m** held in the BNY Mellon current account (£69.944m and £6.477m as at 31 March 2011 respectively). The use of a money market fund provides an underlying diversification of counter-party and avoids exposure to a single institutional balance sheet, in this case the custodian.

The table below provides a breakdown of where the Pension Fund cash is managed:

31 March 2011			31 March 2012	
£000	Rating		Rating	£000
Cash managed externally				
Cash held on deposit				
28,825	AAA	BNP Paribas Investment Partners	AAA	40,851
41,119	AAA	BNY Mellon Liquidity Fund	AAA	17,865
Cash held in Current Account				
6,477	AA	The Bank of New York Mellon	AA	9,761
151	AA	Barclays plc	A+	62
Cash held in a Margin Account				
165	A	Goldman Sachs	A-	329
<u>76,737</u>		Total cash managed externally		<u>68,868</u>
Cash managed internally				
Cash held on deposit				
7,000	AA	Barclays Bank	A+	3,002
5,000	A	Royal Bank of Scotland Group	A	3,004
610	AA	Santander UK	AA	-
-		Svenska Handelsbanken	AA-	3,001
Cash held in Current Account				
540	A+	Lloyds TSB Bank plc	A	1,078
<u>13,150</u>		Total cash managed internally		<u>10,085</u>
<u>89,887</u>		Total		<u>78,953</u>

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The following table summarises the maximum exposure to credit risk of the cash held with the Administering Authority's Treasury Management Team and the Bank of New York Mellon.

31 March 2011		31 March 2012	Maximum limit per Financial Institution	Historical risk of default	Estimated maximum exposure to default and uncollectability
£000		£000	£000	%	£000
Cash managed externally					
	Deposit with bank and other financial institutions				
69,944	AAA Rated	58,716	60,000	-	-
6,628	AA Rated	9,761	-	0.03%	3
165	A Rated	391	-	0.08%	-
<u>76,737</u>	Total cash managed externally	<u>68,868</u>			<u>3</u>
Cash managed internally					
	Deposit with bank and other financial institutions				
7,610	AA Rated	6,003	10,000	0.03%	2
5,540	A Rated	4,082	5,000	0.08%	3
<u>13,150</u>	Total cash managed internally	<u>10,085</u>			<u>5</u>
<u>89,887</u>	Total cash	<u>78,953</u>			<u>8</u>

15.16 Liquidity Risk

Liquidity risk is the possibility that the Fund might not have adequate cash resources available to meet its financial commitments as they fall due.

The ISC reviews its strategy on a yearly basis and where necessary takes steps to ensure that the Fund has adequate readily realisable resources to meet its financial commitments. The majority of the Fund's investments are quoted on major stock markets and are in readily realisable form. The Fund's strategic allocation to alternative investments, which are relatively illiquid, was as a result of a review of strategic asset allocation on 22 February 2012, 27.0% of the Fund's assets. The Fund is relatively immature with almost as many contributors as pensioners, dependants and deferred pensioners. In consequence the Fund has a positive cash flow and is able to pay benefits from contributions received. As the Fund is not in the position of a forced seller (i.e. it does not need to sell assets in order to pay benefits), it is considered appropriate to hold such illiquid investments to increase diversification, minimise risk and improve long-term investment performance.

The Fund as at 31 March 2012 had immediate access to its pension fund cash holdings held internally and externally of **£78.953m** (£89.887m as at 31 March 2011). These monies are primarily invested on an over night basis on the money market.

Officers of the Fund prepare periodic cash flow forecasts to understand and manage the timing of the Funds cash flows. The Statement of Investment Principles outlines the appropriate strategic level of cash balances that the Fund can hold. More detail can be found in the Pension Fund Annual Report and Accounts. In consultation with its institutional consultants, Hymans

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Robertson, the Fund is currently preparing a future cash flow forecast modelling tool which will incorporate the affects of the potential regulatory changes to the future of the scheme which is due to take effect in 2014/15.

15.17 Refinancing Risk

Refinancing risk is the risk of the Fund replenishing a significant proportion of its financial assets at a time of unfavourable interest rates. The Fund is not subject to this particular risk as it does not hold any assets that would require refinancing in the future.

15.18 Custody

In 2006 the Fund appointed BNY Mellon as a global custodian with responsibility for safeguarding the assets of the Fund. As at 31 March 2012 BNY Mellon had \$26.6 trillion of assets under custody making it the world's largest global custodian and had a credit rating of AA-. During 2011/12 the Fund underwent a retender process in respect of its custody services. BNY Mellon was unsuccessful in retaining the contract. The new custodian's contract will commence from October 2012. Monthly reconciliations are performed between the underlying records of the custodian and all investment managers and partnerships of the Fund.

15.19 Investment Management

The Fund has appointed a number of segregated and pooled fund managers to manage portions of the Fund. An Investment Management Agreement is in place for each relationship. All appointments meet the requirements set out in the LGPS (Management and Investment of Funds) Regulations 2009. Reports on manager performance are monitored by the ISC on a quarterly basis. The Fund makes use of a third party performance measurement service BNY Mellon Performance & Risk Analytics Europe Limited. In addition to presenting to the ISC, managers also meet with Fund officers and advisers to review progress.

16. Further information

The Council publishes a separate Pension Fund Annual Report and Accounts. Copies may be obtained from the website www.essexpensionfund.co.uk or by contacting:

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