Essex Pension Fund Board

14:00	Wednesday, 09 July 2014	Committee Room 2, County Hall, Chelmsford, Essex

Please note that there will be pre-meeting training on Accounting and Audit regulations for all Board Members in Committee Room 6 between 12.00pm and 1.00pm. Lunch will be provided.

Quorum: 4

Membership	**Representing**
Councillor R Bass	Essex County Council (Chairman)
Councillor S Barker	Essex County Council
Councillor K Clempner	Essex County Council
Councillor N Hume	Essex County Council
Councillor N Le Gresley	Essex County Council
Councillor J Whitehouse	Essex County Council
Councillor J Archer	Maldon District Council
Councillor R Woodley	Southend-on-Sea Borough Council
Councillor M Danvers	Essex Fire Authority
Mr K Blackburn	Scheme Members
Ms J Moore	Smaller Employing Bodies
Mr C Garbett	Essex Police and Crime Commissioner

For information about the meeting please ask for:
Ian Myers, Senior Committee Officer
Telephone: 01245 430481
Email: ian.myers@essex.gov.uk

Essex County Council

Essex County Council and Committees Information

All Council and Committee Meetings are held in public unless the business is exempt in accordance with the requirements of the Local Government Act 1972.

Most meetings are held at County Hall, Chelmsford, CM1 1LX. A map and directions to County Hall can be found at the following address on the Council's website: http://www.essex.gov.uk/Your-Council/Local-Government-Essex/Pages/Visit-County-Hall.aspx

There is ramped access to the building for wheelchair users and people with mobility disabilities.

The Council Chamber and Committee Rooms are accessible by lift and are located on the first and second floors of County Hall.

If you have a need for documents in the following formats, large print, Braille, on disk or in alternative languages and easy read please contact the Committee Officer before the meeting takes place. If you have specific access requirements such as access to induction loops, a signer, level access or information in Braille please inform the Committee Officer before the meeting takes place. For any further information contact the Committee Officer.

Induction loop facilities are available in most Meeting Rooms. Specialist head sets are available from Duke Street and E Block Receptions.

The agenda is also available on the Essex County Council website, www.essex.gov.uk From the Home Page, click on 'Your Council', then on 'Meetings and Agendas'. Finally, select the relevant committee from the calendar of meetings.

Please note that an audio recording may be made of the meeting – at the start of the meeting the Chairman will confirm if all or part of the meeting is being recorded.

Part 1

(During consideration of these items the meeting is likely to be open to the press and public)

Exempt Items

(During consideration of these items the meeting is not likely to be open to the press and public)

To consider whether the press and public should be excluded from the meeting during consideration of an agenda item on the grounds that it involves the likely disclosure of exempt information as specified in Part I of Schedule 12A of the Local Government Act 1972 or it being confidential for the purposes of Section 100A(2) of that Act.

In each case, Members are asked to decide whether, in all the circumstances, the public interest in maintaining the exemption (and discussing the matter in private) outweighs the public interest in disclosing the information.

19 **Procurement Update**

- Information relating to the financial or business affairs of any particular person (including the authority holding that information);

20 **Urgent Exempt Business**

To consider in private any other matter which in the opinion of the Chairman should be considered by reason of special circumstances (to be specified) as a matter of urgency.

Minutes of a meeting of the Essex Pension Fund Board held at 2.00 pm at County Hall, Chelmsford on 5 March 2014

Present:

Member
Essex County Council

Cllr R L Bass	(Chairman)
Cllr S Barker	
Cllr K Clempner	
Cllr N J Hume	
Cllr N Le Gresley	
Cllr J Whitehouse	

District/Borough Councils in Essex

Cllr J Archer	Maldon District Council
Cllr P Challis	Castle Point Borough Council

Unitary Councils

Cllr A Moring	Southend-on-Sea Borough Council
Cllr G Rice	Thurrock Council

Essex Fire Authority
Cllr M Danvers

Scheme Members
Mr K Blackburn

Smaller Employing Bodies
J Moore

The following officers were also present in support:

Annemarie	Allen	Senior Pensions Consultant (Barnett Waddington)*
Jody	Evans	Head of Essex Pension Fund
Kevin	McDonald	Director for Essex Pension Fund
Barry	Mack	Independent Governance and Administration Adviser (Hymans Robertson LLP)*
Sara	Maxey	Employer Relationship Manager
Graeme	Muir	Fund Actuary (Barnett Waddingham)*
Graham	Hughes	Secretary to the Board

* In attendance for items 1-11 only.

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Councillor Rice was welcomed to his first meeting.

1. Apologies for Absence

Apologies for absence were received from Councillors M Mackrory (Essex County Council), K Bobbin (Essex County Council substitute member), and C Garbett (Essex Police and Crime Commissioner).

2. Declarations of Interest

It was acknowledged that all Councillors under the age of 75 were entitled to join the Local Government Pension Scheme and some Board members had done so.

In connection with the discussion on Employer Analysis (under minute 12 below), Councillors Clempner and Danvers declared an interest as they were members of Harlow District Council and Councillor Challis declared an interest as she was chair of governors of a local academy school.

No other declarations were made.

3. Minutes

Resolved:

That the minutes of the Essex Pension Fund Board held on 9 December 2013 be approved as a correct record and signed by the Chairman.

The Chairman proposed, and it was agreed, to vary the order of business from that stated in the published agenda and to consider the item on Local Government Pension Scheme Reform (Item 5 in the published agenda) next, followed by the item on Funding (agenda item 4 in the published agenda) before reverting to the published order of business.

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4 **Local Government Pension Scheme Reform update**

The Board considered a report (EPB/02/13) by the Head of Essex Pension Fund updating the Board on developments regarding potential structural reforms of the Local Government Pension Scheme (LGPS), required scheme Regulations, and governance arrangements. A formal 12 week public consultation was expected to commence later in the month. Once exact timing of the consultation was known, appropriate arrangements would be put in place to ensure the Board had the opportunity to comment and respond.

The Chairman had written to the Parliamentary Under-Secretary of State in the Department for Communities and Local Government expressing serious concerns about the co-ordination, clarity and timeliness of the development of new Regulations that would apply to the LGPS.

The continued delay in the publication of the Regulations could adversely impact on the timely implementation of required updates to Fund systems and processes and an entry had been added to the Risk Register to reflect this.

Certain transitional arrangements would be put in place for those nearing retirement.

The Chairman’s letter (referred to above) had also expressed concerns about developments in governance and improving scrutiny proposed under the Public Service Pension Act that could generate certain issues for the LGPS which may not be the case for other public sector pension schemes. Concern had also been expressed about the delay in the publication of any proposals on academy pooling.

Resolved:
(i) That the report be noted; and
(ii) a further update report be presented to the next meeting.

5. Funding: Actuarial Valuation

The Board considered a report (EPB/01/13) from the Director of Essex Pension Fund updating the Board on the 2013 actuarial valuation and to report on the recent consultation exercise with the Fund’s Employer bodies on the draft Funding Strategy Statement (FSS). The feedback received from the consultation had not required any significant changes to be made to the draft FSS.

All Employer Bodies had now received their funding results (with the exception of academies). The Funding level valuation was 80% compared to 71% at the time of the last valuation. The improved funding level reflected better investment returns and the use of an economic model for discount rates calculations rather than a gilts plus model. However, the ongoing cost of the Fund had increased to 14.3% now compared to 12.2% at the time of the last valuation due partly to more cautious actuarial assumptions on future investment returns and the anticipated increasing cost of implementing transitional arrangements arising from LGPS.

The key points of the proposed FSS were:
- There would normally be no net reduction in payments where a deficit existed;
- The aim would be to provide payment options based on stability of contributions (generally within 1% of payroll rate);
- The starting point was the 2010 deficit duration less three years where the deficit recovery period was greater than the average future working life;
- Annual up-front payment of deficit allowable;
- Triennial up-front payment of deficit allowable;
- Stepped introduction of new rates would be permissible if required.

Recovery periods for each Employer body were variable reflecting each unique employer profile and different joining dates. The majority of major tax raising Employer bodies had opted for an annual up- front payment to be made in April each year.

There would be a different way to determine contribution rates if an Employer had closed access to the Fund for new employees.

There would be the opportunity for interim reviews of the FSS prior to the next Triennial valuation.

Resolved:
(i) That the report be noted;
(ii) That, subject to minor typographical changes suggested at the meeting being made, the updated FSS be approved for final publication.

Governance

6.

Update on Pension Fund Activity
A(i) 2013/14 Business Plan
A(ii) 3 year business plan
B Risk Management
C Measurement against Fund Objectives (Scorecard)

The Board received a joint report (EPB/03/14) by the Director for Essex Pension Fund and Head of Essex Pension Fund, which provided an update on the 2013/14 Business Plan, a 3 year business plan, risk management and scorecard recording measurement of progress against objectives.

Key developments in the Business Plan and Risk Register were outlined. Work arising from LGPS structural reform would be added to the Business Plan. The contract with a new provider of a new administration system had been signed in early February 2014.

No new risks had been added since the last Board meeting. However, the risk of failing to administer the scheme in line with regulations and policies arising from LGPS Reform, due to the delay in the release of draft regulations in sufficient detail to enable adequate planning, had been moved to red status.

With regard to Annex C (Measurement against Fund Objectives), the Board gave consideration to the scorecard, seeking clarification on points of interest and explanations for areas of concern.

- The Independent Governance and Administration Adviser outlined proposed changes to how training attendance and test results would be recorded in future. Members were requested to advise the Independent Governance and Administration Adviser of any required changes to their personal training record;
- Fund expenditure was currently forecast to exceed fund income (excluding investment income) in 2015/16. In that instance, investment income would be used to fund part of the payment of Fund benefits. The Investment Steering Committee would continue to monitor Fund cash flows;
- It was proposed to delay the date of the next Employee Survey until May 2015 to avoid undertaking it during the period of upheaval implementing LGPS Reform.
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Resolved:

(i) That the update be noted;
(ii) That the Board agreed the detailed actions in the 2014/15 Business Plan and that the three year Business Plan be updated to reflect this;
(iii) That the date of the next Scheme Employer and Member Survey be deferred until May 2015.

7. Investment Steering Committee (ISC) Quarterly Report

The Board considered a report (EPB/04/14) by the Director for the Essex Pension Fund which provided an update on the ISC activity since the last Board meeting.

Resolved:

(i) That the report be noted;
(ii) That the Board recommended to Essex County Council that the Terms of Reference of the Investment Steering Committee be extended to include the following:

To approve and annually review the content of the Pension Fund Treasury Management Strategy.

8. Employer Forum

The Board considered a joint report (EPB/05/14) by the Director for Essex Pension Fund and Head of Essex Pension Fund on matters in connection with convening a 2014 Employer Forum. The Board were updated on the consultation regarding the position of the Smaller Employers Representative (SER) on the Board with a consensus to delay the election for a SER so as to coincide it with new governance arrangements commencing in April 2015:

Resolved:
(i) To note the report;
(ii) To convene the next Employer Forum on Friday 9 May 2014 (10am-12 noon) at a venue to be confirmed. A separate Forum for academies would be convened once clear guidance had been received from central government on any plans for academy pooling.

9. Forward Look

The Board considered a report (EPB/06/14) by the Secretary to the Board which presented a Forward Look detailing the Board's future business.

Resolved:

That the report be noted and approved.

10. Date of Next Meeting

The next Board meeting would be held at 2pm on 9 July 2014 preceded by a Member training session (timing to be confirmed).

Thereafter, certain officers (indicated in the attendance record at the start of these minutes) left the meeting.

11. Exclusion of the Press and Public

Resolved:

That, having reached the view that, in each case, the public interest in maintaining the exemption (and discussing the matter in private) outweighed the public interest in disclosing the information, the public (including the press) be excluded from the meeting during consideration of the following item of business on the grounds that they involved the likely disclosure of exempt information as specified in paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972.

12. Employer Analysis

(Exempt under paragraph 3 – information relating to the financial or business affairs of any particular person)

The Board considered a report (EPB/07/14) on matters in connection with the liquidation of an Employer body.

Resolved:

(i) That the report be noted;
(ii) That a further report be provided once the liquidation of the Employer body was complete.

13.

National Procurement Frameworks
(Exempt under paragraph 3 – information relating to the financial or business affairs of any particular person)

The Board considered a report (EPB/08/14) on the preferred procurement approach regarding the tender of an Independent Governance and Administration Adviser. It was confirmed that shortlisted candidates would be required to make a presentation to the Board.

Resolved:

That the recommendation contained therein in relation to the recommended procurement approach be agreed.

There being no further business, the meeting closed at 3.30 pm.

Chairman
9 July 2014

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AGENDA ITEM 6A

Essex Pension Fund Board	EPB/09/14
date: 9 July 2014	

Local Government Pension Scheme (LGPS) Reform

Councillor Pensions

Report by the Head of Essex Pension Fund
Enquiries to Jody Evans 01245 431700, Ext 21700

1. Purpose of the Report

1.1 To update the Board on the arrangements for Councillor Members in the LGPS 2014

2. Recommendation

2.1 That the board should note the report.

3. LGPS 2014 Regulations

3.1 As highlighted in correspondence from the Chairman of the Essex Pension Fund Board to the Parliamentary Under Secretary of State there have been significant delays in finalising the LGPS 2014 regulations. In particular the key transitional elements effecting existing members which were only received in March 2014.

3.2 One of the highest profile changes with effect from 1 April 2014 was the removal of the provision of a pension arrangement for Local Councillors within the LGPS.

3.3 Transitional arrangements for current Councillor Members who were contributing on 31 March 2014 are in place allowing them to continue membership of the LGPS until the end of their current term of office.

3.4 Following debate in Parliament the regulation changes are to remain in place and the Essex Pension Fund has written to all Councillor Members informing them of the future changes to their pension arrangements.

4. Link to Essex Pension Fund Objectives

4.1 Maintaining awareness of current issues with regard to LGPS reform will assist the Board in achieving the following Fund objectives:

- Ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise
- Act with integrity and be accountable to our stakeholders for our decisions, ensuring they are robust and well based
- To ensure the Fund is properly managed

5. Risk Implications

5.1 Failure to maintain an awareness of current issues with regard to LGPS reform and respond to consultations would mean that the Fund’s views were not taken into account when changes are proposed.

5.2 Failure to administer scheme in line with Regulations.

6. Communication Implications

6.1 Timely communication on regulation changes will be issued.

7. Finance and Resources Implications

None

8. Background Papers

None

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AGENDA ITEM 6B

Essex Pension Fund Board	EPB/10/14
date: 9 July 2014	

Local Government Pension Scheme (LGPS) Reform
DCLG consultation: "Opportunities for collaboration, cost saving and efficiencies"

Report by the Director for Essex Pension Fund

Enquiries to Kevin McDonald 01245 431301, Ext: 21301

1. Purpose of the Report

To allow the Board to:

1.1 be updated on the Consultation issued by DCLG;

1.2 agree the Fund's response.

2. Recommendations

It is recommended that the Board:

2.1 agree, subject to any required amendments, the draft response included at Annex A to this report.

3. Background

3.1 At its meeting on 18 September 2013, the Essex Pension Board agreed the basis of its response to the C*all for Evidence* on the future structure of the LGPS issued jointly by the Local Government Association (LGA) and the Department for Communities & Local Government (DCLG). The response as submitted is attached at annex B to this report.

3.2 Following receipt of responses to the call for evidence, DCLG commissioned analysis of structural reform options to be led by Hymans Robertson. These options covered:

- merging funds; and
- the use of Collective Investments Vehicles (CIVs).

4. DCLG's consultation: "Opportunities for collaboration, cost saving and efficiencies"

4.1 On 1 May, DCLG published the consultation document "Opportunities for collaboration, cost saving and efficiencies" (annex C) along with the analysis undertaken by Hymans Robertson (annex D).

4.2 The Consultation asks a series of questions around the following proposals:

- Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs.

- Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market.

- Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme.

- A proposal not to pursue fund mergers at this time.

4.3 The consultation's emphasis is on CIVs and passive management. Whilst the form of the CIVs has attracted some detailed technical discussion, arguably the most contentious aspect of the debate has centred on the extent of passive management – and whether this ends the active fund management of equities and bonds within the LGPS.

4.4 The ten week deadline for responses ends on Friday 11 July 2014.

4.5 Officers and advisers have had a series of meetings on this matter. Officers have also maintained dialogue with other LGPS Funds on this matter.

4.6 Following discussion with Fund Chairman Cllr Rodney Bass, it was determined that this matter would be initially considered at the 18 June 2014 meeting of the Investment Steering Committee. Following this, a response would then be drafted, based on the points made at the ISC, for the Board's consideration.

5. The draft response

5.1 The Consultation, supported by the commissioned research, observes that in aggregate, the 89 LGPS Funds in England & Wales pay active management fees but experience passive performance.

5.2 Since 1996, the Fund has outperformed its benchmark by 0.4% per annum, gross of fees. Taking fees into account reduces the outperformance to between 0.1%-0.2%.

5.3 Some of the proposals in the Consultation, if adopted, could result in:

- the mandatory collectivisation of all investments; and
- the end of active management in the LGPS for equities & bonds.

5.4 Requiring LGPS Funds to collectivise all investments and / or ending active management of equities and bonds are radical steps. Each would take time, cost money, introduce new risks and almost certainly provoke unintended consequences.

5.5 In the view officers and advisers

- CIVs, where required, need to be fully understood and tested before wider implementation; and
- Local pension committees should have the opportunity to employ both active and passive strategies.

5.6 Following discussion at the ISC on 18 June, it was agreed that the response should include the following:

- concerns over the operational aspects of CIVs
- opposition to enforced use of passive management and / or CIVs
- the approach that Essex adopts
- comments on the background to deficits

5.7 The draft response is attached at annex A.

5.8 **It is recommended** that subject to any required amendments the Board agree the draft response included at annex A to this report.

6. Link to Essex Pension Fund Objectives

6.1 Maintaining awareness of current issues with regard to LGPS reform will assist the Board in achieving the following Fund objectives:

- Ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise
- Act with integrity and be accountable to our stakeholders for our decisions, ensuring they are robust and well based
- To ensure the Fund is properly managed

7. Risk Implications

7.1 Failure to maintain an awareness of current issues with regard to LGPS reform and respond to consultations would mean that the Fund's views were not taken into account when changes are proposed.

7.2 Failure to administer scheme in line with Regulations.

8. Communication Implications

8.1 When consultations on structural reform and revised governance requirements commence, responses will be produced for the Board to consider.

9. Finance and Resources Implications

9.1 Large scale changes to the investment structures of the LGPS will come at significant cost.

10. Background Papers

10.1 Fund response to the Call for Evidence, September 2013 (annex B)

10.2 Consultation & Hymans Robertson report (annex C & D)

Essex County Council

Annex A

ESSEX PENSION FUND

Response to DCLG consultation:
Opportunities for collaboration, cost saving and efficiencies

Background

The Essex Pension Fund is the tenth largest of the eighty nine LGPS funds within England and Wales. It currently has in excess of 530 separate employers, including over 180 Academies.

The Essex Pension Fund Board operates as the s101 Committee (under the terms of the 1972 Local Government Act). The DCLG consultation was an agenda item for the Board at its meeting on 9 July 2014, and the following observations and evidence are based on the Board's consideration of this matter.

Pension Scheme of the Year Awards 2014 Finalist – Public Sector Scheme of the Year

LGC Investment Awards 2013 WINNER
Fund of the Year (Above £2bn)

INTRODUCTION

The Essex Pension Fund welcomes the opportunity to participate in a consultation that is central to how the LGPS invests for its future.

It is encouraging that some common themes raised in a large number of responses to last year's call for evidence have now formed the basis for proposals to both:

- keep asset allocation with local fund authorities and
- enable the availability of transparent and comparable data.

The consultation is set against a backdrop of concern that the LGPS:

- is in deficit
- pays active fees, but
- experiences passive investment performance in aggregate.

These are concerns we share – and as a Fund we take each of these matters seriously. However, in considering these challenges we have developed an approach that differs markedly from the direction in which some of this Consultation's proposals appear to be heading. In particular, our approach leads us to strongly oppose any proposals for LGPS Funds to be compelled to:

- join Collective Investment Vehicles (CIVs);
- end successful active mandates

This response starts by discussing the Essex Pension Fund's consideration of the three concerns highlighted above. We highlight the approach Essex has adopted and where we believe what we do is worth sharing with others. We have responded to the specific questions posed by the Consultation and close with two appendices which detail our approach.

DEFICITS

As at 31 March 2013, the Essex Pension Fund had assets expected to cover 80% of its liabilities. Deficits first emerged within the LGPS in the early 1990s. It is worthwhile recalling that these deficits are the product of a number of factors including those listed below:

- the reduction in employer contribution requirements which coincided with the introduction of the community charge;
- the abolition of tax relief on ACT;
- sharp rises in longevity; and
- global quantitative easing.

Overall we expect that active management fees would have had a very minor impact on deficit levels. However, we recognise that any uncompensated management fee is unwelcome and that is why the Essex Fund has over around 50% of its listed assets managed passively and, where active management is employed, strict criteria are used to select and monitor these managers to increase the likelihood of obtaining value for money.

FEES

The Essex Pension Fund Investment Steering Committee (ISC) includes a formal investment fee review of managers it employs within its annual review of investment strategy and structure. Institutional Consultants Hymans Robertson compare the current fees paid by the Fund with each managers published fee quote to the UK pension fund marketplace at large. This is used, where appropriate, to inform fee discussions with Fund managers and give assurance to the Board that the fees charged to the Fund are not out of line with what is typically charged to other pension schemes of a similar size. The ISC is content this is the case.

The level of fees to be paid is an important part of the decision making process on the engagement of fund managers. However, fees should not be viewed in isolation. Fee analysis ought to form part of a proper process which should also embrace performance and diversification. We return to the matter of diversification in our comments on passive management.

INVESTMENT PERFORMANCE AS AT 31 MARCH 2014

Since 1996 the Essex Fund’s investment performance has been 7.5% p.a. compared to the Fund’s bespoke benchmark. This represents an outperformance of 0.4% p.a. gross of fees.

This investment performance is monitored by the ISC on an ongoing basis. In carrying out this duty the ISC has developed a particular approach which is described below.

The Essex Statement of Investment Principles (SIP) includes a series of investment beliefs (that are kept under review) which are used to shape and maintain the investment strategy. These are replicated in full at appendix 1 and fall under three broad headings:

1. long term investing
2. diversification, and
3. active versus passive management.

The ISC uses these beliefs as a reference point when considering the investment strategy – including the benefits of both active and passive management. This enables the ISC to review the full available opportunity set (i.e. different active approaches and different passive approaches) as it believes restricting the universe reduces the potential value available. It also means we spend time understanding *"why not to invest"* as well as *"why to invest"*.

The SIP (including the Investment beliefs) is consulted upon each year with stakeholders. Adopting this approach allows the Fund's investment governance to be transparent, and the rationale behind decisions around asset allocation and choice of mandate to be clear. The full SIP can be found at:
http://www.essexpensionfund.co.uk/pensionsWeb%20Documents/STATEMENTinvestmentprinciples2013.pdf

In response to the specific questions:

Proposal 1: Common Investment Vehicles

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

Economies of scale
In our response to last year's *Call for Evidence* we highlighted the concern that investing via large entities (5 or 6 funds nationally) had the potential to generate significant, and detrimental, market impact once trading commenced. Whilst the desire to search for economies of scale within the LGPS is understandable, we have concerns that an approach centred on one listed asset CIV for whole of the LGPS would be vulnerable to the dangers of diseconomies of scale. These must be fully understood, and lead us to conclude that a *"one step at a time"* approach on CIVs is far more preferable to a *"big bang".*

Delivery of savings
There are currently 89 separate LGPS Funds in England & Wales, most of which will use external fund investment managers with whom they will have separate individual agreements.

Active mandates
In many cases fund managers charge fees on the basis of the value of the assets managed, and this is typically structured in tiers with the highest charge for the initial tier of asset e.g.:

45 basis points (bps) on the first £50m;
35 bps on the next £50m; and
25 bps thereafter.

In the example shown above, a Fund placing a £100m mandate will pay a higher overall fee of 40bps whereby a Fund placing a £200m mandate will pay a lower fee of 32.5bps. This arrangement tends to benefit Funds with the ability to place larger mandates and corresponds with our experience, as one of the larger LGPS Funds, in terms of how much tiered fee structures benefit the Essex Fund.

It is probable therefore that combining assets through CIVs will benefit some Funds who are currently unable to place larger mandates. It seems likely that the prime beneficiaries would be smaller Funds.

We note that Funds in London have already established a CIV. We understand that as part of that process there was a constructive dialogue with Fund Managers about participation in that CIV, particularly on the level of fees. That development, along with this *Call for Evidence* / *Consultation* process leads us to conclude that the conditions already exist for a national collective dialogue with the Fund Management community about the scope of LGPS fee reviews. Such an initiative would not require further CIVs to be established and could commence immediately.

Passive mandates
The fees payable to passive managers are already relatively low. Would a passive CIV be able to deliver substantial savings on top of this once setup and governance costs were taken into account?

Furthermore we note that passive managers use internal trading in order to save transaction costs. A CIV that consists entirely of LGPS Funds reduces opportunities for internal trading if buyers are not matched by sellers.

Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

In our response to the Call for Evidence we stated "*Accountability within the LGPS to local taxpayers is fundamental. Elected Members of Local Authorities, combined with representatives of other key stakeholders, offer the best means of ensuring such accountability."*

Asset allocation is fundamental to how LGPS funds set investment strategies and the proposal to keep decisions at local fund level is welcomed. However it must also be remembered that decisions on "*where to allocate assets"* are profoundly linked to decisions on *"how the assets are managed"*. In other words it is a false separation to allow LGPS Funds to continue to determine asset allocation whilst denying the same Funds the opportunity to select active equity or bond mandates (under the first proposal in paragraph 4.30). We return to this theme in more detail in our response to question 5.

Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

<u>Private Equity, Infrastructure & Timber</u>
The Essex Pension Fund currently has the following allocations private equity (4%) infrastructure (6%), and timber (2%).

Access to these alternative asset classes can often be influenced by issues of scale. The opportunity set tends to broaden the higher the amount to be committed. In theory, a common approach therefore makes sense for alternative assets. The issue here though appears to be one of timing.

Our infrastructure, private equity and timber portfolios all include future investments to which we have already agreed to commit monies. As of 31 March 2014 there was £315m committed but not yet drawn down. Exiting such arrangements early is possible, but would be accompanied by financial penalties that are not in the interests of the LGPS. It is therefore clear that any transition to a CIV for alternatives would need to be phased in over many years, and we agree with the observation made by Hymans Robertson that this could take up to a decade. (page 3 LGPS Structure analysis. Hymans Robertson, December 2013)

Property

The Essex Pension Fund currently has a 12% property allocation - around half of the Essex property portfolio is directly invested in individual land & buildings and we expect this to increase to around three quarters. We foresee a number of issues for transitioning such assets into a CIV (change of ownership, asset management & maintenance etc) which in turn raise questions on governance.

We note that collective investing in property was particularly popular in the 1990s via the Local Authorities Mutual Investment Trust (LAMIT), prior to developments in the 2000s within the indirect property market (REITS etc). This leads us to conclude that whilst there may be co-investment opportunities for property, the case for a property CIV has not yet been made.

Listed equities & bonds

Unlike alternative investments, there ought to be no impediments on smaller Funds gaining access to these asset classes. Whilst we are comfortable that Funds should have the opportunity to join a CIV should they so wish, we strongly oppose any compulsion to do so. This conviction stems from our belief that active management has a place within the LGPS, and that individual Funds should retain the freedom to appoint from the full universe of investment houses. Again, we expand on this in our response to question 5.

Whilst accepting that past performance is not a guarantee for the future, our experience shows that long term relationships with Fund managers work best. It is unlikely that all Investment Managers currently filling LGPS mandates could be included within a listed asset CIV. Any CIV arrangement which forces Funds to part company with successful managers will be counterproductive.

Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

The key feature of any CIV should be that it is voluntary, not compulsory.

We acknowledge the work currently being undertaken by LGPS Funds on a voluntary CIV for London. In our view, there is merit in allowing this project the space to develop –

so that future decisions on CIVs elsewhere within the LGPS can be made on the basis of firm evidence of a CIV in practise. *"One step at a time"* is a more sensible approach than *"big bang".*

Proposal 2: Passive fund management of listed assets

4.30 The Government therefore wishes to explore how to secure value for money for taxpayers, Scheme members and employers through effective use of passive management, while not adversely affecting investment returns. There is a range of options open to Government and the funds to achieve this:

 Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.

 Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.

 Fund authorities could be required to manage listed assets passively on a "comply or explain" basis.

 Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report

Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

The Fund's SIP includes seven beliefs in total (appendix 1), four of which are relevant to this consultation and are set out below:

Active versus passive management

a. Passive management is appropriate for obtaining a low cost allocation to efficient markets

Where markets offer little scope for adding value through active management (such as individual allocations to UK equities, US equities and gilts) passive management is preferred as a low cost way of accessing the market. This does not include emerging markets where the risk inherent in the market and inefficiency of the market lends itself to active management.

b. Active management is appropriate where a market is relatively inefficient offering opportunities for active managers to add value

Where markets offer substantial scope for added value active management would seem appropriate as a way of increasing overall expected return (after fees) without significantly increasing the overall level of volatility in the funding level.

c. ***A rigorous approach to active manager selection improves the chance of appointing an active manager who will add value over the long-term***
An active manager must outperform their benchmark after fees to add value. The selection of an active manager must assess more than just past performance and look into the infrastructure supporting the performance including; business and ownership, philosophy and process, people, risk controls and fees.

d. ***The assessment of active management performance should be taken with a long-term view and take account of the market environment in which returns are delivered***
Active management is cyclical and periods of underperformance from investment managers should be expected so the structure should be such that when the market cycle is unfavourable for some managers it is favourable for others and vice versa. This is expected to deliver added value over the long-term whilst smoothing the overall performance at the total Fund level. Churning of managers leads to additional costs; however, where the ISC no longer views an investment manager's prospects as positive over the long-term, action should be implemented as soon as possible due to the potential downside risk.

Utilising these beliefs in developing the Investment Strategy has resulted in adopting the following approach managing listed equities and bonds:

Passive management: 45%
Active management: 55%.

 Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.

We maintain that there is a place for <u>both</u> active and passive management. Adopting both approaches allows diversification within the investment firms used. It also manages the concentration risk that can emerge in the replication of certain "market-cap" indices whereby a passive approach can be dominated by a few major corporations.

Mandating Funds to end active management of all listed assets will require a "fire sale" of mandates – many of which have long standing successful records of outperformance. This is clearly not in the long term interests of either the LGPS or its stakeholders. Furthermore, denying Funds access to active management raises serious questions as to whether Funds have the appropriate level of governance.

We also note that this *Consultation* make no reference to the different forms of passive management currently deployed within the LGPS. The Essex Fund currently has part of its passive allocation tracking RAFI indices, as a means to diversify the often underappreciated unintended risks inherent in passive management. Not all LGPS Funds exclusively utilise traditional market cap passive approaches.

 Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.

There are 89 separate Funds in England & Wales. What evidence is there that a “one size fits all” approach is appropriate for each one?

We are also concerned that a compulsion approach will lead to funds implementing changes without thought about the possible consequences.

 Fund authorities could be required to manage listed assets passively on a “comply or explain” basis.

<u>Explain</u>
We believe the Essex fund already sets its investment strategy with a full explanation of the rationale and therefore this is our preferred option.

LGPS Funds have been required to produce SIPs for over a decade. If these are being fully maintained then the rationale, beliefs and approach that underpin each Fund’s investment strategy, including the extent of active & passive management, should be clearly articulated.

If full explanation was made a requirement a more consistent explanation of the LGPS’s stance could commence.

<u>Comply</u>
If a “comply or explain” approach is adopted, it must not lead to an expectation of knee jerk reactions to underperformance during inter-valuation periods. The Fund’s first investment belief is that LGPS funds take a long term view of investment strategy.

However, we note that it is unclear as yet what the LGPS funds are being required to comply to and the sanctions if they do not ‘comply or explain’.

 Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report

We believe the Essex Fund already sets itself a higher hurdle than ‘consider’ and already adopts the broad principles of a ‘comply or explain’ methodology.

KEY CONCLUSIONS

In summary:

- The LGPS is in deficit for a variety of reasons;
- We are supportive of the consideration of CIVs, especially for smaller funds, but only where the cost benefit has been clearly articulated and there is a proven track record of robust management before implementing any investment;
- We do not support compulsion in the use of CIVs, especially where funds have sufficient scale to implement direct mandates of their own (such as the Essex property portfolio);
- This leads us to conclude that the London CIV should be allowed to develop in a way that subsequent LGPS CIVs can learn from;
- We agree that decision making should be kept at a local level;
- This leads us to oppose any attempts to impose pre-determined levels of passive management for listed assets; and
- We support an 'explain' regime and believe this is consistent with the approach already adopted by the Essex Pension Fund.

In addition to the above, we include our investment beliefs in appendix 1 and an initial guide as to how funds that do not adopt this level of governance might apply them to the management of their own funds in appendix 2.

For and on behalf of the Essex Pension Fund

Appendix 1: Core Investment Beliefs

1. **Long term approach**
    a. ***Local authority funds take a long term view of investment strategy***
    This is largely based on covenant. Unlike the private sector, the covenant underlying the Fund is effectively gilt-edged. This means that short term volatility of returns can be acceptable in the pursuit of long term gain. Whilst there is a need to consider stability of contributions, at current maturity levels and with deficits spread over a maximum of 30 years, it is largely the future service rate which is expected to drive instability. One of the best ways to avoid this is to build in margins over the long term.

    b. ***Over the long term, equities are expected to outperform other liquid asset classes, particularly bonds***
    Given 1. a. above, there is a preference for a significant allocation to equities in the Fund as over the long-term as they are expected (but not guaranteed) to outperform other asset classes.

    c. ***Allocations to asset classes other than equities and bonds expose the Fund to other forms of risk premium***
    Investors with a long term investment horizon and little need for immediate liquidity can use this to their benefit as it offers the ability to capture the illiquidity premium on many asset classes, such as private equity and infrastructure.

2. **Diversification**
    a. ***Diversification into alternative asset classes (including property) is also expected to reduce overall volatility of the Fund's funding level***
    Given that the returns from different asset classes are expected to be delivered in different cycles (i.e. not be directly correlated with equity returns), the use of alternative assets can reduce overall volatility in the delivery of Fund returns without leading to a significant reduction in overall expected return, therefore increasing efficiency.

    b. ***In the context of LA funds (open, long duration, not maturing quickly and with high equity content), an allocation to bonds does not offer a match to liabilities, but additional diversification.***
    Where bonds are not used for liability matching purposes, an allocation to these assets can be beneficial from an overall risk/return perspective improving the overall efficiency of the Fund. The corollary to this is that bond benchmarks do not necessarily have to reflect the nature and duration of the liabilities (see benchmark section below), but should be set to provide managers with the sufficient scope to add value.

    c. ***The overweight to UK equities in most UK pension funds is historic and loosely based on currency exposures, rather than a preference for the UK market***
    Although historically the UK may have benefited from better corporate governance, and therefore a higher return, increasingly the rest of the world is catching up and UK equities are not expected to outperform overseas equities over the long term. Given the concerns over market concentration in the UK

market and an increased opportunity set overseas a move towards increased overseas allocation relative to the UK seems appropriate. Concerns about currency risk can be addressed by a separate currency hedging programme.

d. *Benchmarks*
Where appropriate, benchmarks should represent the full opportunity set. For example, for a global equity mandate, a market capitalisation ("market cap") weighted benchmark reflects a passive allocation to the market (analogous to investing in a passive equity mandate and investing in each stock according to its size). It therefore reflects the investable universe of stocks available and represents the starting point for an equity benchmark.

e. To some extent market cap weighted indices reflect past winners, so should be treated with caution
The regional exposures in the World Index are a function of the relative market cap of the regional stockmarkets. In turn, these are a function of the size of the economy as a whole and how well companies have performed in that economy. One measure of the size of the economy could be its overall contribution to global GDP. However, as has been seen in the UK, many companies in the market have little exposure to the domestic economy and, again, this should not be adhered to too slavishly. At the total fund level a fixed weights regional benchmark is therefore preferred in order to maintain an appropriate level of diversification across markets. This is particularly the case when the allocations are maintained by a passive "swing" manager.

f. Emerging market economies may be expected to outperform over the long term as the economy develops and the risk premium falls
As emerging markets develop both politically and economically, become more robust and less dependent on the fortunes of a small number of developed economies (such as the US), the risk of investing in these countries should decrease. The return demanded by investors for investing in these 'riskier' countries will therefore fall reflecting the increased security. This reduction in required return would tend to lead to a systematic increase in stock prices. As a result, a strategic allocation to emerging markets of at least the market cap weight if not slightly above is favoured.

g. Bond benchmarks do not need to reflect the nature and duration of the liabilities
As discussed in the diversification section above, if bonds are not held for liability matching purposes, benchmarks should be set in order to maximise the scope for adding value.

3. Active versus passive management

a. Passive management is appropriate for obtaining a low cost allocation to efficient markets
Where markets offer little scope for adding value through active management (such as individual allocations to UK equities, US equities and gilts) passive

management is preferred as a low cost way of accessing the market. This does not include emerging markets where the risk inherent in the market and inefficiency of the market lends itself to active management.

b. ***Active management is appropriate where a market is relatively inefficient offering opportunities for active managers to add value***
Where markets offer substantial scope for added value active management would seem appropriate as a way of increasing overall expected return (after fees) without significantly increasing the overall level of volatility in the funding level.

c. ***Constraints on active managers reduce their ability to add value***
Active managers should not be unnecessarily constrained (within appropriate risk limits) and should be given the maximum scope to implement their active views. There is therefore a preference for unconstrained mandates e.g. unconstrained global equity mandates and unconstrained bond mandates such as M & G's LIBOR plus approach. This also suggests that, within reason, managers' requests for additional scope should be acceded to.

d. ***A degree of diversification of managers improves the efficiency of the overall structure (i.e. improves the expected return per unit of risk)***
Active manager performance is expected to be cyclical and therefore by appointing a number of managers the delivery of returns is expected to be less volatile. However, too much diversification can lead to expensive index tracking.

e. ***A rigorous approach to active manager selection improves the chance of appointing an active manager who will add value over the long-term***
An active manager must outperform their benchmark after fees to add value. The selection of an active manager must assess more than just past performance and look into the infrastructure supporting the performance including; business and ownership, philosophy and process, people, risk controls and fees.

f. ***The Fund does not have the governance structure in place to take tactical views and market timing is very difficult***
Both timing investments into the market and taking tactical views are very difficult given the governance structure in place and the time taken to agree and implement decisions. Where possible these decisions are left to professional investment managers who are closer to the market and can implement tactical views in a more timely fashion. This highlights the importance of not unnecessarily constraining active managers and providing them with appropriate scope.

g. ***The assessment of active management performance should be taken with a long-term view and take account of the market environment in which returns are delivered***
Active management is cyclical and periods of underperformance from investment managers should be expected so the structure should be such that when the market cycle is unfavourable for some managers it is favourable for others and vice versa. This is expected to deliver added value

over the long-term whilst smoothing the overall performance at the total Fund level. Churning of managers leads to additional costs; however, where the ISC no longer views an investment manager’s prospects as positive over the long-term, action should be implemented as soon as possible due to the potential downside risk.

Appendix 2: Application of Core Investment Beliefs

In applying the investment beliefs to the wider LGPS, we would suggest that a 'comply or explain' criterion might involve setting out a clear justification relative to the following questions:

1. Is an investment consistent with the long term risk/return goals and strategic asset allocation of the fund? i.e.
    a. Is the expected return consistent with the fund's requirements?
    b. Is the time horizon of the asset consistent with the funds time horizon?
    c. Is the absolute risk level of an investment within tolerance levels?
    d. When combined with the existing portfolio, do total risk levels remain within tolerance levels?
    e. Is the liquidity of the investment consistent with cash/liquidity requirements of the fund?
    f. Are transaction costs/fees reasonable and is current market pricing attractive?
    g. Will the investment have a meaningful impact on the expected outcomes of the fund?

2. Should a CIV be used?
    a. Can the fund access the investment directly?
    b. Is a CIV with proven track record available?
    c. Will fees for the CIV (after taking account of transaction costs) be lower than alternative manager options?

3. Should an asset be managed actively or passively?
    a. Can the investment be managed passively?
    b. Will use of both active and passive management diversify specific risks within an investment?
    c. Are there attributes that I seek from an asset class that cannot be managed passively (high income for example)?
    d. Are there passive alternatives to active management which will give the same broad market exposures?
    e. Is a passive option available, but sub optimal (cash + mandates for example)?
    f. What might be the unintended risk of passive or active management (benchmark concentration, momentum bias in market capitalisation benchmarks etc)?
    g. Is there evidence that active management has consistently shown to be effective in this asset class and am I confident I can identify the attributes that led to that outperformance and select managers that exhibit them?
    h. Are there attributes of a market that I can manage passively, but would not want to (corporate governance in emerging markets for instance)?
    i. Are active management fees reasonable relative to the outperformance targeted and relative to industry peers?
    j. What are the appropriate constraints to apply to an active manager to allow scope to add value without overly increasing risk?
    k. Is there an understanding to assess manager performance over the long term and only make changes when necessary?

ESSEX PENSION FUND

CALL FOR EVIDENCE ON FUTURE STRUCTURE OF THE LOCAL GOVERNMENT PENSION SCHEME (LGPS)

Background

As at 31 March 2012, the Essex Pension Fund was the tenth largest of the eighty nine LGPS funds within England and Wales. It currently has around five hundred separate employers, including well over one hundred Academies.

The Essex Pension Fund Board operates as the s101 Committee (under the terms of the 1972 Local Government Act). The DCLG/LGA Call for Evidence was an agenda item for the Board at its meeting on 18 September 2013, and the following observations and evidence are based on the Board's consideration of this matter.

RESPONSE

- Accountability within the LGPS to local taxpayers is fundamental. Elected Members of Local Authorities, combined with representatives of other key stakeholders offer the best means of ensuring such accountability.

- Combining or merging existing Funds has the potential for unintended consequences:

I. Altering the structure of LGPS Funds in a manner that diminishes the input and role of Elected Members of Local Authorities, dilutes the fundamental relationship with the local tax payer.

II. There are 89 LGPS Funds in England & Wales, each with a separate investment strategy, asset allocation, liability profile and funding level. The combination or merger of one or all of these aspects will invariably give rise to a scenario of “winners and losers”. Managing such a legacy should not be underestimated.

III. Local Funds make local decisions. For example, the Essex Fund’s, direct property portfolio has been established on the agreed principle that no direct investment is made within the County of Essex (including Southend and Thurrock) . The rationale is to avoid any potential conflict between the role of the respective administering and planning authorities. There will be numerous other examples throughout the LGPS. Combining or merging investment portfolios could undermine the decisions and principles on which they were established.

IV. Unwinding such principles/investment decisions highlighted at III above needs careful consideration. Any action that leads to a fire sale of assets is contrary to the interests of the LGPS. In the case of so called “Super Funds” there are real possibilities that both transition trading and on-going trading could have significant market impact.

- In the debate since the launch of this call for evidence, some supporters of the move to a very small number of Funds appear to claim that bigger Funds mean lower investment fees. This premise relies on no changes in the market behaviour of the investment management houses that LGPS Funds choose to utilise. It is not unreasonable to assume that wholesale change (for example the move to five “Super Funds”) will have considerable impact on the supply side, and fee charging structures would – in such a scenario – be unlikely to remain intact. Banking estimated savings in advance is unwise.

- Informal surveys between Funds have revealed different approaches adopted in the treatment of investment expenses. Some funds disclose both invoiced and non-invoiced (often pooled fund) investment expenses, others only disclose invoiced expenses. As a consequence, comparisons of investment fees paid between Funds are not on a like for like basis. A greater degree of certainty in this area is required before proper comparisons are possible and long term conclusions are drawn.

- One of the stated objectives of the call for evidence is “improving investment returns”. The WM Local Authority universe compiles the investment returns of around 100 LGPS Funds. Many commentators have already highlighted that repeated WM results demonstrate that there is no correlation between size of Fund and investment returns.

- Around 60 of the 89 LGPS Funds in England and Wales participate in the CIPFA benchmarking club. These costs of in house administration per scheme member for both the club average and the Essex Fund are set out below

CIPFA Benchmarking In house administration cost per scheme member		
	Club average	Essex Pension Fund
2009/10	£22.72	£20.35
2010/11	£22.14	£19.05
2011/12	£21.54	£18.57
2012/13	£20.87	£17.80

- These figures highlight that since the run up to the 2010 Actuarial Valuation, the average LGPS Fund has reduced its costs. Furthermore, the figures demonstrate that the Essex Fund remain below average.

- The club average is around 50% of cost for private sector pension administration based on available data (Capita Hartshead Annual Pension Scheme Administration Survey 2009/10 and Capita survey of 2011/12).

- The absence of some LGPS funds from benchmarking data clubs, and the lack of certainty over the basis for disclosing investment expenses make the case for universal transparent data to be supplied on a consistent basis. The Essex Fund supports the calls for the newly formed shadow national Scheme Advisory Board to address this matter.

- The last few years have been characterised by significant changes in the way many LGPS Funds approach procurement. Frameworks have been established for actuarial services, investment consultancy and custody. The benefits, including savings in procurement costs and timescales, have been well documented. The Essex Pension Fund is one of the members of the framework for the procurement of administration software. The Essex Pension Board has recently agreed to explore a framework for the procurement of Governance Services. Fund officers are liaising with colleagues at Norfolk Pension Fund on this matter.

- The effort on cross Fund collaboration, led by the Norfolk Pension Fund, amongst others, was recognised recently at the *Professional Pensions* Scheme of the Year Awards as the prize for Best Innovation went to National LGPS Frameworks. Further development of this initiative has considerable potential within existing structures.

KEY CONCLUSION

- Determinations on structural reform of the LGPS must take into account the full costs of transition to new arrangements. To properly address this matter a full and open review process is necessary before change to the statutory basis of the LGPS is embarked upon. The benefits of change are currently unclear, but the associated costs will be real.

Department for
Communities and
Local Government

Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies

Consultation

May 2014
Department for Communities and Local Government

This document/publication is also available on our website at www.gov.uk/dclg

If you have any enquiries regarding this document/publication, email contactus@communities.gov.uk or write to us at:

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Contents

1. The consultation process and how to respond

Scope of the consultation

Topic of this consultation:	The structure of the Local Government Pension Scheme and opportunities to reduce administration and investment management costs.
Scope of this consultation:	The consultation sets out the evidence for proposals for reforms to the Local Government Pension Scheme and opportunities to deliver savings of £660 million a year for local taxpayers. The Government seeks respondents' views on the proposals set out in section four, and asks respondents to consider how if adopted, these reforms might be implemented most effectively.
Geographical scope:	This consultation applies to England and Wales.
Impact Assessment:	It is not possible to provide an impact assessment at this stage as the detailed mechanism needed to implement the proposed reforms is still being developed.

Basic Information

To:	The consultation is aimed at all parties with an interest in the Local Government Pension Scheme and in particular those listed on the Government's website: https://www.gov.uk/government/publications/local-government-pension-scheme-regulations-information-on-who-should-be-consulted
Body/bodies responsible for the consultation:	Secretary of State, Department for Communities and Local Government. The consultation will be administered by the Workforce, Pay and Pensions division.
Duration:	The consultation will last for 10 weeks, opening on 1 May and closing on 11 July 2014.
Enquiries:	Enquires should be sent to Victoria Edwards. Please email LGPSReform@communities.gsi.gov.uk or call 0303 444 4057.
How to respond:	Responses to this consultation should be submitted to LGPSReform@communities.gsi.gov.uk by **11 July 2014**. Electronic responses are preferred. However, you can also write to: Victoria Edwards

	Department for Communities and Local Government Zone 5/F5, Eland House Bressenden Place London, SW1E 5DU Please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please give a summary of the people and organisations it represents and where relevant, who else you have consulted in reaching your conclusions.
After the consultation:	The responses to the consultation will be analysed and a Government response published. Should any legislative changes be needed, a further consultation will follow.
Agreement with the Consultation Principles:	This consultation has been drafted in accordance with the Consultation Principles.

Background

Getting to this stage:	This consultation has been developed drawing on three sources of evidence: • A call for evidence on the future structure of the Local Government Pension Scheme, which ran from 21 June to 27 September 2013. 133 responses were received and analysed, helping to inform this consultation. • An analysis of the responses to the call for evidence provided by the Shadow Scheme Advisory Board. • Supplementary cost-benefits analysis of proposals for reform commissioned from Hymans Robertson using the Contestable Policy Fund. The commission did not extend to making recommendations. The Shadow Board's analysis, the Hymans Robertson report and the Government's response to the call for evidence are all available on the Government's website: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.
Previous engagement:	As outlined above, this consultation follows a call for evidence that gave anyone with an interest in the Scheme the opportunity to inform the Government's thinking on potential structural reform. The call for evidence was run in conjunction with the Local Government Association and the responses were shared with the Shadow Scheme Advisory Board, which provided the Minister for Local Government with their recommendations and analysis of the responses. The call for evidence also drew on a round table event that took place on 16 May 2013 with representatives of administering

	authorities, employers, trade unions, the actuarial profession and academia. This event discussed the potential for increased co-operation within the Scheme, including the possibility of structural change to the existing 89 funds.

Additional copies

1.1 This consultation paper is available on the Government's website at: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies

Confidentiality and data protection

1.2 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

1.3 If you want the information that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act 2000, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, in itself, be regarded as binding on the Department.

1.4 The Department will process your personal data in accordance with the Data Protection Act 1998 and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties. Individual responses will not be acknowledged unless specifically requested.

Help with queries

1.5 Questions about the policy issues raised in the document can be sent to LGPSReform@communities.gsi.gov.uk.

1.6 A copy of the Consultation Principles is at www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance. Are you satisfied that this consultation has followed these principles? If not or you have any other observations about how we can improve the process please email: consultationcoordinator@communities.gsi.gov.uk

1.7 Alternatively, you can write to:

DCLG Consultation Co-ordinator,
Zone 8/J6, Eland House,
Bressenden Place
London SW1E 5DU.

2. Introduction and background

Introduction

2.1 The Government believes that there is scope for significant savings, of £660 million per year, to be achieved through reform of the Local Government Pension Scheme. To that end, from 21 June to 27 September 2013, the Government ran a call for evidence on structural reform of the Local Government Pension Scheme. The paper asked respondents to consider what might be done to improve fund performance and drive efficiencies across the Scheme.

2.2 This consultation represents the next step in reform of the Scheme, building on the responses to the call for evidence and further cost benefit analysis of potential options for reform. It sets out the Government's preferred approach to reform and seeks views on the proposals.

Background

2.3 With assets of £178 billion in 2012-13, the Local Government Pension Scheme is one of the largest funded pension schemes in Europe. Several thousand employers participate in the Scheme, which has a total of 4.68 million active, deferred and pensioner members.[1] The Department for Communities and Local Government is responsible for the regulatory framework governing the Scheme in England and Wales.

2.4 The Scheme is managed through 89 funds which broadly correspond to the county councils following the 1974 local government reorganisation as well as each of the 33 London Boroughs. In most cases, the fund administering authorities are upper tier local authorities such as a county or unitary council, but there are also some administering authorities established specifically to manage their fund, for example the Environment Agency Pension Fund and the London Pension Fund Authority. The fund authorities have individual governance and working arrangements. Each fund has its own funding level, cash-flow and balance of active, deferred and pensioner members, which it takes into account when adopting its investment strategy, which is normally agreed by the councillors on the fund authority's pensions committee.

2.5 Employer contributions to the Scheme, the majority of which are funded by taxpayers, were more than £6 billion in 2012-13. The costs of managing and administering the scheme were estimated as being £536 million in 2012-13.[2] However, the actual costs are likely to be rather higher; the investment costs alone have recently been estimated as in excess of £790 million.[3] While investment returns and the costs of providing

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[1] Scheme asset value and membership figures taken from Department for Communities and Local Government statistical data set - Local government pension scheme funds summary data: 2012 to 2013 https://www.gov.uk/government/statistical-data-sets/local-government-pension-scheme-funds-summary-data-2012-to-2013

[2] Local government pension scheme funds summary data: 2012 to 2013

[3] Department for Communities and Local Government: Local Government Pension Scheme structure analysis, Hymans Robertson p.11. https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies

benefits are the most significant drivers of the overall financial position of funds, management costs also have an impact on funding levels and thus the pension contributions made by employers and scheme members.

2.6 Under the Public Service Pensions Act 2013, there will be a requirement for a national scheme advisory board, as well as a local board for each of the 89 funds. The regulations that will establish national and local governance arrangements have not yet been made and the Department will be consulting on these issues shortly. In the meantime, scheme employers and the trade unions have established a Shadow Board, which has been considering a number of issues connected with the Scheme, including its efficient management and administration. In addition, the Minister for Local Government has asked the Shadow Board to consider how the transparency of the funds might be improved.

Getting to this stage

2.7 In 2010, the Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission. The purpose of the Commission was to review public service pensions and to make recommendations on how they might be made more sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers.

2.8 Lord Hutton's final report was published on 10 March 2011 and formed the basis for major reforms to all public service pension schemes. The new Local Government Pension Scheme which came into effect on 1 April 2014 is the first scheme to be introduced that follows Lord Hutton's principles for reform as enacted in the Public Service Pensions Act 2013.

2.9 Lord Hutton highlighted the collaborative approach being taken by funds within the Local Government Pension Scheme and recommended that the benefits of co-operative working between local government pension funds and opportunities to achieve efficiencies in administration more generally should be investigated further.[4]

> **Recommendation 23**: Central and local government should closely monitor the benefits associated with the current co-operative projects within the Local Government Pension Scheme, with a view to encouraging the extension of this approach, if appropriate, across all local authorities. Government should also examine closely the potential for the unfunded public service schemes to realise greater efficiencies in the administration of pensions by sharing contracts and combining support services, including considering outsourcing.

2.10 More generally, Lord Hutton went on to comment about the need for change and improved scheme data. At paragraph 6.1 he said:[5]

[4] Independent Public Service Pensions Commission: Final Report p.17 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207720/hutton_final_100311.pdf

[5] Independent Public Service Pensions Commission: Final Report p.122

In its interim report, the Commission noted the debate around public service pensions is hampered by a lack of consensus on key facts and figures and a lack of readily available and relevant data. There are also inconsistent standards of governance across schemes. Consequently it is difficult for scheme members, taxpayers and commentators to be confident that schemes are being effectively and efficiently run. It also makes it more difficult to compare between and within schemes and to identify and apply best practice for managing and improving schemes.

2.11 The Department therefore co-hosted a round-table event to consider these issues with the Local Government Association in May 2013. There were 25 attendees from administering authorities, employers, trade unions, the actuarial profession and academia. The discussion centred on the possible aims of reform, the potential benefits of structural change and the work required to provide robust evidence to analyse the emerging options and establish a starting point and target.

2.12 The objectives for reform identified at the round-table fed into a call for evidence on the future structure of the Scheme, which ran from 21 June to 27 September 2013. This asked respondents to set out the data required to enable a reliable comparison of fund performance and to consider how the administration, management and structure of the Scheme might be reformed to address the objectives identified at the round-table event. These objectives included reduced fund deficits and improved investment returns, as well as reduced investment fees and administration costs, greater flexibility of investment, especially in infrastructure and more use of better in-house investment management.

2.13 133 responses were received to the call for evidence and these submissions have been analysed to inform this consultation. A separate response to the call for evidence has been published and is available at: https://www.gov.uk/government/consultations/call-for-evidence-on-the-future-structure-of-the-local-government-pension-scheme. The Shadow Scheme Advisory Board has also reviewed the responses to the call for evidence and submitted recommendations to the Minister for Local Government. Its findings have been considered in the development of this consultation and are available via a link on its webpage or from the Shadow Board's website: http://www.lgpsboard.org/index.php/structure-reform/board-analysis-menu.

2.14 To support the call for evidence, the Minister for Local Government and the Minister for the Cabinet Office commissioned additional analysis using the Contestable Policy Fund. The Fund gives Ministers direct access to external policy advice through a centrally managed match fund, allowing Ministers to draw directly on the thinking, evidence and insight of external experts. Following a competitive tender process, Hymans Robertson were selected to establish the aggregate performance of the Scheme by asset class and to provide a detailed cost-benefit analysis of three potential options for reform:

- Establishing one common investment vehicle for all funds;
- Creating five to ten common investment vehicles for fund assets
- Merging the existing structure into five to ten funds.

2.15 The analysis set out the costs and benefits of each option; the time required to realise savings; the practical and legal barriers to implementation and how they might be addressed. Hymans Robertson's findings have been reflected in this consultation, alongside the call for evidence responses and analysis by the Shadow Scheme Advisory Board. A copy of the Hymans Robertson report, which did not extend to making recommendations, is available on the Government's website: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies

3. The case for change

Summary of the proposals

3.1 Having considered the responses to the call for evidence, as well as the Shadow Board's recommendations and the Hymans Robertson report, the Government believes that the following steps are needed to help ensure that the Scheme remains affordable in the long term for both employers and members. The proposals aim to balance the opportunities from aggregation and scale whilst maintaining local accountability.

3.2 The package of proposals set out in this document include:

- Establishing common investment vehicles to provide funds with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs.
- Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market.
- Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme.
- A proposal not to pursue fund mergers at this time.

3.3 Hymans Robertson's analysis, which was based on detailed, standardised data, demonstrated that the significant savings could be achieved by the Scheme if all of the funds adopt the following proposals in full. The Government is interested in exploring these proposals further with a view to maximising value for money for taxpayers, Scheme employers and fund authorities.

Proposal	**Estimated Annual saving**
Moving to passive fund management of all listed assets, accessed through a common investment vehicle.	£420 million
Ending the use of "fund of funds" arrangements in favour of a common investment vehicle for alternative assets	£240 million

3.4 The saving of £420 million associated with moving to passive management of listed assets is comprised of two elements:

- Reduction in investment fees: £230 million
- Reduction in transaction costs: £190 million

The performance that is reported by the Local Government Pension Scheme funds is net of these transaction costs.

3.5 The savings associated with passive fund management can be achieved quickly, within one to two years. The annual savings arising from using common investment vehicles for alternative assets would build gradually, with the full annual savings reached over 10 years, as existing contracts came to an end.

3.6 This package of proposals provides a clear opportunity to substantially reduce the investment costs of the Scheme. They are most effective when adopted by all 89 funds and the Government proposes to implement them together. Indeed, the passive management of listed assets could be most easily facilitated through a common investment vehicle.

3.7 In addition, the cost of investment has been estimated to be considerably higher than previously reported. Recognising the need for more reliable and comparable performance and cost data, the Government will continue to work with the Shadow Scheme Advisory Board to improve the transparency of fund data as set out in paragraph 5.3.

3.8 The remainder of this section sets out the objectives and rationale for reform and the evidence underpinning the approach taken. A more detailed explanation of the proposals for reform is provided in section four.

The objective of reform

3.9 The cost of the Local Government Pension Scheme has risen considerably since the 1990s, with the increased costs falling predominantly on Scheme employers and local taxpayers. In England alone, the cost to Scheme employers has almost quadrupled from £1.5 billion in 1997-98 to £5.7 billion in 2012-13. Indeed, when the Welsh funds are also considered, the total cost to employers is around £6.2 billion a year.[6] The Government has already taken action to reduce the cost of the Scheme and make it more sustainable and affordable to employers and taxpayers in the long term. For example, the new 2014 Scheme with a revised benefit structure came into effect on 1 April, helping to reduce and rebalance the cost between members and employers. However, it is clear from examining the aggregate data on the Scheme which has come to light as part of this review, that there is more that can be done to improve the sustainability of the funds.

3.10 At present, the funds report that administration and investment management costs are £536 million per year, of which £409 million is attributed to investment. Indeed, the reported cost of investment in cash terms has continued to rise in recent years: from £340 million in 2010-11; to £381 million in 2011-12; and £409 million in 2012-13.[7] In fact, using more detailed and standardised data CEM Benchmarking Incorporated, as sub-contractors to Hymans Robertson, identified that the fees for investment management of the Scheme could be much higher than reported, at in excess of £790 million. Some of the fees for investment management are not fully transparent to the funds and are therefore difficult to quantify. In practice, the actual cost of investment to the funds is likely to be even higher than £790 million, as their analysis did not include other costs in their calculation such as transaction costs and performance related fees on alternative assets.

3.11 Coupled with the responses to the call for evidence, Hymans Robertson's analysis has provided a system review, shedding light on the aggregate performance of the Scheme by asset class, as well as the transactions and processes that underpin the

[6] Local government pension scheme funds summary data: 2012 to 2013
[7] Local government pension scheme funds summary data: 2012 to 2013

costs of investment. The work carried out by CEM Benchmarking Incorporated found that while funds were paying investment fees comparable with a peer group of funds of much larger size with similar mandates, there remained considerable scope for savings through a more efficient approach to investment.

3.12 The priorities of reducing fund deficits and improving investment returns set out in the call for evidence are underpinned by one overarching objective: that the Scheme remains sustainable and affordable for employers, taxpayers and members in the long term. Having considered this new aggregate view of the funds, the evidence indicates that there are opportunities to reduce costs without damaging overall Scheme performance. The Government therefore believes that it is right to consider opportunities to reduce costs and deliver value for money for employers and taxpayers, in pursuit of the overarching objective of a more sustainable and affordable Scheme.

Reducing fund costs or tackling deficits?

3.13 Although the call for evidence was developed around the primary objectives of reducing fund deficits and improving investment returns, very few responses set out ideas for managing deficits in a different way. The Shadow Scheme Advisory Board argued that more thinking could be done to consider how deficits might be addressed in the longer term. Its sixth recommendation stated[8]:

> The Board will support the Government by (a) developing a shortlist of feasible options for managing deficits and (b) conducting further research on the costs and benefits of the key options for reform.

3.14 The Government agrees that opportunities to improve funding levels should continue to be explored and looks forward to considering the Shadow Board's proposals for alternative ways of managing deficits. **Respondents to this consultation are also invited to submit any feasible proposals for the reduction of fund deficits.**

3.15 While very few submissions effectively tackled deficit reduction, both public and private sector respondents recognised that the Scheme may benefit from addressing the secondary aim of reducing investment costs, partly by managing investments more efficiently. Taking action to reduce the cost of running the Scheme will help to meet this objective by increasing the funding available for investment. In the longer term, this should help to improve the funding level of the Scheme and reduce the pressure on employer contribution rates. This consultation therefore focuses on the cost savings to be found through collaboration and more efficient investment.

Achieving scale to reduce fund costs

3.16 There is already a growing consensus across the Local Government Pension Scheme that there are opportunities to deliver further efficiencies and savings for local taxpayers through collaboration. When the call for evidence was launched, funds in

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[8] Call for Evidence on the Future Structure of the Local Government Pension Scheme: The Local Government Pension Scheme Shadow Scheme Advisory Board analysis and recommendations, p.4 http://www.lgpsboard.org/images/CFE/20140115SSABreportFINAL

Wales, Scotland and London had already begun to research the benefits of scale and explore the relative merits of mergers and common investment vehicles. Similarly, shared administration arrangements had been established in a number of areas including across Kensington and Chelsea, Hammersmith and Fulham, and Westminster; as well as in Northamptonshire and Cambridgeshire.

3.17 Several responses to the call for evidence cited earlier reports or academic research into the benefits of fund size, drawing heavily on the exploratory work of Scotland, Wales and London, as well as the international experience of countries including Australia and Canada.[9] On balance, these reports found that there was no clear link between investment returns and fund size. However, they did show that there were significant benefits to scale, such as lower investment and administration costs, easier access to alternative asset classes like private equity and hedge funds, and improved governance. This view was also reached by the Shadow Board in its analysis of the call for evidence responses, which argued that:[10]

> The evidence appears to show indirect benefits of larger fund sizes, although any direct link between fund size and investment return in the Local Government Pension Scheme is inconclusive.

3.18 Although managed as 89 funds, with an asset value of £178 billion the Local Government Pension Scheme clearly has the potential to achieve the benefits of scale realised by larger funds. Whilst many of the funds have gone some way to achieving this by using procurement frameworks or establishing joint-working arrangements, there is more that can be done. This consultation will set out how using common investment vehicles and passive management for listed assets can in the long term lead to savings of over £660 million a year for the Scheme.

Achieving efficiencies and safeguarding local accountability

3.19 The call for evidence asked interested parties to suggest options for reform that would best meet the primary and secondary objectives set out in paragraph 2.12 above. A range of tools and approaches to achieving greater economies of scale were suggested, with fund mergers, common investment vehicles, and existing collaborations such as procurement frameworks all discussed extensively.

3.20 Two themes were discussed consistently when respondents sought to evaluate the merits of the main proposals for reform:

- The potential cost and time required for implementation;
- The importance of local accountability.

Costs and benefits of the proposals

3.21 Around half of the responses discussed the cost effectiveness of merging funds and how this might be implemented. Many argued that while savings could be achieved as a result of economies of scale, more analysis was needed to ensure that the benefits

[9] A list of the most commonly referenced papers can be found on the Shadow Scheme Advisory Board's web-pages: http://www.lgpsboard.org/index.php/structure-reform/responses-public-view
[10] The Local Government Pension Scheme Shadow Scheme Advisory Board analysis and recommendations, p.3

of mergers outweighed the cost and time required to implement them successfully.

3.22 Analysis was undertaken by Hymans Robertson who evaluated the costs and benefits of three options for reform over 10 years. They found that although significant savings could be realised over the period by amalgamating into five funds, merger could take around 18 months longer to implement than common investment vehicles; the delay in the emergence of savings leading to a significant reduction in the net present value of savings over 10 years. The report also showed that the savings achieved by pooling assets into two common investment vehicles would be slightly higher than if 10 were used.[11]

Possible model for reform	Net present value of savings over 10 years (£ billions)
Assets pooled into two common investment vehicles	£2.8
Assets pooled in 10 common investment vehicles	£2.6
Fund assets and liabilities merged into five funds	£1.9

3.23 The calculations shown exclude the impact of the reduced transaction costs, which Hymans Robertson showed would also help to deliver additional savings of £1.9 billion for the Scheme over 10 years.

3.24 A number of fund authorities also submitted evidence of the benefits to their fund of procurement frameworks such as the National LGPS Frameworks. A procurement framework provides authorities with a short list of organisations who can bid for contracts, reducing the time and cost of running a more substantial process.

National LGPS Frameworks' response to the call for evidence cited one fund who had used their actuarial framework to secure services at a procurement cost of £4,000 instead of the estimated £30,000-£40,000 required for a full procurement process. If this same rate of savings applies to Global Custodian procurements, with costs again reduced by 90 per cent, the Framework believes savings of £90,000 per fund can be found.

3.25 Although there are clear benefits to using frameworks, the scale of savings achievable does not match those possible through more substantial reform such as common investment vehicles. However, the Government believes that there is still a role for procurement frameworks to play in delivering savings for the Scheme and is keen to see this opportunity taken up by more of the funds.

Local accountability

3.26 Most call for evidence responses stressed the importance of local accountability and the direct link to elected councillors, which would be lost if funds were merged. At present the authority's Councillors, usually through the pensions committee, are asked to agree the fund's investment strategy. The authority then publishes an annual report which details the costs and investment performance of the fund, enabling the public to assess how effective the investment strategy has been. Some respondents argued that this allows local taxpayers to hold the fund and local councillors to account. As one fund authority stated:

[11] Local Government Pension Scheme structure analysis; Hymans Robertson p.6.

"There is a clear, democratic link to local voters and businesses through elected members sitting on pensions committees…

The regulatory requirements to produce an annual report and accounts and policy statements…ensure that key information on the management of funds is held in the public domain. This approach ensures local and national accountability.

The Pensions Committee believes that a forced merger of funds could only weaken accountability and the democratic link."

3.27 However, a smaller number of respondents queried the benefit of this link, emphasising the importance of Myners Principle 1 – that administering authorities should ensure that investment decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make effective decisions and monitor their implementation.[12] Although Councillors on the committee receive training, there is a risk that they have neither a background in finance nor the time to invest in developing the knowledge required to a sufficient depth. In addition, some suggested that the frequent turnover of Pensions Committee members as a result of the electoral cycle made it difficult to ensure a long term view of the investment strategy.

3.28 The ability to set a tailored investment strategy and determine the asset allocation locally was seen as vital amongst respondents from both the public and private sectors. This is perceived as an important tool for managing each fund's unique funding position and cash-flow requirements. Several respondents also emphasised the importance of local accountability as a means to ensuring the representation of Scheme members and employers. As one Scheme employer set out in their response to the call for evidence:

The existing arrangements in English County Council and London Funds promote and facilitate a clear link between the relevant individual Fund and employing bodies… As the public sector continues to fragment the number of scheduled/ admitted bodies will increase making all the more important a genuinely "local", as presently exists, link between employers and Funds.

3.29 Under a fund merger, asset allocation would need to take place at the new, larger fund authority level. However, common investment vehicles offer greater flexibility and can be established with the asset allocation made either centrally within the vehicle, or by the local fund authority.

3.30 Around 15 responses to the call for evidence stressed that common investment vehicles could achieve the benefits of scale attributed to fund mergers, without the associated disruption, implementation time, cost or loss of local accountability. As one fund outlined when talking of pooling assets in common investment funds:

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[12] Pensions Regulator – adaptation of Myners principles for the Local Government Pension Scheme http://www.thepensionsregulator.gov.uk/docs/igg-myners-principles-update.pdf

This approach might realise significant scale benefits more speedily and with less disruption, while still retaining local accountability and decision making on key matters such as deficit recovery plans and asset allocation.

3.31 Having considered the responses to the call for evidence and Hymans Robertson's analysis, the Government has decided not to consult on fund mergers at this time. However, there remains a strong case for achieving economies of scale through the use of common investment vehicles.

4. Proposals for reform

Proposal 1: Common investment vehicles

The case for change

4.1 Using common or collective investment vehicles to aggregate the Scheme's investments and moving to passive investment of listed assets has the potential to deliver significant savings of over £660 million per year, through reduced investment and other costs for all asset classes in the Scheme. These savings were set out by Hymans Robertson, whose report showed that it was likely that the economies of scale from aggregation would be best accessed through common investment vehicles.

4.2 Further savings arise from the efficient structure offered by a common investment vehicle. Within any common investment vehicle or pooled fund, money will flow in and out as investors purchase and redeem units in the fund. If those buying and selling units within a pool can be matched, fund managers will not need to sell assets to meet redemption requests and as such the volume of transactions can be minimised, improving cost efficiency.

4.3 Common investment vehicles may also deliver savings by reducing the use of "fund of funds" to access alternative assets, such as hedge funds, private equity, property and infrastructure. Fund of funds are used to achieve the scale required for individual funds to make investments they may not be able to access directly. However, this introduces an additional layer of fees, increasing the total cost of investment. Setting up a common investment vehicle would help funds achieve the scale required to invest, without the high costs associated with a "fund of funds".

4.4 Hymans Robertson found that investment fees for alternative assets were particularly high compared to other asset classes, accounting for less than 10 per cent of the Scheme's assets, but for at least 40 per cent of fees.[13] The firm's analysis showed that savings of up to £240 million per year could be achieved by ending the use of "fund of funds" across the Scheme, provided that the existing contracts were permitted to run their full course in order to avoid potentially significant termination costs. Consequently, although some savings would begin to accrue straight away, this annual total would be reached over 10 years.[14]

4.5 The wider benefits of common investment vehicles include improved transparency. As the funds would be subject to the same investment costs and asset managers, the effect of asset allocation and local decision making would become more transparent, revealed in part by the variation in investment returns. This should provide the Department, fund authorities and taxpayers with an opportunity to compare the effectiveness of a fund's asset allocation. In addition, the vehicle could provide a platform for the operation of national framework agreements, helping to minimise the cost of procurement and other administrative costs of investment such as actuarial and custodial services.

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[13] Local Government Pension Scheme structure analysis; Hymans Robertson p.11
[14] Local Government Pension Scheme structure analysis; Hymans Robertson p.7

4.6 A common investment vehicle for alternative assets could also help to improve governance by providing an independent assessment of alternative investment strategies, particularly for local infrastructure investment. A pooled vehicle could make it easier for funds to invest in infrastructure when appropriate opportunities arise, by providing a cost effective way to realise the scale needed.

4.7 As discussed in paragraph 3.28, local determination of a fund's asset allocation was seen as a vital consideration amongst respondents to the call for evidence. A common investment vehicle could be designed to allow asset allocation to remain at local fund authority level, consistent with ensuring that decisions are taken in line with existing local accountabilities.

Proposal for reform

4.8 The Government believes that there are clear advantages to funds in pooling their assets in common investment vehicles for all asset classes, but that all asset allocation decisions should remain with the fund authorities.

4.9 Hymans Robertson's analysis demonstrated that there were slightly higher returns over ten years if the funds were organised through one common investment vehicle for listed assets and a second for alternatives, rather than a greater number. This evidence suggests that savings will be maximised by the creation of two vehicles: a single common investment vehicle for listed assets organised by asset class (for example, UK equity, European equity, UK bonds and so on), and a second vehicle for alternative assets.

4.10 Concentrating the Scheme into two common investment vehicles may increase its exposure to risk. Several public and private sector responses to the call for evidence also stressed that capacity constraints may begin to apply if a fund became too large. As one fund authority stated in their response to the call for evidence:

> Furthermore there may be issues about capacity – the best fund managers may be closed to new business, and even if indeed the capacity exists, they may be reluctant to have too much business from a single client (as that creates business risks).

4.11 However, the Government believes that the exposure to risk should be mitigated if the asset allocation remains as diversified as it is at present. The Hymans Robertson report noted that the issue of capacity constraint would not apply to the common investment vehicle for listed assets if it were invested in passive funds.

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

Further considerations

A. Changes to the investment regulations

4.12 The current investment regulations place restrictions on the amount of a fund that can be invested in certain types of vehicle, for example limited partnerships in aggregate are subject to a limit of 30 per cent. In addition, while some types of common investment vehicle are listed within the regulations, others are not. Squire Sanders, as subcontractor to Hymans Robertson, indicated that secondary legislation could be used to reform the investment regulations, removing the anomalies created between different types of vehicle and any ambiguity about the funds' ability to invest substantially in common investment vehicles.

4.13 The Government recognises that the investment regulations are in need of review. The Department will consult separately on reforms to these regulations, including any changes required to facilitate investment in common investment vehicles. **However, any initial thoughts would be welcome in response to this consultation.**

B. The type of common investment vehicle

4.14 The term collective or common investment vehicle can be used very broadly and take different forms. At this time, the Government would like to seek views on the specific type of common investment vehicle to be used, but anticipates that the following principles might underpin the design:

- Pooling of assets, possibly on a unitised or share basis;
- Safeguards for individual funds, for example through Financial Conduct Authority authorisation;
- Governance arrangements considered as part of wider governance reforms arising from 2013 Public Service Pensions Act;
- Strategic asset allocation remains with individual funds; and
- An option for other funded public service pension schemes to participate in the common investment vehicles if they wish.

4.15 There are a number of types of common investment vehicle available that might fulfil some or all of these principles. One such model currently under review is the tax transparent Authorised Contractual Scheme.[15] However, careful consideration of the governance arrangements for any common investment vehicle would be needed before any more detailed proposals are developed.

Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

Proposal 2: Passive fund management of listed assets

4.16 There are two main types of investment approach, which can be used individually or in combination.

- Passive management typically invests assets to mirror a market in order to deliver a

[15] More information can be found on the Financial Conduct Authority's website: http://www.fca.org.uk/firms/firm-types/collective-investment-schemes/authorised-contractual-schemes

return comparable with the overall performance of the market being tracked.

- An actively managed fund employs a professional fund manager or investment research team to make discretionary investment decisions on its behalf.

4.17 The Local Government Pension Scheme makes use of both of these approaches, although active management is used more extensively than passive. By applying their expertise, it is hoped that active managers will deliver a level of return in excess of the market's performance, although this comes at a much higher cost than passive management. A few funds gave examples of how they had benefited from active management in their response to the call for evidence.

For example, the active manager of one fund had outperformed their performance benchmark by 3.2 per cent since 2007 and by 5.7 per cent in the last three years.

4.18 However, Hymans Robertson cite evidence from defined benefit pensions funds in the United States which shows that for equities, returns are explained predominantly by market movements and asset allocation policy, with active management playing no role[16].

The case for change

4.19 There are some risks associated with paying for active management, since not all active managers will be able to achieve returns higher than the market rate. Hymans Robertson was therefore asked to examine the performance of the Scheme in aggregate to see whether the funds' overall performance was benefiting from active management.

4.20 Hymans Robertson considered the performance before fees of equities and bonds in aggregate across the Scheme over the 10 years to March 2013. This new analysis, evaluating the funds' investment as one Scheme, showed that there was no clear evidence that the Scheme as a whole had outperformed the market in the long term. They concluded that listed assets such as bonds and equities could have been managed passively without affecting the Scheme's overall performance.

Equity market [17]	UK	North America	Europe excluding UK	Japan	Developed Pacific excluding Japan	Emerging Markets
FTSE Index	10.7	9.5	11.4	7.4	16.4	18.2
Aggregate Local Government Pension Scheme	10.8	8.4	11.6	7.5	17.3	17.1
Excess active return gross of fees	0.1	-1.1	0.2	0.1	0.9	-1.1

[16] Local Government Pension Scheme structure analysis; Hymans Robertson, p.19. Data based on 'Rehabilitating the Role of Active Management for Pension Funds' by Michel Aglietta, Marie Briere, Sandra Rigot and Ombretta Signori.
[17] Local Government Pension Scheme structure analysis, Hymans Robertson, table 9 p.20. Sources: State Street Investment Analytics (The WM Company), CEM Benchmarking Inc. *This is Hymans Robertson's estimate of the extra cost which reflects the low fees that the Local Government Pension Scheme in aggregate pay for active management of UK equities. The global cost premium is estimated by CEM as 0.56%

Extra cost (per annum) of active	0.34*	0.27	0.20	n/a	0.49	0.53

4.21 This analysis of investment return is specific to the performance of the Local Government Pension Scheme in aggregate.

4.22 In their report, Hymans Robertson quantified the fees savings achievable from moving to passive management of listed assets as £230 million per annum, assuming that all funds participated.[18]

4.23 In addition to the savings arising from lower fees, a move to passive management will also reduce the level of asset turnover. This occurs as investment managers buy and sell assets within an asset class. Both passive and active managers buy and sell assets, but turnover is generally much higher, and therefore more costly, under active management. Hymans Robertson estimated that if all of the Scheme's UK and overseas equities had been managed passively in the financial year 2012-13, turnover costs would have been around £190 million lower.[19]

4.24 Hymans Robertson also conducted a detailed analysis of the transition methodology and costs to move to passive management of all listed assets. They identified that the cost of transition could be around £215 million.[20] These transition costs are approximately equal to the savings achieved from reduced turnover costs in just one year.

4.25 Their analysis of transition also concluded that any market disruption will be limited as there is no proposed change to asset allocation. Hymans Robertson suggested that a single coordinated but phased transition would minimise market impact.

Proposals for reform

4.26 The Hymans Robertson report concluded that if the Scheme acts collectively and moves all listed assets into passive management, investment fees and turnover costs could be reduced by up to £420 million per year. This represents a significant saving for the funds, employers and local taxpayers which would begin to accrue within two years of moving to passive management of listed assets.

4.27 Having considered this analysis, the Government believes that funds should make greater use of passive management for all listed assets such as bonds and equities. Alternative assets such as property, infrastructure or private equity would continue to be managed actively through a separate common investment vehicle.

Further consideration

A. Take up of passive management

4.28 A number of the responses to the call for evidence emphasised that a small movement in investment performance has the potential to have a more significant impact on the Scheme's finances than the savings achievable from investment management fees. It is therefore important that full consideration is given to the

[18] Local Government Pension Scheme structure analysis; Hymans Robertson p.7
[19] Local Government Pension Scheme structure analysis; Hymans Robertson p.7
[20] Local Government Pension Scheme structure analysis; Hymans Robertson p.17

impact of a move to passive management on overall Scheme performance.

4.29 The Government acknowledges that, as set out in paragraph 4.17, there are funds who feel they have benefited from active management. However, Hymans Robertson's analysis of the savings associated with moving to passive management of listed assets is underpinned by a full consideration of investment performance by asset class across the Local Government Pension Scheme. This analysis shows that a move to passive management would not have damaged returns across the Scheme as, in aggregate, the funds' investment performance has replicated the market in much the same way as passive investment.

4.30 The Government therefore wishes to explore how to secure value for money for taxpayers, Scheme members and employers through effective use of passive management, while not adversely affecting investment returns. There is a range of options open to Government and the funds to achieve this:

- Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.
- Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.
- Fund authorities could be required to manage listed assets passively on a "comply or explain" basis.
- Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report

Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

5. Additional considerations

Data transparency

5.1 Although all of the funds publish annual reports setting out their costs and investment returns, a theme common to the majority of responses to the call for evidence was the need for greater transparency and more comparable data. As one fund outlined in its response to the call for evidence:

> There is currently insufficient information available to permit a robust comparison of different Local Government Pension Scheme funds. This includes data on investment performance, investment management costs, pension administration costs, and actuarial information. All of this data should already be available within each Local Government Pension Scheme fund but there needs to be a central repository to collate and analyse the information and ensure that it is comparable.

5.2 Moving to a common investment vehicle will help to facilitate this transparency, as the investment fees derived from a common vehicle will be more comparable. It will also help to highlight the effect of asset allocation and fund decision making. Since the funds would be investing through the same vehicles, the effect of asset allocation will be more easily seen from the resulting variation in investment returns. The common investment vehicles would also allow greater clarity over variations between asset allocations and actuarial discount rates.

5.3 However, it is clear that further improvements are needed to ensure published Scheme data is comparable between funds. The Minister for Local Government has asked the Shadow Board to look at data transparency in more detail and it has already made progress in this area, bringing together all of the funds' annual reports on its website. The Government is keen to support the Shadow Board in this work and looks forward to working with it to ensure more comparable data is available in the future.

Procurement frameworks

5.4 As set out in paragraph 3.24, there are clear advantages and savings to making use of the National LGPS Frameworks. The frameworks provide funds with the opportunity to reduce the cost and time associated with procurement. By developing a short list of approved candidates, the frameworks can help funds reduce the time taken to procure a service from six to nine months to a matter of weeks, as well as offering standardised terms and conditions. In addition to offering savings to the funds, the small fee paid by funds to access the framework helps to ensure that the model is self-financing in the long term.

5.5 At present, frameworks have been established by the National LGPS Framework for investment consultancy, global custody and benefit and actuarial services. The Government believes that funds can deliver further savings, using these frameworks to procure a range of services including actuarial and investment advice. Funds should give serious consideration to making greater use of these frameworks. In addition, common investment vehicles could be used as a platform from which to operate such frameworks.

Administration

5.6 The question of how to improve the cost effectiveness of administration was posed in the call for evidence as a secondary objective for structural reform. Around 12 submissions suggested that larger funds were able to achieve lower administration costs. Some fund authorities and pensions administrators set out the benefits they had seen from aggregating administration services, arguing that significant savings could be achieve from reduced staff and accommodation costs, greater automation, member and employer self service and I.T cost reductions. For example, as a shared service for fund authorities set out in their response:

Local Government Shared Services ("LGSS") Pensions Service is a collaborative venture between two Scheme funds established in October 2010, which has already saved £500k per annum in pensions administration.

5.7 However, while these savings are valuable to the Scheme, they are small in comparison to the cost reductions associated with greater passive management of listed assets and the use of common investment vehicles. In addition, as some respondents stressed, the administration of the Scheme is already facing a period of significant change with the introduction of the 2014 Scheme from 1 April 2014.

5.8 Having considered these factors, the Government has decided not to consult on administration reform at this time. However, the call for evidence has highlighted the scope for potential administrative efficiencies as well as the associated risks. At this stage, the Government proposes to allow the administration arrangements for the 2014 Scheme to mature before considering reform any further.

HYMANS ROBERTSON

Department for Communities and Local Government

LGPS structure analysis

December 2013

Linda Selman

John Wright

For and on behalf of Hymans Robertson LLP

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LGPS structure analysis PAGE

Appendices

Introduction

There is much that the LGPS currently does well and a substantial body of evidence that administering authorities have been good stewards of invested funds:

- The LGPS has procured investment management services at fee levels that compare favourably with those paid by larger international peers, particularly for investments in traditional asset classes – this is testimony to the cost saving ethos and effectiveness of local authority procurement practice; and
- A number of initiatives have already been established and further pilot projects are underway which aim to reduce costs; these include joint procurement frameworks, collective investment vehicles, shared services and voluntary Fund merger.

Nonetheless, in order to achieve further meaningful savings, everyone in the LGPS community will need to remain committed to pursuing further and more widespread improvements in investment efficiency through collaboration and reform.

The primary purpose of this research project is to quantify the potential for additional **cost savings** across the LGPS using the best objective evidence and data currently available and to assess how those cost savings might be **accessed most readily**.

The project deliverables include quantification of potential savings in investment management costs for a range of reform options. However, we were not asked to provide any recommendation on a preferred approach. The preferred approach will be a matter for government to determine after a full consultation.

We are indebted to the commercial organisations and local authorities who made significant contributions to this project by providing performance data, costings and other valuable information that has enabled us to complete this research. We have acknowledged their contributions at the end of this report. The willingness of those organisations to help and the general support we have received from the wider LGPS community during this important project are evidence of the commitment of all involved to make sure that future decisions are based on robust and objective analysis.

This paper is the work of three partner organisations, Hymans Robertson, CEM Benchmarking Inc. (a global firm specialising in the benchmarking of investment performance and costs) and Squire Sanders (UK) LLP (a global law firm with a leading public sector pensions practice). It is the hope of Hymans Robertson and its partners that this report will provide the solid evidence base that is required for a well-informed consultation on the means by which the LGPS can make further cost savings for a sustainable future.

Linda Selman | John Wright

Linda Selman | John Wright

Executive Summary and Key Findings

Purpose of project

- The primary purpose of this research is to quantify the potential for **cost savings** across the LGPS using the best objective evidence and data currently available and to assess how those cost savings might be **accessed most readily**.

Key findings

Investment costs

- Total asset management costs across the LGPS in 2012 were estimated at **£790m** (c.**44bps of total assets**), of which £745m was investment management costs and £45m oversight costs
- On a consistent basis total asset management costs for an international peer group of large funds with same asset mix were estimated at **41bps**.
- The investment costs **exclude**:

  a. performance fees on alternative assets such as private equity, hedge funds, etc. (However, they do include performance fees paid on traditional assets); and

  b. **turnover costs** (investment performance figures include the impact of turnover costs)

- Overall fees paid to fund managers by the LGPS are slightly lower than those paid by large peers for similar mandates. There is evidence that LGPS funds have been successful in securing particularly low levels of fee on some asset classes.
- The greatest potential for cost savings would result from changes to implementation style (i.e. less use of active managers and less expensive means of investing in alternative asset classes).

Investment performance

- There are some funds which have performed consistently well relative to their peers. However, for the LGPS taken in aggregate, equity performance **before fees** for most geographical regions has been no better than the index.
- This outcome is consistent with wider international evidence which suggests that any additional performance generated by active investment managers (relative to passively invested benchmark indices) is, on average, insufficient to overcome the additional costs of active management.

Traditional asset classes – potential savings

- Greater use of **passive investment** ("trackers") for listed equities and bonds could save **£230m (13bps)** per year without damaging investment performance in aggregate across the LGPS.
- Greater use of passive investment is also expected to reduce turnover costs. We estimate that the reduction in turnover cost in 2012-13 as a result of investing passively in listed equities would have been c.£190m.
- The turnover costs are a drag on the performance delivered by active management and their impact is included in the reported asset returns.
- The benefits of passive investment for listed securities are likely to be best accessed through one (or a very small number of) pooled arrangement(s). If this asset pool included both LGPS funds and other non-LGPS pooled investments, this would maximise future "crossing" benefits (matching buyers and sellers to reduce transaction costs). The most appropriate type of collective investment vehicle needs to be established as part of next steps.

- The one-off **transition cost** involved in moving existing LGPS assets into suitable passive investments is estimated to be circa £215m provided the transition is effected over a timescale designed to minimise costs. c.£47m of this is stamp duty.
- To help minimise the transition cost, it would be preferable to have the LGPS implementation carried out as a single co-ordinated exercise; that is what this cost estimate assumes.
- This may seem like a significant up-front cost but it is actually no more than the hidden additional turnover costs incurred in active management which will be saved by investing passively for just one year.
- No additional funding or up-front cash is required from government or from local authorities. Transition costs are met from the assets of the scheme and would be reflected in asset valuations (like other investment transaction and turnover costs).
- Even allowing for other implementation costs, the payback period is likely to be just over **one year** from date of the transition to passive arrangements.

Alternative assets – potential savings

- LGPS funds invest in "**alternative assets**" (private equity, hedge funds, infrastructure) for good reasons (diversification and return). Currently it is difficult for individual funds to access these investments with an appropriate degree of diversification without using "Funds of Funds" approaches. These are expensive because they add additional layers of fees on underlying funds. By pooling assets for alternatives across the LGPS, funds would be able to substantially reduce the use of Funds of Funds.
- Less use of Funds of Funds for alternative assets and early elimination of high fee alternative assets could eventually save another £240m (13bps) **or more** per year. It is not possible to achieve this saving immediately since it will be necessary to:

a. establish suitable LGPS wide investment vehicles; and

b. allow existing investments to unwind year by year over the next decade to avoid early exit costs. Further savings might be possible at a later stage using in-house teams. This would require significant investment in specialist in-house resource but we believe this would be more than compensated by more effective implementation and additional fee savings.

How to achieve these cost savings

- All of the above cost savings could be achieved with minimal legislative change (e.g. requiring changes to secondary legislation governing investment limits). If the government chooses to use compulsion to maximise the benefits, there would be additional legal issues to consider.
- While the cost savings identified could be achieved without significant structural reform, asset pooling would be necessary to achieve the full potential of these cost savings and to enable higher levels of participation without which cost savings would be eroded.

Costs and benefits of structural reform

The three options for **structural reform** in the scope of this project were set out by DCLG:

- **Option 1: A single asset pool**

  Under this option the 89 administering authorities would remain but there would be a single collective investment fund for all assets. Decision making on asset allocation and contribution strategies would remain with the 89 administering authorities. They would also continue to be responsible for their own liabilities, employer liaison and member administration.

- **Option 2: 5 to 10 asset pools**

  This option is the same as 1 except that there would be 5 to 10 collective investment funds (groupings beyond the scope of this report). The 89 administering authorities would remain. Each would be responsible for decision making on asset allocation and contribution strategies and for its own liabilities, employer liaison and member administration.

- **Option 3: 5 to 10 merged funds**

  Under this option, the 89 separate LGPS funds would be replaced by 5-10 merged funds. Responsibility for assets, liabilities, deficit management, employer liaison and member administration would all transfer to the new organisations responsible for the 5 to 10 merged funds.

- These three options differ in terms of:

  a. local investment decision making (it is assumed that under options 1 and 2 local decisions on strategic asset allocation would be retained, but not investment manager choice or implementation style);

  b. cost savings (options 2 and 3 may not be optimal scale for cost savings from implementation of passive investment and asset pools for alternatives);

  c. implementation costs and timescale and payback period (option 3 is likely to cost most to implement and take longest); and

  d. legal issues (might be more complex for option 3, fund merger).

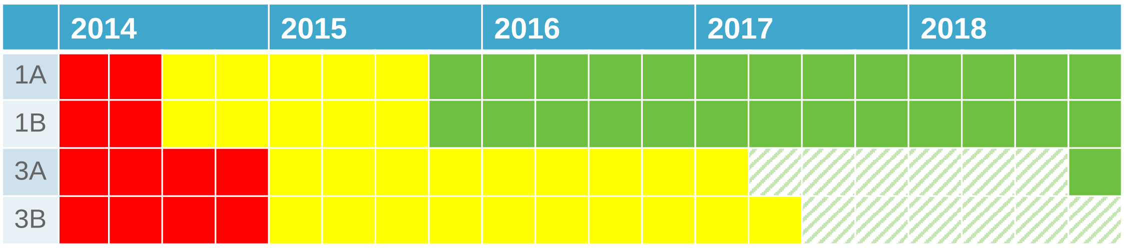
- Under Option 1, the net present value of savings is estimated to be circa £2.8bn over 10 years and £6.6bn over 20 years, based on:

  - Full participation
  - Using very large asset pools for passive investment
  - Using LGPS wide asset pool to reduce the Fund of Funds investment for alternatives

  These numbers take account of investment transition costs which will be paid out of the assets of the scheme. The numbers also take account of other operational costs of new arrangements, including set up costs for any collective investment vehicles and the associated ongoing monitoring and oversight arrangements.

- In addition the net present value of the savings over ten years from reduced transaction costs as a result of switching to passive investment in listed securities is £1.9bn. **Options 2 and 3** have similar benefits, slightly higher costs (although still modest relative to the cost savings) and longer payback periods. In the case of option 3, we have assumed it takes c.18 months longer to implement change. This delay reduces cost savings over 10 years by c.£0.7bn.

The picture below shows the implementation time-line for each of the options.



Consultation, decision, legislative changes

Establishment, procurement, implementation, transfer of function, asset transition

Benefits on-stream

Range of uncertainty for benefits on-stream under option 3

Option 1A - Asset pool, existing provider
Option 1B – Asset pool, new CIV
Option 3A – Merger, select from existing administering authorities
Option 3B – Merger, establish new authorities (eg NDPBs)

Option 3 potentially delays benefits by 18 months or more

- The financial benefits quantified in the net present value measure in this report are most sensitive to the following factors, in descending order of significance:

  1. Participation/take-up;
  2. Extent of implementation – passive only or passive and alternatives;
  3. How early the changes are implemented;
  4. The level of fee savings on passive relative to current actual fees across the LGPS; and
  5. Scale of transition cost.

- The LGPS currently spends c£45m on investment oversight (this is twice the amount spent by large international peers). There might be modest additional cost savings in this area (e.g lower spend on advisers). Some of the savings could most appropriately be redeployed on internal resource for more widespread risk management including the greater amount of complexity resulting from the multi-employer nature of the LGPS (a feature not always present in the peer group).

A summary of the net present value of benefits is shown below.

Option	Net present value of benefits over 10 years	Net present value (10yrs) of active management transaction costs	Comments
1	£2.8bn	£1.9bn	• Optimises benefits of pooling assets for passive and alternatives
2	£2.6bn	£1.9bn	• Sub-optimal size for investment scale benefits (e.g. crossing benefits on passive and diversification on alternatives)
3	£1.9bn	£1.4bn	• More complex legal issues to be resolved • Could take significantly longer to implement, resulting in loss of cost savings • Transfer of data and member administration from 89 funds to 5 or 10 makes implementation more onerous and more costly • Combining member administration in this way may not be optimal approach • Sub-optimal size for investment scale benefits • Additional project implementation risk with little additional benefits

Other funded public sector schemes (stage 2)

- In practice it is likely to be extremely difficult to apply any similar approach to cost saving across those schemes, if it involves compulsion on investment choice, since they are governed by private Trust Law and there are greater legal barriers to be overcome. Voluntary participation in any asset pooling may deliver some benefits. The implementation approach for any agreed changes should be designed to make this possible.

Conclusions and summary

The investment fee savings we identify are £470m p.a. In the table below we identify the breakdown of these savings. We estimate that the reduction in turnover cost in 2012-13 as a result of investing passively in listed equities would have been c.£190m.

Cost saving per annum	How	Timescale
£230m (12bps)*	More passive investment	Within two years
£240m (13bps)**	Lower cost alternatives	Full annual saving not achievable until Year 10
£190m (11bps)	Lower turnover	Post transition

* The cost saving equates to 15 bps of the value of listed securities, or 27bps of the actively managed listed securities

** The cost saving equates to 136 bps of the value of alternatives.

- There are a number of **conditions** for the delivery of the estimated benefits:
  - Legislative changes as required (e.g. secondary legislation on current investment limits).
  - Large (industry wide) asset pools to maximise scale benefits including crossing opportunities within passive arrangements.
  - Careful management of the transition to the new passive arrangement to minimise explicit costs and market impact costs (possibly a one-off LGPS wide exercise)
  - For Funds of Funds and alternatives, existing investments should be allowed to run their course to avoid incurring losses due to early redemption. All new investment would be made into new arrangements with lower implementation costs.
  - Full or widespread participation. Our estimates are based on full participation across the LGPS. It is a matter for government whether to use compulsion.
- The potential cost savings outlined above could be achieved with or without significant structural reform. However, asset pooling is necessary to deliver some of the potential cost savings fully (e.g crossing benefits in passive investment and more affordable access to alternatives) and may be helpful to enable high levels of participation without which the benefits could be lost.
- Next steps may include further consideration of legal aspects (especially if the government is considering compulsion) and practical details such as the most suitable and cost efficient types of vehicle for asset pooling (this may differ between passive investment and alternatives) and the mechanism by which the actual cost savings will emerge via employer contribution rates.
- These measures could **reduce LGPS investment costs by nearly a third** if the change to more passive investment is implemented and by **more than half once changes to alternatives work through.** Together the two changes could deliver savings of **£6.6bn over 20 years** if implemented effectively.

Scope, principles, limitations

Options in scope

In this report we consider three options for structural reform of the LGPS set out by DCLG.

Option 1: A single asset pool

Under this option the 89 administering authorities would remain but there would be a single collective investment fund for all assets. Decision making on asset allocation and contribution strategies would remain with the 89 administering authorities. They would also continue to be responsible for their own liabilities, employer liaison and member administration.

Option 2: 5 to 10 asset pools

This option is the same as 1 except that there would be 5 to 10 collective investment funds. The 89 administering authorities would remain. Each would be responsible for decision making on asset allocation and contribution strategies and for its own liabilities, employer liaison and member administration.

Option 3: 5 to 10 merged funds

Under this option, the 89 separate LGPS funds would be replaced by 5-10 merged funds. Responsibility for assets, liabilities, deficit management, employer liaison and member administration would all transfer to the new organisations responsible for the 5 to 10 merged funds.

Objective

The primary objective of this exercise is to identify (and quantify using the best currently available data and evidence) the most significant potential cost savings and to assess how they might most readily be achieved under the three options. A different objective would require a different approach to the assessment and analysis of the options for structural reform.

Clearly all cost savings are measured relative to the status quo.

Scope of report

The scope includes:

- quantification of current investment management costs (including investment management costs and turnover costs)
- identification (and quantification) of potential cost savings and the means by which they might most readily be achieved
- analysis of net of fees performance;
- estimation of cost of change (investment transition costs, cost of establishing new structures, future operational and oversight costs)
- cost benefit analysis of the three options; shape and timing of emergence of savings; payback period; annual cash savings and, since could be different under current actuarial practice, timing of high level implementation programme;
- emergence of benefits via contribution reductions; risks to benefits realisation; sensitivities on financials;
- practical and legal impediments to implementation (and benefits realisation); and
- high level assessment of the applicability of the options in scope to other (non-LGPS) funded public service schemes.

In benefits quantification, the focus is on “hard” data on cost reduction, rather than potential less easily quantifiable performance enhancements, including “governance premium”.

The following are NOT in scope:

- a recommendation on which option should be taken forward;
- dealing with deficits;
- member administration; and
- quantification of any governance dividend under different structure.

We have not considered how liabilities are managed; however, we have made the assumption that each employer will remain liable for the financing of their own liabilities, so the number of "employer liability pots" will be the same irrespective of the option chosen.

Principles

In undertaking this project we have sought to adhere to the following principles:

- benefits quantification is evidence based, using the best data currently available;
- where there is no reliable, relevant evidence or data for benefits, this is not taken into account in the central scenario in the cost benefit analysis;
- our reporting is restricted to commentary and analysis based on data and evidence, not opinion (if there are any grey areas at the boundaries we distinguish between fact and opinion);
- we state any critical conditions for the delivery of any assumed benefits (e.g. the degree of participation);
- our analysis of legal barriers is based on our understanding of the law as it currently stands.

Reliances and Limitations

Our report is addressed to our client for this project, the Department for Communities and Local Government (DCLG), for the sole purpose of assessing the cost and benefits of three options for structural reform of the LGPS (and other funded public sector pension schemes) as set out in the scope above along with practical and legal impediments to change. It has not been prepared for any other purpose.

This report must not be shared with any other party without our prior consent and if shared must be disclosed in its entirety. We do not accept any liability to any third party.

The information in this report is based upon our understanding of legislation and events as at 12 December 2013 and we have used all reasonable endeavours to ensure the accuracy or completeness of the information contained herein. DCLG acknowledge that we have relied on data and legal advice provided by our partner organisations in compiling this report, CEM and Squire Sanders, both under sub-contracting arrangements. Whilst reasonable efforts have been made to ensure the accuracy of the data and advice expressed, we cannot verify the accuracy of such advice and data and we cannot be held liable for any loss arising from use and/or reliance on such advice and data.

It should be noted that we do not provide legal services and therefore, we accept no liability to any third parties in respect of any legal opinions expressed in this report. Third parties are advised to take independent legal advice in respect of any legal matters arising out of this report.

A number of other organisations provided data to assist the project; for the avoidance of doubt, those organisations not party the client agreement with DCLG are not in any way liable for data they have provided.

1 Cost assessment

Highlights

- Based on data from a sample of 18 LGPS funds who volunteered their data, total asset management costs across the LGPS in 2012 were estimated by CEM Benchmarking Inc at £790m (c.44 bps of total assets)
- Of this £745m was investment costs and of that c.£710m was paid to active managers
- Moving equities and bonds fully passive would reduce fees by c.£230m p.a.
- The cost of transitioning equities and bonds to passive is estimated to be c £215m, of which £47million is stamp duty on purchases of UK equities
- The reduction in turnover cost in 2012-13 as a result of investing passively in listed equities would have been c. £190m.
- Alternatives are less than 10% of total assets but account for 40% of total fees
- Management costs for alternatives could be significantly reduced by reducing/removing the use of fund of funds though this would take time to achieve due to the long term nature of the underlying contracts.

Total costs of managing the assets

In order to assess the total costs of the management of the assets of the LGPS and then identify where and to what degree savings can be made we have relied on analysis carried out by CEM Benchmarking Inc based on detailed information supplied voluntarily by 18 LGPS funds with total assets (as at 31 December 2012) of £38bn. This sample is representative of the LGPS by fund size; i.e. it represents small, medium and large funds in appropriate weightings. Table 1 below shows the breakdown by asset size.

The CEM analysis has identified the total costs and allocated them across asset classes down to a very detailed level and by implementation method (active vs passive, internal vs external, direct vs fund of funds). These realistic costs have then been applied to a fund size of £180bn with the actual asset allocation of the aggregate LGPS. Appendix 1A sets out the methodology applied by by CEM and provides more detailed results from their analysis.

Table 1: Analysis of funds included in CEM investment cost benchmarking exercise

Fund size	All LGPS	Funds included
£5bn +	29.9%	23.6%
£2-5bn	35.1%	46.2%
£1-2bn	20.9%	19.4%
Less than £1bn	14.0%	10.7%
Total	100%	100%
Total Assets	£180bn	£38bn
Number of funds	89	18

Investment management costs

The CEM analysis at aggregate Scheme level extrapolates from the data provided by eighteen LGPS funds to estimate total investment management fee costs of £750m, equivalent to 41.5 bps of the assumed assets of £180bn. These costs include performance related fees on conventional assets but exclude performance-related fees on alternative assets. Turnover costs are also excluded.

Table 2 below breaks down these costs by asset class and by active and passive management.

Table 2 – investment management costs by asset class

Asset class	% of total assets	Active fees (£000)	Passive fees (£000)	Total (£000)	% of total fees
Equities	65.8	256,963	31,103	288,068	38.5
Bonds and cash	17.6	54,535	7,141	61,674	8.2
Property	6.8	97,996	0	97,996	13.1
Alternatives	9.8	300,883	268	301,151	40.2
Total	**100.0**	**710,377**	38,512	**748,890**	**100.0**

While this is a huge amount of money, the CEM analysis indicates that the LGPS as a whole is paying on average less than the peer group for active external investment management which makes up the bulk of the costs. The peer group would be paying £18m more than the LGPS for similar services. This reflects our experience that many funds have negotiated well with managers to bring their fees down. In particular, the data provided to CEM shows that LGPS funds are paying significantly less in fees paid for active management of their UK equities compared to that paid by the peer group; this may be at least partly influenced by the fact that the UK is the home market for LGPS funds. This differential is sufficient to reduce the total annual investment management fees paid by the LGPS by c. £50m. While there may still be scope to negotiate lower fees, the inevitable conclusion is that there is a limit to the benefit that can be secured by seeking further reductions in manager fees. It follows that, if costs are to be reduced significantly, other solutions have to be found.

The larger part of the fee burden suffered by the LGPS is for active management (£710m) which is significantly more expensive than a passive approach. Chart 1 (opposite) compares the allocation of LGPS fund assets with the fees paid to manage those assets. The chart highlights how cheap passive management of equities is and the disproportionate amount of the LGPS fee budget that arises from investment in alternatives. The management of active equities and bonds together account for £311m of fees. Alternatives account for less than 10% of the assets but for at least 40% of the fees (CEM's analysis does not capture performance-related fees on alternative assets).

Chart 1: Total LGPS fund value and fee budget split by asset class

Reducing investment management costs

There are three key ways to reduce the costs of the investment management of the assets of the Scheme;

1 Reduce the level of active management in favour of passive – the fees for passive management are significantly lower than the fees for active management;

2 Reduce the layers of fees that are inherent in fund of funds arrangements which are common in the management of property and alternatives, and

3 Move more of the assets from external to internal management.

Reducing active management in favour of passive

In aggregate, the LGPS uses less passive management than the peer group of large funds in the CEM analysis. (The use of passive management by the 18 LGPS funds combined is higher than that of the peer group of funds in the £25-£45 billion size group. However, the very large global funds make more extensive use of passive management than both LGPS funds in aggregate and global funds in the size range up to £45bn).

Realistically passive management is only available on listed assets, i.e. bonds and equities where there are market indices which can be replicated using either physical stock or derivatives or ETF's. Based on the analysis of the data submitted to CEM, we estimate that there is potential to save up to £230m p.a. if all of the equities and bonds are managed passively. Over 80% of these gains (c£193m) is attributable to equities. While there would be costs involved in transitioning from the current actively managed portfolios to passive which we quantify below, the savings are relatively easily accessible.

Table 3: Estimated fees p.a.after moving all of equity and bond management to passive

	Fees (£000)	% of total fees
Equities (all passive)	95,217	18.4
Bonds (all passive)	23,089	4.5
Property (all active)	97,996	18.9
Alternatives (predominantly active)	301,151	58.2
Total	517,453	100.0

We consider in Chapter 2 of this report the potential impact on performance, i.e. the returns that may be generated from an asset structure which is predominantly passive compared to one that is managed actively. We have included a more detailed analysis of the fee savings achievable for listed securities by moving from active management to passive in Appendix 1B.

Reducing the layers of fees in fund of funds arrangements

The Scheme has more assets in fund of funds than the peer group. This is likely to be due to the relatively small size of the individual LGPS funds relative to the average size of the peer group. The fund of funds route has enabled the LGPS to diversify their exposure but comes with an additional layer of fees. We believe that there are significant savings to be achieved by accessing alternative assets more directly than the Scheme does at the moment. There is global research which identifies the reduced costs achieved by very large funds that invest directly into private equity in general and infrastructure in particular. CEM's analysis indicates that the higher use by the Scheme of fund of funds arrangements for investing in private equity relative to the global peer group adds c. £14m to investment management costs; the peer group still has a significant level of fund of funds exposure so there could be even bigger gains to be made than this figure indicates.

However we believe that the costs involved in 'dismantling' the existing fund of fund structures are likely to be extremely onerous and that the sensible approach would be to allow existing closed end funds to run off, while ensuring that any commitment is conducted differently / directly. Lower costs will be easier to achieve if we can identify some means of consolidating the assets of the Scheme that are allocated to alternatives, e.g. into a single entity, to access investment opportunities as cheaply and effectively as possible. We return to this below.

Moving assets from external to internal management

External active management tends to be much more expensive than internal or passive management. The Scheme uses more external management than the peer group. CEM's analysis indicates that the impact on the costs of the Scheme of using more external management than the global peer group is of the order of £57m of which c.£21m are associated with alternative assets. Research carried out by CEM[1] showed that the fee for an active EAFE (essentially global ex North America) equity mandate managed externally was over four times as much as an internally managed mandate (46bps v 10 bps).

Six of the 89 LGPS funds in England and Wales already manage a significant portion of their assets internally and qualify for inclusion in State Street's peer group of internally managed UK pension funds. (To qualify for inclusion more than two thirds of assets must be invested by in-house fund management team.) We consider the relative performance of internally and externally managed funds in Chapter 2.

Oversight, custodial and other costs

The CEM analysis indicates that if the experience of the 18 funds is extended to the whole Scheme, the LGPS is estimated to be spending c.£45m on oversight, custodial and other asset related costs. This includes consulting and performance measurement of c. £11.5m. CEM estimates that as a whole the LGPS is paying c £22m more than the peer group with c £9m of this being excess consulting and performance measurement costs. The balance of the excess cost is allocated to 'oversight'. Given that for the LGPS this represents the costs of 89 funds, each with similar oversight functions, against the cost of a single fund in the peer group there is an implication that reducing the number of entities required to oversee the investments could result in some savings and that this should be possible without compromising the quality of the oversight. (Alternatively the same expenditure might be applied in more effective ways through collaboration or structural change.) However the cost savings here are of second order magnitude compared to the potential savings in direct investment management costs.

[1] **'The World's Lowest Cost Funds, Herbert Lum, Research Director, CEM Benchmarking Inc, Oct 2006**

Table 4: comparison of Oversight, Custodial and Other Costs

Activity	LGPS (£000s)	Peer Group(£000s)	Cost/savings(£000s)
Oversight	19,077	6,512	12,565
Custodial/trustee	9,881	9,881	-
Consulting /performance measurement	11,522	2,696	8,826
Audit	1,911	1,274	637
Other	2,542	2,839	-297
Total	**44,933**	**23,202**	**21,731**

Other costs of investment – turnover and transactions costs

All investment portfolios suffer transaction costs due to dealing in the underlying assets. Even a passively managed portfolio has some turnover due to changes in the constituents of the benchmark which will happen at regular intervals and the need to re-invest dividend income from the underlying holdings. The level of activity in an actively managed portfolio can be significantly higher and this has an adverse impact on costs. Not all transaction costs can be measured easily and accurately. There are explicit costs like broker commission and stamp duty which are measurable but other 'implicit' costs like the bid offer spread, market impact and opportunity cost are harder if not impossible to measure. Appendix 1C sets out more detail and definition of the components of transaction costs.

Table 5 below sets out the annual cost impact at the level of turnover of the market index for equities and the additional cost for incrementally higher levels of turnover.

Table 5: Turnover and transaction costs (bps)

		excess cost relative to passive			
Market	passive	25% turnover	50% turnover	75% turnover	100% turnover
UK	0.08	0.20	0.45	0.70	0.95
North America	0.01	0.06	0.14	0.21	0.29
Japan	0.01	0.14	0.29	0.44	0.59
Europe ex-UK	0.03	0.09	0.21	0.32	0.43
AP ex Japan	0.04	0.15	0.33	0.51	0.69
Emerging Markets	0.10	0.20	0.48	0.76	1.04

According to State Street, the average internally managed fund turns over a quarter of its UK equity portfolio each year while the All Funds Universe average is 46% p.a. If we apply the turnover that State Street identified for the LGPS in the 2012-13 year across both UK and overseas equities and compare this to the cost of turnover if all of the equities had been managed passively, the extra cost identified is of the order of £190m p.a. This assumes that the turnover in non-UK equities is evenly spread across all regions and comes with the caveat that the costs of turnover vary by region. Due to stamp duty of 0.5% on purchases the UK is an expensive market in which to trade, beaten only by emerging markets. It should be noted that this analysis does not capture all the elements of implicit costs e.g. market impact. We estimate that market impact could add a minimum of a further 5 bp of total equity assets turned over to costs, i.e. an additional £56m p.a.. Table 6 below sets out the composition of the £190m.

While there might be some debate about the actual transaction costs incurred by managers, it is worth noting that the transaction levels in 2012-13 were lower than the average for the five years to 2013. Based on the average turnover for the five years to 2013, the £190m would become £240m assuming the same transaction costs.

Another element of transaction costs is generated by mandate turnover as funds replace managers who have underperformed. However the impact of these transactions is included in the turnover identified by The WM Company and cannot easily be separated. The procurement activity associated with mandate turnover generates additional costs but these are small in relation to the other costs of change.

Table 6 – estimated cost of turnover for LGPS equities

Market	One-way turnover %	Estimated. transaction costs (bid/offer plus fees) %	Excess cost of active manager turnover	Asset allocation at 1 Apr 2012 %	Extra cost on £180bn (£000s)
UK	22.5	1.00	0.175	25.4	79,827
North America	34.5	0.30	0.092	10.8	17,881
Japan	34.5	0.60	0.199	3.4	12,202
Europe ex-UK	34.5	0.45	0.137	8.0	19,732
Asia Pacific ex Japan	34.5	0.72	0.215	3.6	13,908
Emerging Markets	34.5	1.12	0.308	5.2	28,871
Global	34.5		0.150	6.0	16,200
Total				**62.4**	**188,621**

Costs of turnover in government bonds will be significantly lower than in equities though the level of turnover is likely to be higher; State Street identify 45% one-way turnover in government bonds for the aggregate LGPS in 2012-13. Transaction costs in alternative assets are significant.

Investment management costs under status quo and alternative structures

Increasing the element of passive management

It would be possible to increase the proportion of the Scheme managed passively under either ‘status quo’ or any of the three alternative structures that this report considers.

The research we have done, as part of this project, on the passive management of equities leads us to the conclusion that there is a significant advantage to being an investor in a very large fund. The advantage comes from the reduction in frictional costs of trading either into or out of the passive pool of assets and from the regular rebalancing activity that is required. The managers of passive funds that we interviewed all described a process whereby flows of money either into or out of the passive fund benefit from a high degree of ‘crossing’. Simply put, with a large number of investors with different behaviour patterns, at any dealing date there are likely to be both buyers and sellers. The first stage of deciding how to manage these transactions is to match the buyers and sellers as far as is possible at the unit level (e.g. one investor selling UK equity fund units and another investor buying). The next stage is typically to use the residual cashflow to carry out any desirable rebalancing to improve the tracking of the assets in the fund. After that there may still be further opportunities for matching at the asset level with transactions that are taking place for other clients. However the larger part of the crossing is done at the unit level, perhaps because the 'shape' of the trades, buys and sells, is a good match. The managers we interviewed cited crossing between 20% and 60% of cash flows at unit level and relatively modest levels, c 10%, of crossing at asset level.

Under the status quo the bulk of LGPS assets that are managed passively are invested in pooled funds managed by the three largest passive managers and therefore arguably already benefit from the unit crossing of a large fund. As an example of scale, Legal and General's UK equity fund is £42bn and the resources applied to the management of the firm's passive business include c. 20 investment managers.

Option 1 implications

If the passive investment of the 89 funds was in a pooled fund or funds (if more than one manager were employed) dedicated to LGPS then there is likely to be a reduction in the crossing opportunities as all of the investors are likely to have cashflows going in the same direction as each other. While the UK equity assets would amount to almost £46bn, there would only be about £6bn invested in each of Japan and Pacific Basin ex Japan if the current asset allocation were maintained across the Scheme.

Option 2 and 3 implications

The same issues, i.e. reducing the opportunities for crossing units, apply as for option 1 although, with even fewer LGPS participating in each collective investment vehicle (CIV), the chance of crossing opportunities would be even lower. Under the 5 fund scenario would be c £36bn, resulting in less than £9bn of assets in the UK equity sub fund and around £1.25bn each in Japan and Asia Pacific Basin ex Japan.

Under each of these two options the issue of scale might be addressed by either;

- The CIV(s) holding units in one or more of the existing pooled funds rather than investing on a segregated basis, or
- Agreeing an arrangement with an existing passive manager to set up a sub-fund within an existing fund specifically for LGPS investments.

There are a number of reasons why we do not believe that internal management can compete with the current external managers of passive funds;

- The low fees that currently prevail for passive management
- The value of the crossing opportunities that are available when there are different investors in the pool with varying cashflow patterns
- The significant costs of resourcing the activity effectively (e.g. L&G have a team of c 20 managers allocated to managing passive mandates)
- The track record the existing managers have of adding value relative to benchmark.

Reducing the layers of fees in fund of funds arrangements

The evidence globally is that it is only the very largest funds that invest directly into alternative assets using their own internal resources. This reflects the significant costs associated with the level of due diligence required to invest directly into private equity or infrastructure. Under options 2 and 3, even with only five CIVs, we do not believe that it would be practical to achieve adequate diversification for each £36bn fund through direct investment. We believe direct investment in alternative assets is only viable if the assets allocated are invested in a single and appropriately resourced collective vehicle.

Moving more of the assets from external management to internal management

A study by CEM[2] showed that on average six front office investment staff were required for every US$10billion (£6bn) of assets managed internally. State Street[3] report that the internally managed LGPS funds employ teams that range in size from 8 to 22 with an average of 13. The largest of the internally managed LGPS funds is c. £10bn so LGPS staff numbers look quite large. State Street suggest that this may be because the LGPS funds are small relative to the funds in the CEM study (average US$90billion). However, our discussions with a number of the internally managed funds suggest that these figures probably include the 'back office' and accounting staff. CEM found that for every one front office investment member of staff there were 1.7 staff members engaged in governance, operations and support. Under the 5 fund model in options 2 and 3, this would imply 36 front office staff and 60 back office staff for each of the 5 asset pools or merged funds if all of the assets were managed internally. However these staffing requirements would be reduced if the listed assets were managed passively.

Transition costs – increasing the element of passive management

While it is clear that, once in place, passive management of the equities and bonds would be cheaper than active management there are costs involved in the transition. In order to quantify these costs we designed a hypothetical transition. This involved moving all of the listed equities and bonds that are currently managed actively (apart from the small elements that are currently managed internally) to passive management.

The total costs of transition are estimated as c.£215 million. It should be noted that c.£47 million (22%) of the estimated transition cost is UK Stamp Duty on the purchase of UK equities involved in the reorganisation.

The cost estimate for transition assumes that implementation is carried out as a single co-ordinated exercise. The process and timescale for the transition is designed to minimise costs. The volume of trades involved will require multiple tranches of transitions to avoid high market impact costs.

Appendix 1D provides more information on transition methodology and the estimated costs.

[2] 'How Large Pension Funds Organize Themselves', Jody MacIntosh and Tom Scheibelhut, Spring 2012
[3] Lessons from Internally Managed Funds, March 2013

2 Performance impact of changes in asset management

Highlights

- While some funds have a good and consistent performance, there is no evidence that, in aggregate, the Scheme has outperformed regional equity markets over the ten years to 2012-13
- This is consistent with both UK and global evidence which suggests that any additional performance generated by active investment managers is on average insufficient to overcome the additional costs of active management
- There is evidence that internally managed pension funds in the UK have outperformed those with no internal management even before fees are taken into account
- However, global evidence suggests that the lower cost of internal management is the main reason for the outperformance of funds that have more internal management.

Methodology

In this chapter we examine the potential for the changes in the management of the assets to impact on the investment performance. We have examined published research that provides evidence on UK and Global pension funds. For LGPS specific data we have used two sources of data;

1 Our proprietary database of LGPS fund performance which records for each fund, performance at total asset level for each the eight financial years from 2005-06 to 2012-13. This database has been built up over time by sourcing data from the published Annual Reports. It forms the basis for Table10 below.

2 Data supplied by State Street Investment Analytics detailing the returns by asset class at the aggregate Scheme level for each of the 10 years from 2003-05 to 2012-13. This information is summarised in Appendix 2a and forms the basis for Table 9 below.

The LGPS investment model

The most common model for the management of the assets of an LGPS fund is a combination of active and passive management with external managers being hired to manage all of the assets. Those funds that have made allocations to alternatives, specifically hedge funds, private equity and infrastructure, have used a significant level of fund of funds structures. Some of the property exposure also incorporates funds of funds to get adequate diversification. A number of funds have some element of internal management (most commonly passive equities) but only six qualify for inclusion as internally managed under State Street's definition which requires over two thirds of the assets to be managed in-house.

There is a significant cost differential between active and passive management as we have shown in Chapter 1. Active management is selected on the assumption that the manager will outperform the benchmark by more than the additional cost of investment. The focus on what the extra cost is has been on the element that relates to manager fees. However, as we demonstrated in Chapter 1, there is an additional drag on active performance from the higher levels of turnover that active managers undertake. The impact of transaction costs is included but hidden in the reported performance. Although managers are required to make disclosures on the costs they incur, it is impossible to identify the full impact of trading costs.

Comparison of performance of active v passive management

UK evidence

State Street Investment Analytics published their most recent analysis of Active and Passive Management in July 2012. In the report, they 'consider the ranges of risks and returns for passively and actively managed equity portfolios of UK pension funds relative to broad market indices.'

Table 7 below shows the ten year returns by equity market for the passive and active equity portfolios of UK pension funds. The passive portfolios have, as expected, closely tracked the appropriate indices; the weighted averages for all regions are within 0.2% of the index return. The record of the actively managed portfolios shows a range from an outperformance in World Pacific ex Japan of 0.9% p.a. to an underperformance of 1.1% p.a. in North America.

The returns quoted do not take account of investment management fees.

Table 7: Ten years to end 2011: Index and Weighted Average Returns (% p.a.) (Gross of fees)

Equity market	UK	North America	Europe ex UK	Japan	Developed Pacific ex Japan	World Pacific ex Japan
FTSE Index	4.8	2.8	4.3	2.5	12.1	10.9
Passive Portfolios	4.8	2.6	4.3	2.6	12.2	-
Active Portfolios	4.9	1.7	4.5	2.0	11.8	11.8

Global evidence

Research based on the asset allocations of US defined-benefit pension funds for the period 1990-2008 tested the role of three factors, market movements, asset allocation policy and active portfolio management, in explaining their returns. The results are reported in ‘Rehabilitating the Role of Active Management for Pension Funds’ by Michel Aglietta, Marie Briere, Sandra Rigot and Ombretta Signori. Table 6 below summarises their findings.

Table 8: decomposition (%) of pension funds’ actual net returns 1990-2008 (Net of fees)

Factor	Global Allocation	Stocks	Fixed Income	Cash	Real Assets	Hedge Funds	Private Equity	TAA
Market*	90	96	70	26	47	54	26	75
Asset allocation	4	2	3	13	2	2	2	5
Active Management	2	0	20	36	40	40	54	16
Interaction effect	4	2	7	25	11	4	18	4

*Market returns are defined as average returns of all pension funds

While the performance of traditional asset classes is driven mainly by market movements and active management makes little impact, active management plays a significant role for the alternative asset classes, particularly real assets, hedge funds and private equity. For equities, 96% of the return volatility is explained by market movements, 0% by active management and 2% by policy allocation. For real assets, market movements account for only 47% of performance while active management accounts for 40% highlighting the potential to add value through asset selection due to the heterogeneity of performance.

LGPS evidence at aggregate Scheme level

Data from State Street Investment Analytics (The WM Company)

A number of LGPS funds have a good and consistent record of investment performance over long periods. However this is not replicated across the Scheme. In this section we consider the performance that has been achieved within equities (broken down into regions) and bonds. We do not consider the contribution from asset allocation.

We have examined the data for the aggregate LGPS (including Scotland and Northern Ireland) for the ten year period ending on 31 March 2013.

Table 9: Ten years to 31 March 2013; Index and weighted average returns (% p.a.) (Gross of fees)

Equity market	UK	North America	Europe ex UK	Japan	Developed Pacific ex Japan	Emerging Markets
FTSE Index	10.7	9.5	11.4	7.4	16.4	18.2
Aggregate LGPS	10.8	8.4	11.6	7.5	17.3	17.1
Excess active return	0.1	-1.1	0.2	0.1	0.9	-1.1
Extra cost (p.a.) of active	0.34*	0.27	0.20	n/a	0.49	0.53

Sources: State Street Investment Analytics (The WM Company), CEM Benchmarking Inc.

*this is our estimate of the extra cost which reflects the low fees that the LGPS in aggregate pay for active management of UK equities. The global cost premium is estimated by CEM as 0.56%

Appendix 2A includes detailed analysis of performance across equities and bonds broken down into different time periods. Although some periods show stronger performance than others, there is no strong evidence that the aggregate Scheme has outperformed the market in the long term.

The funds' aggregate equity returns and the funds' regional equity returns are highly correlated with the broad market index. Correlation data provides an indication of the strength of the relationship between the funds' returns and the underlying index returns. It does not provide any information on the scale of the relative moves. For example, even the returns of a very active equity manager are likely to be highly correlated with the broad market index, typically in excess of 0.8. The correlations observed at aggregate Scheme level in equities are well in excess of 0.9 which reflects the high degree of overlap between the fund and the index holdings. Considering performance at the aggregate Scheme level masks the extent of the dispersion of returns across the funds.

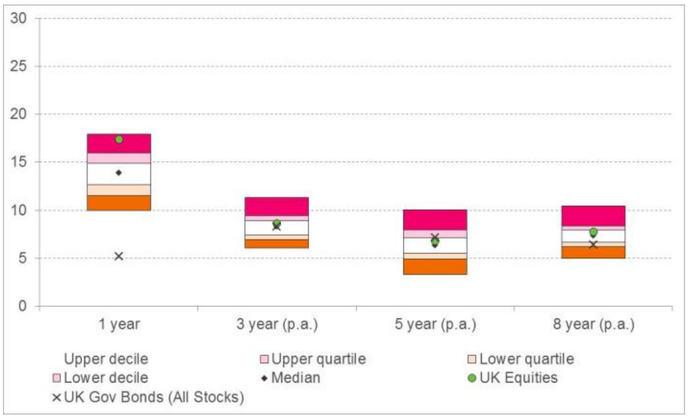
Analysis based of Hymans Robertson's data

We have gathered the performance data for each of the LGPS funds at aggregate fund level over the eight years to 31 March 2013 and analysed it for each annual period and over the longer term. The difference here is that we are able to track the performance of each individual fund. Table 10 overleaf shows in tabular and graphical form the dispersion of returns over 1, 3, 5 and 8 years and for reference plots the returns for UK equities and UK government bonds over the same periods. Over 8 years the best performing fund has returned 5.5% p.a. more than the worst performing fund. Our analysis shows some evidence of funds with both consistently good and consistently poor performance.

In Appendix 2B we have included some further analysis by fund size. That analysis shows that there is no strong evidence that larger (>£1bn) LGPS funds have performed better than smaller funds (<£1bn) though there is evidence that the performance is more widely dispersed for the smaller funds. This is counter to global research on the performance of large funds relative to small funds and may reflect the small sample size and the fact that even the largest LGPS fund is small in the global context.

Table 10: Dispersion of returns for LGPS funds over 1, 3, 5 and 8 years to 2012-13

	1 yr	3yrs (p.a.)	5yrs (p.a.)	8yrs (p.a.)
Maximum	17.9	11.3	10.1	10.5
Upper quartile	14.9	8.9	7.1	7.9
Median	**13.9**	**8.3**	**6.4**	**7.4**
Lower quartile	12.6	7.4	5.5	6.7
Minimum	10.0	6.0	3.3	5.0
UK equities	**17.4**	**8.6**	**6.8**	**7.8**
UK gov. bonds	**5.2**	**8.3**	**7.2**	**6.4**



Comparison of internal versus external management

UK evidence

State Street Investment Analytics monitor the performance of 21 funds that manage more than two-thirds of their assets internally using an in-house fund management team. The analysis was last performed on data as at end December 2011 when the funds were valued at £174bn. The average size of the internally managed funds was £8bn; four funds were valued at less than £1bn. Six of the funds that were included were LGPS funds and their total assets amounted to £17bn.

Table 11: Performance of internally managed funds (%p.a.) to the end of 2011 (before fees)

	5 yrs	10yrs	20yrs	25yrs
Internal	3.7	6.2	8.6	8.9
All Funds	3.5	5.9	8.3	8.6
Relative	0.2	0.3	0.3	0.3

As the cost savings from using internal management are significant, the differential performance after costs are taken into account will be even more substantial.

Global evidence

Research by CEM[4] showed that funds with more internal management outperform funds with less at the total fund level. On average, funds earned 4.6 basis points more net value added for every incremental ten percent of internal management. The lower cost of internal management was the main reason for the differential.

Further research by CEM[5] examined the differential in performance between internal and external management at the asset class level. They found that before costs there was no statistically significant difference in gross value added performance between internal and external management at the asset class level. However, after costs were deducted internal management performed better than or equal to external management in all asset classes considered and there was a statistically significant difference in the performance of internally managed global non-US developed market equities (EAFE) of 96 basis points of net value added. Table 12 below summarises the results.

Table 12: Higher (lower) value added for internally managed assets in bps

Asset class	Gross of costs	Net of costs
US Stock	(23)	0
EAFE Stock	57	96
Emerging Markets stock	(32)	28
Fixed Income	(15)	0

The findings were consistent across country of domicile for the funds and across fund sizes in excess of $20billion and those less than $20billion.

Internal management in the LGPS

We have identified five LGPS funds each of which would qualify to be included in the State Street Investment Analytics peer group of funds that are managed internally. Table 13 overleaf summarises their performance relative to the universe of LGPS funds over the eight years to 2012-13 and relative to their own benchmarks over ten years. While these funds have done well relative to their peer group they have not all managed to beat their benchmarks which provide a measure of what would have been achieved through passive management.

[4] Internal Management Performed Better, Hubert Lum, December 2007
[5] Internal management does better after costs, Terrie Miller and Chris Flynn, October 2010

Table 13: LGPS Funds with internal management

Fund	Total assets as at 31 March 2013 £bn[1]	Performance % p.a. 8 years to 31 Mar 13[2]	Rank over 8 years[2]	10 year Fund performance % p.a.[1]	10 year Benchmark return % p.a.[1]
Derbyshire	3.1	8.1	19	9.9	9.6
East Riding	3.1	7.9	29	10.1	10.2
South Yorkshire	5.3	8.3	12	9.9	9.9
Teeside	2.9	8.5	7	10.2	9.4
West Yorkshire	9.9	8.3	10	10.2	n/a

Sources: [1]Fund Annual Reports 2012-13, [2]Hymans Robertson database

As part of our research for this project we interviewed three out of these five funds to find out more about how their internal arrangements work and their investment philosophy. A key characteristic which is borne out by global evidence was low turnover at both stock and mandate level and indeed one cited the low turnover as having added 20-25bps to performance.

Impact of reducing the use of fund of funds

Implementation using fund of funds results in high costs and this has an inevitable impact on performance. Research by CEM highlights that the fund of funds style of investing under-performed direct internal investing by 6.8% for private equity (1996-2012), by 5.5% for property (1995-2012).

Table 14: Average value added (%) relative to customised investible benchmarks* by implementation style

Asset Class	Internal	Direct Limited Partnership	Fund of Funds
Private Equity	6.2	1.8	-0.6
Real Estate	0.7	-1.1	-4.8

* The investable benchmarks use a mix of public market equity and REIT indices that varies by region. The benchmarks are custom-lagged for each fund. The real estate benchmark is adjusted for the higher leverage of public indices.

The fees disclosed for these alternative asset classes are frequently understated. The three most common reasons are:

- Management fees are frequently reduced by revenue sharing (commonly called rebates)
- Carry (e.g. performance fees) is excluded
- For fund of funds, the costs of the underlying funds are excluded.

3 Financial analysis

Highlights

- Moving all of the equities and bonds to passive management will produce fee savings of c £230m p.a.
- Reducing the use of fund of funds and removing very high cost alternatives will produce further fee savings of c £240m p.a. though the full annual saving will not be achievable until year 10
- The cost of transitioning the equities and bonds to passive management is estimated at £215m
- These are the elements that have the biggest impact on the calculation of the net present value of the savings. The additional costs, e.g. establishing, operating and overseeing collective investment vehicles, are relatively insignificant, although we have taken them into account,
- The financial benefits are most sensitive to the following factors in descending order of importance
  - The participation or take-up rate (i.e. how many of the LGPS funds decide to invest through the pooled approaches)
  - The extent of the implementation of the changes – passive only or passive and alternatives
  - How early the changes can be made
  - The level of the savings on passive relative to current actual fees paid across the LGPS
  - The scale of the transition cost
- The net present value calculated over ten years varies by option; Option 1 £2.8bn, Option 2 £2.6bn and Option 3 £1.9bn

Overview

The financial analysis is based on two components, relating to the change of investment approach:

- The costs involved in undertaking the change; and
- The benefits arising over time from the changes which result in lower manager fees. In relation to benefits, the basis we have employed is to evaluate benefits in a relative sense, i.e. the difference between the new fees and the fees currently being paid by the LGPS in aggregate

The financial plan takes account of the incidence of both costs and benefits. Our analysis in Chapter 2 showed that there will be no meaningful impact on the returns generated under the new investment approach. Accordingly, we have made no allowance for either higher or lower investment returns.

Administration services are out of scope for this project. We have therefore excluded any assessment of potential future cost savings from re-organisation of administration services, under all three options.

Costs

The principal costs are:

- Establishment costs, e.g. the costs of specialist operating resource (personnel, support and infrastructure, including IT) for any new entities that are created. We have assumed a fixed cost of £500,000. It may be possible to use private sector partners in this area to contain costs.
- The cost of a dedicated investment management team for the collectivised alternative assets. We have made assumptions as to the initial size and quality of the investment team and allowed for this team to

grow in the years following establishment. An allowance has been made for the costs of office space, IT and other support services. This element of our assumptions was 'sense checked' against the actual experience of IFM Investors who have extensive experience of investing in alternative assets. IFM was established over 20 years ago and is owned by 30 major not for profit pension funds.

- Costs relating to the creation of collective vehicles. This will depend on the number of vehicles and their structure, e.g. different approaches might be required for listed securities and alternative assets. We have assumed a cost of £300,000 for a listed securities vehicle and £780,000 for an alternative assets vehicle.
- Contractual adjustment costs relating to procurement of new agents that are necessary and any penalty costs relating to the terminations of contracts of existing agents. Because notice periods are short (typically 3 months or less), we do not believe there to be any material termination costs.
- Project management, actuarial advice (for option 3) and legal costs.
- Transition costs relating to the direct and implicit costs involved in restructuring assets. This is the dominant cost element and essentially relates purely to the listed asset component. Much of the investment in alternative assets is held in closed-ended funds which would be expensive to exit early. Consequently, we have assumed that existing investments in closed-ended funds will be maintained and allowed to run off. However, we envisage that new investment in alternatives would adopt a different structural approach.

Benefits

The principal benefits arise from:

- A switch from active to passive management for listed assets, which results in a significant saving in fees. We have used the data set out in Chapter 1 of this report.
- A gradual shift in the management of an element of alternative assets, from a fund of funds approach to a direct or funded approach. The benefit comes from the removal of an additional layer of fees, although the fact that the closed ended funds are allowed to run off means that the benefit comes through gradually. We have assumed the run-off takes place evenly over a 10 year period.
- The early closure of high fee contracts, where termination is straightforward (without penalty) and where the value of the product is of questionable value (in an aggregate LGPS context). This benefit amounts to c. £100 million p.a.; we have assumed that it will start to emerge 12 months after the decision to proceed is taken.

Time period

Our approach enables us to model the incidence of costs and benefits quarter by quarter. We modelled the first 10 years and the next 10 years. We have used a discounted cash flow basis to calculate the net present value (NPV) of the aggregate saving (benefits less cost) over the first 10 years of the project.

A key assumption for the purpose of quantifying benefits is the implementation timeline, including assumptions as to when costs will be incurred and when benefits will start to emerge. More detail on implementation plans and timelines is given in Chapter 4. For consistency, net present value calculations for all options have been calculated as at 1 January 2015. We have assumed this is the date when the decision is taken regarding the option which is to be adopted.

For the purpose of financial modelling, central assumptions in the net present value calculation include the following:

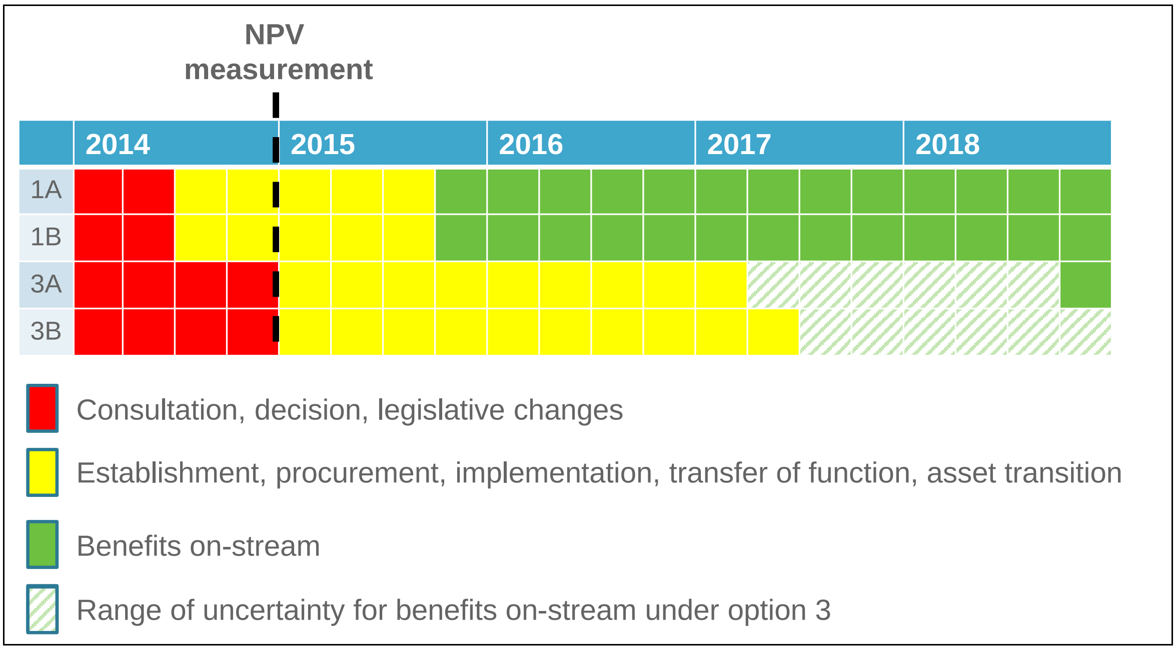
1) Under options 1 and 2, cost savings from the switch to passive investment come on-stream in Q4 2015;

2) Under option 3 (fund mergers), there is an 18 month time lag relative to options 1 and 2. Cost savings are assumed to start emerging in Q2 2017.

We expect the transition to new operational arrangements to take longer for option 3 (fund merger) because of the additional work and complexity involved in transferring membership data and records, member administration and liabilities, particularly if new administering authorities are established. There is also greater uncertainty in our timeline estimates for full fund merger due to greater uncertainty over legal impediments.

In practice the time lag could be greater than the assumed 18 months, in which case our estimate of the NPV of benefits under option 3 (over a 10 year period measured from 1 January 2015) could be an overstatement. On the other hand, even under option 3, the switch to investing passively (using asset pooling across the LGPS) could be implemented before fund merger, so the cost savings could emerge sooner.

The following graphic shows the incidence of various aspects of the project for structural change.



Other financial assumptions

- Initial value of the assets - £180bn
- Asset growth rate – 6% p.a.
- Discount rate – 5.5% p.a.
- CPI assumption – 2.5% p.a.

Risk to savings delivery

The principal risks to delivery of the savings will arise from:

- A take up of the new structure which is lower than modelled or in which the take-up comes through more slowly
- Time delay, i.e. if implementation is held up
- Greater transition costs than modelled.

Sensitivity to assumptions

Participation/take-up

Assuming there is no compulsion, the assumption relating to the extent of participation in the new investment structure has a significant impact on the savings that can be anticipated. We have tested the impact of 100%, 50% and 10% participation. With lower participation, the cost of transition will reduce and this has been reflected in our modelling. However the costs of creating collective vehicles and the establishment costs are unlikely to reduce.

While, as we have observed earlier in this report, the impact of turnover and transaction costs in active portfolios is already reflected in the reported performance numbers, we have indicated the incremental impact on savings of this element of cost for each level of participation.

Costs

The largest element is the transition cost, which for a full transition to passive management has been estimated to amount to £215 million. This assumes that, after consolidating listed LGPS assets and identifying the portion to be traded, the transition is managed over a period of time rather than being achieved in a 'big bang' approach. Approximately £47 million reflects UK stamp duty on the buy side of the UK equity transition. We have tested the impact of the transition cost being 10% and 100% higher than estimated. This latter figure represents something close to a 'big bang' approach.

We have indicated the sensitivity of the savings to the option adopted, allowing for the additional costs involved for options 2 and 3 of having five collective investment vehicles rather than one. Additonally we have modelled a delay of 18 months in implementation for option 3 due to the additional legislation that is likely to be required.

Benefits

The major element relates to the fee reduction arising from the change from active to passive management on quoted equities and bonds which amounts to approximately £230 million p.a. in current cost terms. A change in the approach to the management of alternatives results in the gradual emergence of savings of approximately to £1.1 billion over 10 years assuming 100% participation.

We have modelled our central assumption of £230 million p.a. savings and savings £30m higher and lower. We have estimated figures for all 3 of the options.

Observations

- The level of take-up will have a significant impact on the savings achieved
- The extent of the implementation, i.e. whether the alternatives are restructured as well as moving the traditional assets to passive, is likely to have the next most significant impact
- In contrast a variance in the cost of the transition to, or the fees paid for, passive management will have a more limited impact.

Summary results - Comparative savings over 10 years

Table 15: sensitivity to take-up/participation – option 1 assumed

Take-up	Savings in manager fees		Manager fees and transaction costs
	Passive and alternatives £bn	Passive Only £bn	Passive only £bn
100%	2.8	1.7	3.6
50%	1.4	0.8	1.8
10%	0.2	0.2	0.3

Table 16: sensitivity to DCLG options (1, 2 and 3) and transition costs – assumes 100% take-up

Transition cost assumption	Option 1 (one passive CIV, 1 alternatives CIV) £bn	Option 2 (5 passive and 5 alternatives CIVs) £bn	Option 3 (5 passive and 5 alternatives CIVs with 18 month delay in implementation) £bn
£215m	2.8	2.6	2.0
£240m	2.8	2.6	2.0
£400m	2.6	2.4	1.8

Table 17: sensitivity to DCLG option and level of passive fees – assumes 100% take-up

Assumption for savings from passive fees	Option 1 (one passive CIV, 1 alternatives CIV) £bn	Option 2 (5 passive and 5 alternatives CIVs) £bn	Option 3 (5 passive and 5 alternatives CIVs 18 month delay to implement) £bn
Central assumption - £230m across equities and bonds	2.8	2.6	2.0
Lower savings on passive - £200m	2.5	2.2	1.7
Extra savings on passive - £260m	3.2	2.9	2.3

4 Implementation project plans

Introduction

In this chapter we set out high-level implementation plans for establishing and managing a collective investment vehicle (options 1 and 2) and for fund merger (option 3). More detailed plans can be made available.

Assumptions specific to establishing CIVs (options 1 and 2)

- We have made some specific assumptions.
- DCLG is shown in the project plan in relation to the current project. We have assumed the involvement will relate to a preferred collective investment option. The period may be extended to allow for consultation. It is not clear to what extent activity will be conducted by other groups while the consultation proceeds.
- We have assumed there will be a "managing entity" which will direct activity around a collective vehicle. Because this will involve management activity over and above investment management, we have assumed that the managing entity will not be the direct "operator" of the collective investment vehicle, but will have a subsidiary company which will be the operator; this assumes that the managing entity will have "control" of the operator, rather than using a third party operator. The operator will need to be regulated by the FCA, which is the reason for setting it up as a subsidiary of the managing entity. Other activities conducted by the managing entity include:
  - Producing promotional and other material for potential CIV investors, i.e. LGPS funds
  - Reporting to and communicating with investors, both in relation to investment management activity, but also discussing aspects such as range of investment options, fee discussions, performance reporting
  - Monitoring the activity of the operator
  - Monitoring the activity of CIV providers (managers, custodian, etc.)
  - Assisting with resource, e.g. human resource function, IT, administrative personnel, offices accommodation, compliance, etc.
  - Assisting with procurement.
- We have assumed that a steering group will be established as a predecessor to the managing entity. This could be formed of a committee set up by a group of established administering authorities. The steering group would conduct preliminary investigations around the architecture of the collective vehicle. The managing entity is essentially a legal formation set up to continue the activity initiated by the steering group. The precise legal form of the managing entity is not defined – it might be formalised within an existing entity which collaborates across administering authorities.
- In order to establish the collective vehicle, both the operator and the vehicle itself will need (FCA) authorisation. The managing entity is likely to be a 'qualifying parent undertaking' under Part 12A of FSMA. The FCA has powers to oversee and give directions to the parent of an authorised person if that parent is not itself authorised.
- We have assumed that there will be a pilot transition of assets into the CIV, e.g. a single asset class transition could take place, as a live test of processes, prior to building out a wider group of sub-funds. This might not be consistent with a major transition to passive investment, which is likely to be more effective (in terms of speed and transition cost) if conducted in a single step.
- The actual project plan will depend on the specific architecture within the collective vehicle, so elements of the plan will change to accommodate specifics.

- We outlined implementation plans for two scenarios:
  - Under 1A we assume that an **existing provider** is procured – there may be savings in the establishment costs and timescale but any time saving may be offset by the required length of the procurement process;
  - Under 1B we assume that a **new vehicle and operator** are established as described above.

Fund merger (option 3)

- We considered two scenarios:
  - Under 3A, we assume that **existing administering authorities** are selected to run the 5 merged funds. This may reduce the time taken to establish and make operational the new arrangements. However, time must be allowed for a transparent and rigorous selection process.
  - Under 3B we assume that **new agencies** are established to run the merged funds. These may be some form of Non-Departmental Public Body (NDPB). It may take any new agencies longer to become operational since they will need to procure property, staff, systems and external services and establish and test their own operational procedures and controls before the process of transfer from existing administering authorities can commence.

For fund merger (3A and 3B) in addition to transferring assets, the implementation will include transfer of all functions associated with the running of an LGPS fund including member administration, employer liaison, in-house investment monitoring and management and governance arrangement. This is a complex exercise and is likely to take significantly longer to implement. We assume that this activity is over and above the structural changes that might be implemented on the investment management side since the 5 merged funds will need access to asset pools to achieve cost savings on investment management (the primary focus of this research).

Key stages

The table below sets out the main stages involved in each of the options. The detailed plans behind these stages can be made available.

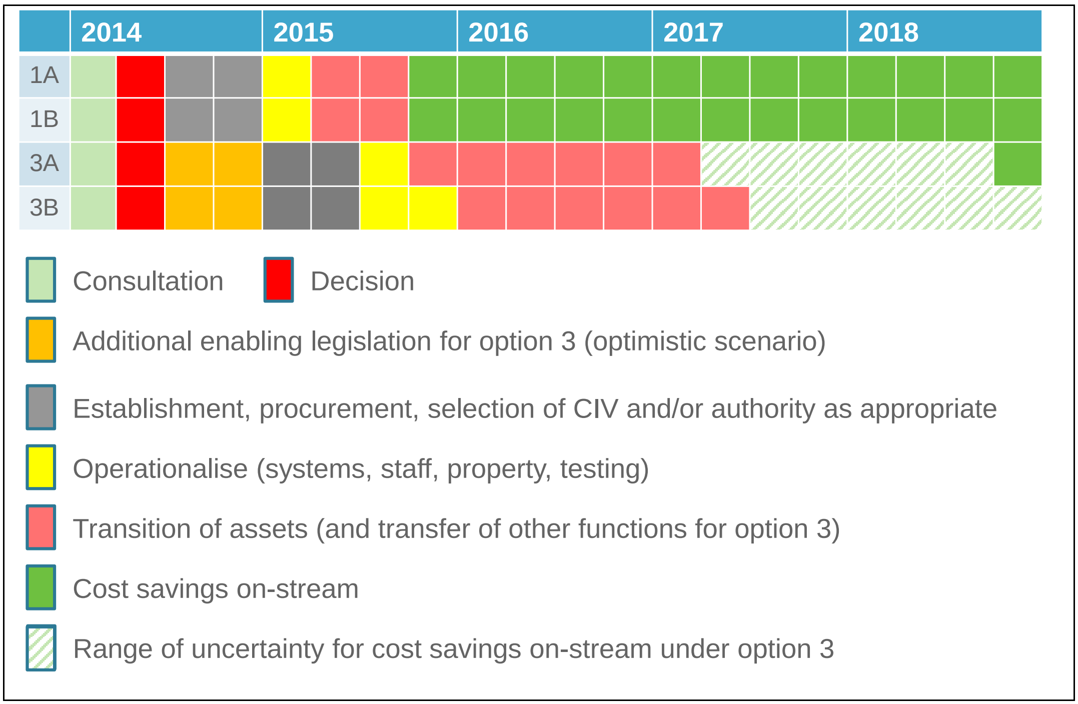
Table 18: Key stages and elapsed time from January 2014

Option	1A Asset pooling Existing provider	1B Asset pooling New vehicle and operator	3A Merger 5 existing authorities	3B Merger 5 new authorities
1) Consultation	3m	3m	3m	3m
2) Assessment of consultation responses; government decision	3m	3m	3m	3m
3) Legislation changes	N/A (c.6m but in parallel with 1) and 2)	N/A (c.6m but in parallel with 1) and 2)	6-18m	6-18m
4) Specify requirements for new entities	N/A in parallel with legislation	N/A in parallel with legislation	N/A in parallel with legislation	N/A in parallel with legislation
5) Establish new vehicle / authorities or select from existing	6m (procurement)	3m (select)	6m (selection process)	6-12m
6) Operationalise (infrastructure, controls, procure IT for administration, staffing)	3m	6m	3m	6-12m
7) Transition (assets) and transfer (liabilities and member admin)	6m	6m	18-24m	18-24m
8) Benefits start to emerge	21 months (Q4 2015)	21 months (Q4 2015)	Between 39 and 57 months	Between 42 and 72 months

High level comparison of timelines

The illustration below compares timelines for options 1A, 1B, 3A and 3B.

- Option 1A - Asset pool, existing provider
- Option 1B – Asset pool, new CIV
- Option 3A – Merger, select from existing administering authorities
- Option 3B – Merger, establish new authorities (eg NDPBs)



Conclusions

Clearly asset pooling (options 1A and 1B) can be effected considerably more quickly. There is a greater degree of uncertainty over implementation timescales for fund merger (option 3) – possibly in the range 3 to 6 years from January 2014 - depending on the implementation approach and the time taken to resolve legal aspects.

For financial modelling of cost savings we have assumed there is a timelag relative to options 1 and 2 of at least 18 months before cost savings from option 3 (merger) come on-stream.

5 Practical impediments to change and mitigation

Background

The main impediments to change relate to:

1. The level of adoption for any new structure or change in investment approach designed to reduce costs, i.e. obtaining "buy in" or creating statutory powers to compel;
2. Difficulties around new implementations arising from Schedule1 limits within the current LGPS Investment Regulations;
3. Delays arising from any need for new entities to be established;
4. Delays or difficulties arising from funding and resourcing any new entities with required skills;
5. Project risk in relation to the restructure; and
6. Whether costs of the restructure will exceed benefits that can be achieved over a reasonable time frame or any lack of certainty over the potential scale of benefits.

Some of these impediments apply to each of the three options under consideration, for example, the current Schedule 1 limits (2 above). The impact of items 3 and 4 above may differ between one option and another.

Practical impediments to change

Issue	Resolution
Making the change There are risks and costs relating to the change in structure.	
• The opportunity for other means of cost saving is foregone while new entities and vehicles are being established	• Formal planning will minimise delays. Some other opportunities may continue
• The project may take longer than expected or may be implemented poorly	• Formal planning will minimise delays and risks of poor implementation
• Provider contract termination penalties may add to costs	• Notice periods are short, but a full assessment would be required
• Procuring providers will add delay and cost	• This will depend on the structure used and the parties procured
• Who will bear the costs of change?	• The charge will be against assets (see estimate)
• Transition will have an impact on markets	• Unlikely if well planned and phased
• Transition costs may be significant (or higher than envisaged)	• Should have large retained assets and low disruption. • Significant existing security turnover will be suspended. The saving in normal turnover cost will offset transition cost. • Existing investments in alternatives will be allowed to run off avoiding early termination costs.

Risks to realising benefits

Issue	Resolution
Criticisms of proposed changes – stakeholder concerns	
• Savings could be achieved without setting up CIVs. A feeling that any of options 1/2/3 are taking a sledgehammer to crack a nut.	
• A belief held by well-run funds and funds with good performance that the real problem to be addressed is poorly performing funds and good funds should be left alone	• If there is no compulsion, funds with good performance can opt out
• A perception or belief that option 3 will result in merging deficits and cross-subsidies between well-funded and poorly funded funds and employers.	• Easily avoided. Actuaries can continue to track individual employer/fund costs
• It is too difficult	• Switch to passive for listed assets is relatively straightforward
• Savings will be too small	• Report shows expected savings
• Significant shift to passive has impact on active managers	
• Significant shift to passive – scepticism about passive and belief that active management benefits are worth the extra cost	• Research indicates lack of certainty of returns from active management
• Change in asset allocation will disturb markets (and investee companies)	• No asset allocation shift planned
• Decision making will become more concentrated, thereby increasing risk	• Asset allocation decision making left with funds in options 1 and 2
• Investment entities will become too large, creating capacity limits which will inhibit investment choice	• Move to passive essentially removes capacity constraints on listed assets. Scale will improve efficiency on alternative assets
• New entities may be inadequately resourced?	• Require adequate resourcing as a condition
• Will the new structure be future proof?	• Address in the plan

Details to be addressed

Issue
Who will bear the cost of change?
Entities running collective vehicles and merged funds
• Who will run the collective vehicles and merged funds?
• What procurement process is required for their selection as operators?
• How and by whom will collective vehicles and merged funds be governed and held accountable?
• What level of resource do new entities require?
• Existing administering authorities have tax-raising powers which, in extremis, might be used to finance pension obligations not met by participating employers. Under option 3, would the entities running merged funds have precepting powers or ability to levy?
Collective vehicle investment choices
• What investment choices would be available?
• Can new categories of asset be added?
• Will "hedging" categories (e.g. liability hedging) be included?
• What alternative asset options would be made available?
Actuarial aspects
• Impact of cost savings on employer contributions

Future proofing

To what extent are the options future proof? The current project relates only to investment elements of structural reform. Can the result allow for:

- Future flexibility in funding and contribution management?
- Future flexibility in member and employer administration?

Option 3 has greater challenge in this area than options 1 and 2. The entity running a "merged fund" would need skills in investment, funding strategy (deficit management) and administration. These are essentially independent skill sets. The optimal future structure for administration, for example, may not be the same as that for investment pooling. Setting up an entity to manage all of three of these activities

- would be more complex;
- could add to establishment costs;
- could delay implementation and the emergence of cost savings.

6 Legal impediments to change and mitigation Squire Sanders

Issue	Resolution
Powers to enact change Options 1 and 2 Can funds be compelled to invest assets exclusively in collective investment vehicles which have been set up?	No power currently exists. Secondary legislation would be required to change the current investment powers of an administering authority
Option 3 Status of "power" to merge funds (assets and liabilities)	Would need specialist counsel opinion to determine if primary legislation can be avoided and to rebut challenge.
Investment regulations Limits within existing legislation will inhibit the flexibility of pooled vehicles to provide the appropriate solutions	Re-draft the Investment Regulations (e.g. using a prudential risk framework)

Executive Summary: Legal Issues

Options 1 and 2: Common Investment Vehicles: Issues and Interim Conclusions

1. The power of investment of an LGPS fund is vested in the administering authority, which also has a duty to invest monies it does not need to make payments from the fund. As such, since there is no power for another person, such as the Secretary of State, to exercise that function instead without regulatory intervention, administering authorities cannot be compelled to exercise their discretion to invest in a CIV (or any other instrument) without removing that function from them. On how such intervention might be made, however, see below generally under Option 3.

2. The Investment Regulations currently constrain LGPS funds' investment powers by reference to some, but not all of the available structures and do so by reference to the legal form of the vehicle. Those Regulations expressly restrict investments in unit trusts, open-ended investment companies (OEIC) and life insurance unit linked funds when such vehicles are managed by the same body to impose maximum limits of 35% of fund assets at the time when an investment is made. Limited partnerships in aggregate (whether or not managed by the same body) are subject to an overall maximum limit of 30%, again measured at the time the investment is made.

3. Further limits apply by reference to other investments according to whether the investment is listed on a recognised stock exchange. Unlisted investments which are not caught by another limit under the Regulations are in aggregate limited to 15% of the fund, again at the time the investments are made.

4. The Regulations' treatment of the financial services authorisation status of the expressly defined collective vehicles mentioned in 2 above is not the same. In order for an OEIC to benefit from the 35% limit, it must be a UCITS fund. This has implications for the investment powers of an OEIC, when compared to the alternative named vehicles, when used by an LGPS fund, as it would be constrained by the UCITS prudential rules in a way which need not apply to an unauthorised unit trust or limited partnership. A unit linked life fund is subject to separate prudential rules on the "permitted links" that the fund may hold, so again there are constraints as to what that vehicle may invest in.

5. While the unit trusts and limited partnership models have therefore an advantage in terms of investment freedom, they would, as with any other non-UCITS and non-life insurance funds, be subject to the Alternative Investment Fund Managers Directive, which imposes prudential rules on both the managers of such vehicles (and third parties involved in their operation) and the vehicle itself. Each model will have significant financial services implications in its establishment and operation.

6. The Regulations are silent on other legal forms of collective investment which are recognised under foreign jurisdictions. These include established overseas vehicles, which operate on a tax transparent basis, such as the Irish common contractual fund and the Luxembourg equivalent, fonds commun de placement. (Other Luxembourg law collective vehicles could be used.) The Regulations may limit investments in these other vehicles if they are incapable of being otherwise characterised as unit trusts, OEICs or limited partnerships, either to the unlisted securities limit of 15% and/or to a single holding limit of 10%.

7. The new UK equivalent to these Irish and Luxembourg tax transparent entities, the authorised contractual scheme (ACS) may be established on either a limited partnership or a tenants in common co-ownership basis. The ACS is not mentioned in the Investment Regulations, so the same consideration of how the limits apply to an ACS on the tenants in common model as in 6 above would apply; the alternative limited partnership structure is of course covered by the Investment Regulations.

8. Different regulatory capital and tax treatments apply to each of the above vehicles, so the cost of operation and the investment efficiency of each from an LGPS fund's perspective will differ according to which model is used. Similarly, there are recognised means of segregating liability under sub-funds for some but not all models.

Collective Investment Vehicles: Key Differentiators

	Unauthorised UT	OEIC (UCITS)	LP	ACS	Life Fund
Direct Ownership of Assets by investors	no	no	yes	yes	no
Capital Requirements for operator	AIFM	UCITS	AIFM	AIFM	Life Directives (solvency II soon)
Restrictions on Investments	QIS limits (mainly real estate)	UCITS limits	QIS limits (mainly real estate)	QIS limits (mainly real estate)	Permitted links restrictions
Tax Transparent	no	no, but favourable tax regime	yes	yes	no but favourable tax regime
Enhanced Insolvency Protection	no	no	no	no	policyholders ahead of unsecured creditors
Segregation of Sub-Funds	no	yes	no	yes	no

Conclusions

The anomalies created between the different collective investment vehicles could be addressed under secondary legislation by removing the current limits and adopting a prudential framework as used in the private sector. This would need to be accompanied by governance changes to ensure that the new flexibility created by reform of the Investment Regulations was not abused.

Option 3: Merged funds

Issues

9. A full merger of LGPS funds into however many new funds are deemed appropriate can only be achieved by confirming that the assets and liabilities of existing administering authorities can be transferred from their current control to other authorities or to new statutory bodies. In turn this leads to the following question: does the Secretary of State have the necessary powers to compel mergers of assets and liabilities? If not, primary legislation will be necessary to create such powers.

10. It is also necessary to look at other powers than those which govern the transfer of assets and liabilities. These include the degree of statutory prescription of functions which applies to current administering authorities and how scheme employers are mandated to adhere to a particular LGPS Funds.

11. The final consequential issue is whether third parties, whose rights and obligations are not expressly covered under the statutory framework, can also have their obligations and rights novated or assigned to apply to a new structure without individual contractual amendments.

Interim conclusions

12. The Secretary of State does possess broad powers to make regulations under both the Superannuation Act 1972 (1972 Act) and the Public Service Pensions Act 2013 (2013 Act) in relation to the LGPS. The architecture of the legislation is complex. The LGPS is one scheme (in the sense of a tax approved entity as opposed to different benefit structures created over time) and, although governed by different legislation, administering authorities' funds are not hypothecated by reference to pre and post 2014 benefit structures. Where statutory powers differ under primary legislation, care must be taken about interpreting how they may be exercised to the scheme as a whole and to administering authorities' funds individually.

13. Our analysis of these powers confirms that while they are very similar in wording and effect in nearly all cases, particularly in relation to the way that administering authorities are mandated to have responsibility for their own funds and how scheme employers are attached to such funds, the wording used in relation to the power to "amalgamate" (ie merge) funds is different. Under the 1972 Act, there is an express power to amalgamate, but under the 2013 no such express power exists. It should be noted that the relevant powers relate to "funds", which are not defined in either piece of primary legislation, but we take the term generally to refer to assets, not liabilities.

14. Although the 1972 Act power to amalgamate funds has not been revoked, it may be inadvisable to rely on that power alone to merge funds (or liabilities) given that it has no reference to post April 2014 benefits.

15. For these reasons and given the risk of challenge without a clear statutory power on this issue, we recommend that an opinion is sought from leading Counsel as to the scope of the 2013 Act powers.

16. The 2013 Act does contain regulation making powers by which the Secretary of State may change the person who is responsible for providing benefits under the LGPS (ie the administering authority).

17. In relation to the final question under paragraph 11 above, there is no express power to novate or assign contracts between administering authorities and third parties (whether admission agreements or supply contracts for services). The 2013 Act does contain a power for the passing of consequential, supplementary, incidental or transitional provisions by regulations. Thus, if it can be established that an appropriate power does exist in the 2013 Act to merge assets and liabilities, it may be that that power could be used to effect such reorganisation of contractual arrangements.

18. There are some recent precedents for reorganisation of LGPS assets and liabilities, relating to the abolition of the GLC and metropolitan councils under the Local Government Act 1985 ie under primary legislation.

Non-LGPS funds: application of Options

19. Since each of the schemes under consideration is governed by a separate trust deed and rules and not statute, like the LGPS, the investment and merger powers of those schemes are bespoke to each arrangement. Without further investigation as to the relevant trust powers, all that can be concluded is that there is no power to compel the trustees of these schemes either collectively or singly to invest in a CIV or to merge, either with each other or under a newly established scheme which might be established for LGPS funds.

7 Stage 2 funds

Background

Private sector – governance framework

In the private sector, the Trustee of an occupational pension scheme is a legally separate entity from that of its sponsoring employer or indeed any of the participating employers. The Trustee is the legal owner of the underlying assets but looks after those assets on behalf of the beneficiaries. The ability to pay beneficiaries' benefits, defined in a Trust Deed and Rules, depends on the resources of the scheme which are made up of the assets, the investment return on the assets and future contributions from the employer(s) and, if applicable, the members of the scheme. The employer's ability to continue making the contributions, i.e. its covenant, is therefore central to the security of the beneficiaries' benefits. The Trustee has a duty to collect the contributions, to invest the assets and contributions prudently and to help ensure that the correct benefits are paid to the right people at the right times. The trustee is therefore pivotal to the security of the benefits. Partly because of this, trustees are subject to much trust law (both pension and non-pension) and are heavily regulated. As a fall back, there is the Pension Protection Fund (PPF). However, the benefits payable from the PPF are typically lower than would be paid from the scheme.

Trustees in place for some time tend to build up a fairly strong pool of knowledge and skills. To help them, they appoint advisers. Trustees are required by law to appoint a scheme actuary, an auditor and investment manager(s). The funding must normally be agreed with the employer and the trustee has to consult with the employer on investment strategy. Ultimately, however, it is the trustees rather than the employer who have the final say.

Public sector – governance framework

In the LGPS, the administering authority for a fund (which is usually also the main employer) is responsible and liable for the benefit payments. The benefits themselves are guaranteed under statute; that is the payment of benefits does not depend on the state of the assets of the scheme nor the contributions paid into it by the employer. As a consequence, the interest of the members in the LGPS lies largely in the arena of service delivery and communication, rather than security of assets. The administering authority may, and usually does, delegate pension activities under s101 of the Local Government Act 1972 to officers and committee(s). Best practice guidance mandates the formation of a pensions committee, called the section 101 committee. Unlike the Trustee situation, the section 101 committee is not legally separate from the administering authority. The running of an LGPS Fund is arguably therefore a "buffer fund" which assists in budgeting and contribution smoothing because of its impact on the administering authority's finances. Although never tested in the courts, there is widespread belief that, as a fall back, the Government would be the ultimate guarantor for the benefits. To date, LGPS Funds have not been as heavily regulated as their private sector counterparts but this is gradually changing as strengthened governance of LGPS Funds is sought. Funds have to appoint an actuary and an auditor but the reporting mechanism and nature of the actuarial advice differs from private sector scheme arrangements. The officers are very much the 'executive' arm of any committee(s) but invariably decisions are made by committee following officer recommendations. The high turnover among members of committees makes it difficult for the knowledge and skill level to build up. Whilst an actuary and an auditor have to be appointed, funding and investment are ultimately the responsibility of the administering authority.

Changes expected to be made through current governance reforms are likely to reduce some of the differences between the running of a private sector fund and its LGPS counterpart.

Other funded public sector schemes

The spreadsheet of schemes identified by DCLG as falling to be considered in Stage 2 is included as Appendix 6A. We have traced information on 23 out of the 65 funds listed. A summary of our findings of the broad asset allocations for these funds is included in Table 19 below.

Table 19: Asset allocation of some other funded public sector schemes

Pension Fund	Equities %	Bonds %	Property %	Alternatives %	Value (£m)
BR (Railways Pension Scheme)	57	33	9	2	18,226
British Coal Staff Superannuation Scheme	68	17	7	7	9,105
Mineworkers Pension Scheme	66	19	10	5	10,960
The BT Pension Scheme	23	46	11	20	38,783
The Audit Commission Pension Scheme	0	14	0	86	662
Bank of England Pension Fund	0	100	0	0	3,122
The British Museum Company Ltd Ret Bens Plan	8	15	15	62	10
British Tourist Board Staff Pension Life Assurance Scheme	41	27	9	23	197
British Transport Police Railway Pension Scheme	53	17	9	21	76
British Waterways Pension Fund	57	43	0	0	308
Combined Nuclear Pension Plan (all sections)	40	35	10	15	678
Combined Nuclear Pension Plan (Closed section)	70	30	0	0	72
GPS Pension scheme (at 31/3/2012 before transferring to CNPP) in WEC/UAM/SLC	38	34	9	19	539
Nirex Pension Scheme (part of CNPP)	50	50	0	0	26
Environment Agency Active Fund	78	19	3	0	2,122
Environment Agency Closed Pension Fund	0	100	0	0	167
Financial Services Authority	48	45	6	0	484
Highlands and Islands Airports	58	42	0	0	71
Highlands and Islands Enterprise	61	39	0	0	64
Legal Services Commission No.4 Pension Scheme	45	52	0	3	352
OFCOM Staff Pension Scheme	16	22	0	62	249
PCPF	69	21	10	0	493
Student Loans	40	30	10	20	57
WEIGHTED AVERAGE/TOTAL	**41**	**38**	**9**	**12**	**86,824**

Feasibility of applying changes to these schemes

Since each of the schemes under consideration is governed by a separate trust deed and rules and not statute, like the LGPS, the investment and merger powers of those schemes are bespoke to each arrangement. Without further investigation as to the relevant trust powers, all that can be concluded is that there is no power to compel the trustees of the schemes either collectively or singly to invest in a CIV or to merge, either with each other or under a newly established scheme which might be established for LGPS funds.

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Appendix 1a Investment cost benchmarking CEM Benchmarking Inc.

The CEM approach

The CEM investment benchmarking survey and methodology has been developed over 21 years in conjunction with leading global pension funds. CEM captures the entire cost of investing the assets[6], including internal costs, investment manager fees and the cost of oversight and governance. Note that pension administration costs are specifically excluded from the analysis.

CEM takes great care to capture data consistently and accurately:

- They discuss the data collection process with all potential participants before starting
- They have a standard on-line survey that includes guidance on categorising data and that immediately identifies unusual or outlying data
- They discuss data issues with funds at length

They use defaults (typically peer or universe averages) where a fund cannot provide robust data.

The main drivers of pension investment costs are:

- Economies of scale (funds with more assets have a scale advantage)
- Asset mix (e.g. private equity is much more expensive than public equity)
- Implementation style (e.g. active is more expensive than passive management
- What funds pay relative to peer funds for similar assets and activities

CEM's Cost Benchmarking Methodology – gathering, collating and analysing the LGPS data

Detailed data was gathered from 18 LGPS funds (who volunteered their data) with combined assets of c£38bn. This Combined LGPS Fund Small is treated as a proxy for one of the five asset pools / merged funds under DCLG options 2 and 3. The combined costs for these funds were compared with a global peer group of 21 funds in the range £25bn to £45bn (median £35bn size, LGPS 6th in size). CEM calculated a Benchmark Cost for Combined LGPS Fund Small. The Benchmark Cost applies the median cost for each asset class from the peer comparators to the Combined LGPS Fund's actual asset mix. The effect is to neutralise the impact of asset mix differentials in the cost comparison. By comparing Combined LGPS Fund's costs with the Benchmark Cost it is possible to understand whether Combined LGPS Fund's costs are reasonable and to analyse why they compare the way they do.

As a proxy for a single asset pool, as included in DCLG option 1, the cost data for the 18 sample LGPS funds was used again but CEM superimposed the current actual asset mix for the whole of the LGPS to assets of £180bn. CEM recalculated a Benchmark Cost for this larger fund, Combine LGPS Fund Large in the same way. The 16 global peers for this comparison have assets in the range £67bn to £408bn (peer median size £101bn, LGPS 4th largest).

[6] All investment costs are included with two exceptions: transaction costs(related to buying/selling securities) and performance fees for private market asset classes (e.g. Private Equity, Real estate, Hedge Funds, Infrastructure). These costs are excluded because of historical difficulties in obtaining comparable data from participating funds.

Cost results

Combined LGPS Fund Small

Combined LGPS Fund Small's total investment costs were 57.5 bps (0.575% of total assets). This comprised direct investment management costs of 55.0 bps and oversight, custodial and other costs of 2.5bps.

The Benchmark Cost was 54.6 bps – so Combined LGPS Fund Large was 2.8 bps more expensive than the benchmark.

Table 20: Explaining why Combined LGPS Fund Small's costs are 2.8bps higher than Benchmark Cost

	Excess Cost/(Savings) £000s	Excess cost/(Savings) bps
Higher cost implementation style		
• Greater use of fund-of-funds	7,751	2.1
• Differences in the use of active management	(13,664)	(3.6)
• Higher use of external management	22,177	5.9
• Higher use of overlays	513	0.1
	16,778	4.5
Paying more than peers for similar assets/activities		
• External investment management costs	(7,120)	(1.9)
• Internal investment management costs	(217)	(0.1)
• Oversight, custodial and other costs	1,229	0.3
	(6,107)	(1.6)
Total	10,670	2.8

The 18 LGPS funds have higher costs because

- They use more fund of funds than the peer group
- They have less internal management and therefore use more external management than the peer group.

These higher costs are offset to some extent because the LGPS funds

- Have more assets managed passively than the peer group does
- Pay less than the peer group for external management.

Combined LGPS Fund Large

Combined LGPS Fund Large's total investment costs were 44.0 bps (0.46% of total assets). This comprised direct investment management costs of 41.5 bps and oversight, custodial and other costs of 2.5bps.

The Benchmark Cost was 40.6 bps – so Combined LGPS Fund Large was 3.4 bps more expensive than the benchmark.

Table 21: Explanation of why Combined LGPS Fund Large's costs are 3.4bps higher than Benchmark Cost

	Excess Cost/(Savings) £000s	Excess cost/(Savings) bps
Higher cost implementation style		
• Greater use of fund-of-funds	7,030	0.4
• Differences in the use of active management	9,840	0.5
• Higher use of external management	57,422	3.2
• Lower use of overlays	(16,060)	(0.9)
	58,233	3.2
Paying more than peers for similar assets/activities		
• External investment management costs	(18,210)	(1.0)
• Internal investment management costs	183	0.0
• Oversight, custodial and other costs	21,731	1.2
	3,705	0.2
Total	61,937	3.4

When the Combined LGPS Fund Large is compared to the larger peer group most of the same characteristics are observed as for the Small Fund. The notable difference is in the use of passive management. The LGPS fund uses less passive management than the peer group; larger funds have a higher allocation to passive management than the smaller funds. Some global research suggests that this is because of the diseconomies of scale that the largest funds experience and which increase the risk of moving prices against themselves when transacting in quoted equities.

Appendix 1b Detailed analysis of active to passive savings

Asset Class	Holdings (£millions)	Actively managed (£millions)	Passively managed (£millions)	Current Fees (£000)	Passive fees (£000)	Savings
Equities						
Asia Pacific	13,343	7,032	6,311	31,196	13,210	17,986
UK	49,406	24,162	25,244	101,538	19,268	82,270
Europe ex UK	15,146	7,934	7,213	20,413	20,296	117
US	17,490	8,475	9,016	28,814	10,319	18,495
Emerging Markets	8,835	6,131	2,705	56,391	19,790	36,601
Global	13,704	12,802	902	49,716	12,334	37,382
Total equities	**117,924**	**66,536**	**51,391**	**288,068**	**95,217**	**192,851**
Bonds						
UK	17,130	8,655	8,475	24,144	14,218	9,926
Emerging Markets	708	708	0	5,722	1,770	3,952
Global	5,783	5,783	0	25,835	4,800	21,035
Index linked	7,934	2,524	5,409	5,370	2,301	3,069
Total Bonds	**31,555**	**17,670**	**13,884**	**61,071**	**23,089**	**37,982**
Property	12,146	12,146	0	97,996	97,996	-
Alternatives	17,528	17,406	122	301,151	300,883	268
Cash				603	603	-
Total	**179,153**	**113,758**	**65,397**	**748,889**	**517,787**	**231,102**

Appendix 1c Components of transaction costs

Explicit transaction costs

Some transaction costs are said to be explicit because they do not depend on the trade price and are usually documented separately from it. They include brokerage commissions, market fees, clearing and settlement costs, and taxes/stamp duties all of which are generally known in advance, before the execution of the trade.

Commissions

Brokerage commissions are paid to intermediaries for executing trades. Although they differ from one intermediary to another, they are a fixed and visible component of transaction cost.

Market fees

Market fees are paid to trading venues for executing trades on their platforms. They are usually bundled into brokerage commissions for investors. These fees vary; on average, higher volume markets have the lowest costs. In recent years, competitive pressure has led to a significant reduction in these explicit costs.

Clearing and settlement costs

Clearing and settlement costs are related to the process whereby the ownership of securities is transferred. When the trading venue owns the clearing and settlement system, these costs, which are fixed and visible transaction cost component, are usually included in market fees. Like the latter, clearing and settlement costs differ from one trading venue to another.

Taxes/stamp duties

Tax rates or specific stamp duties are known in advance ; for example purchases of UK equities attract stamp duty of 0.5% of the purchase price.

Implicit transaction costs

Transaction costs are more than just brokerage commissions, market fees and taxes. The cost of a transaction depends on its size, the timing of the trade and the way in which it is handled. The impact of these factors is implicit in the trade price and cannot be known in advance. These implicit costs can be broken down into their components: spread, market impact and opportunity costs.

Spread

The spread is the difference between the best offer price (i.e. the lowest price at which the securities can be bought) and the best bid price (i.e. the highest price at which the securities can be sold).

Market impact

Market impact is the difference between the actual execution price for a transaction and the price that would have prevailed if the security had not been traded; in other words the amount by which the transaction moved the price.

Opportunity costs

The decision to trade and the actual trade do not usually take place at the same time. Market prices can move for or against the proposed trade. The opportunity cost is the loss (or gain) incurred as a result of the delay in completion of a transaction following the decision to trade.

Appendix 1d Transition test methodology

Background

In order to consider cost of transition for the LGPS, we asked two transition managers to estimate cost of change. The managers are experienced in the transitioning of LGPS assets and are aware of the portfolio distributions of institutional managers of UK mandates. Part of the instructions provided to the transition managers was to err on the side of prudence, which in this case means aiming to avoid an underestimate of the cost.

The transition was limited to listed securities, i.e. UK and global equities, which accounts for over 80% of aggregate LGPS assets. It is not feasible to transition property or alternative assets, e.g. private equity or other assets in closed funds.

The transition model

The legacy portfolio

Listed assets comprise 83% of aggregate LGPS assets, and are currently managed as follows:

- Approximately 23.5% of these assets are currently managed passively
- Approximately 12.5% of assets are currently managed internally, i.e. the securities are held in dedicated portfolios managed by personnel in the administering authorities
- The balance (47% of assets) are currently managed by external active managers.

The target portfolios

We asked the transition managers to consider the following transition scenario:

- The existing passively managed assets and internally managed assets would remain in place.
- All externally managed assets (c£84bn) would transition to passive management.

Asset allocation

We used the data as at 30 September 2013 from The WM Company as the basis for the asset allocation of “legacy” assets. In relation to the shape of the target portfolio we made the following assumptions:

- The shape of the allocation to equities (i.e. the proportions held in the UK and regional overseas equity markets remained unaltered.
- In relation to bonds, WM data showed a modest allocation to overseas index-linked bonds which we transferred to UK index-linked gilts and a modest allocation to pooled bonds which we transferred to UK fixed interest (a composite of gilts and corporate bonds).

Transition approaches

The transition managers’ approaches follow three stages:

1) Comparing the legacy and target portfolios, in order to determine overlap of securities (both by security name and the number held). These holdings will transfer in kind between the legacy and target portfolio and will bear no costs (other than custody costs of re-denomination)
2) Internal crosses within the transition management operation (e.g. with other clients). This includes dual listed shares, e.g. the legacy portfolio may hold US-listed depositary receipts which are essentially the US-listed clone of a security listed on another exchange.
3) Externally traded securities with execution normally conducted via programme trades and through brokered deals. Transition managers make extensive use of this type of dealing so broking commissions are set at

the lowest commodity level. Trades are executed efficiently to minimise market impact, i.e. avoiding the size of dealing affecting the dealing price. Clearly exchange costs and duties are unavoidable.

Provisos

- The cost estimate assumes that implementation of the transition is carried out as a single co-ordinated exercise.
- The process and timescale for the transition is designed to minimise costs; the volume of trades involved will require multiple tranches of transitions to avoid high market impact costs.

Analysis of test transition

UK equities

UK equities form the largest equity category. The transition manager made assumptions about the shape of portfolios of active UK equity managers (based on their knowledge of managers' portfolios from transitions they conduct and our breakdown of the largest managers of UK equity mandates for the LGPS and the proportions of assets they manage).

The transition managers estimated that approximately 60% of assets would be retained (essentially a nil cost transfer) and 40% of assets would need to be sold (and replacement holdings bought). Cost of trading of UK equities was estimated at £9.5 million (sell side) and £56.8 million (buy side). The high cost of the buy side is due to unavoidable stamp duty of 0.5% of the value of buy trades.

Overseas equities

The transition manager made assumptions about the shape of portfolios of active global and overseas equity managers mandates (based on their knowledge of managers' portfolios from transitions they conduct and our breakdown of the largest managers of these mandates for the LGPS and the proportions of assets they manage).

The transition managers estimated that just over half (approximately 53%) of assets would be retained (essentially a nil cost transfer) and approximately 1% of the balance can be transferred between overseas and UK holding (dual listing). That leaves approximately 46% of overseas assets to be traded externally. Cost of trading of overseas equities was estimated at £42.7 million (sell side) and £42.0 million (buy side).

Bonds

The bond transition involved a movement of approximately £17.6 billion of assets from active to passive mandates. For securities within these mandates, 32% of assets will be retained in the target portfolio. This leaves a net transaction of approximately £12 billion of buys and sells. The transition managers estimated a cost of £45 million for executing these trades.

Summary

The estimate for transition costs from external to active management was as shown in table 22 opposite.

Based on aggregate LGPS assets of £180 billion, where the amount of listed assets is approximately £150 billion, the transition cost would result in a transition "slippage" amounting to just under 0.12% of LGPS assets.

Table 22: Analysis of transition costs

Asset category	Transition cost £m
UK equities	90
Overseas equities	87
Bonds	38
Total	215

Potential variation in transition cost

It will be necessary to conduct further, more detailed, investigations of transition arrangements before any transition is conducted. This will include obtaining greater detail on the constituents of the current actively managed portfolios. Planning of the transition is vital. This will include elements such as phasing of tranches and timing between tranches.

In our financial analysis in Chapter 3, we have shown the sensitivity of financial outcomes, dependent on more prudent (i.e. higher) assumed transition costs.

Comments

- The cost of transition may seem significant as an up-front cost but it is actually no more than the hidden additional turnover costs incurred in active management which will be saved by investing passively for just one year.
- No additional funding or up-front cash is required from government or from local authorities. Transition costs are met from the assets of the scheme and would be reflected in asset valuations (like other investment transaction and turnover costs).
- Even allowing for other implementation costs, the payback period (i.e. the period over which savings from the transfer from active to passive management will exceed the cost of transition) is likely to be just over **one year**.

Appendix 2a Performance analysis

All of the Fund performance data used in this Appendix is based on aggregate WM Local Authority data from State Street Investment Analytics (The WM Company).

Performance and correlation

Overview

A summary of asset class performance is shown in tables 1 and 2. All performance is shown gross of managers' fees, but does reflect the cost of transactions and turnover. We provide additional information on each region and asset class in the following sections. General points to note include:

- In table 23, we have provided one, three, five and ten year performance to 31 March 2013. These represent a snapshot over time. There is overlap between these four time periods, e.g. the one year performance to 31 March 2013 is included in the all four figures quoted; the three year figures form part of the five year and ten year data.
- In table 24 we have provided performance for the four years to 31 March 2007, the two years to 31 March 2009 and the four years to 31 March 2013. This allows the analysis to show how Funds and markets performed going into, during and coming out of the financial crisis.
- Funds use a range of underlying benchmark indices. The indices shown in tables 1 and 2 provide an indication of relative performance; but will not necessarily reflect the benchmarks used by the underlying Funds; this is most notable for Global, Asia Pacific and Emerging Markets mandates, where a large number of benchmark indices exist.
- Each benchmark index operates with specific rules, e.g. treatment of taxes, timing of additions and exits from the index, approach to reinvesting dividends etc. Depending upon the specific rules, the index rules may not be practically replicated so would act as a headwind or they may create an opportunity to add value above the benchmark return (even if invested on a passive basis). As an example, UK pension funds can reclaim tax paid on dividends in some areas of the Pacific, whereas the index assumes that only dividends net of tax are reinvested. Typically, passive funds in the Pacific area can outperform the index by 0.2% p.a. purely on the basis of the tax reclaimable.
- The Funds' performance includes a combination of active and passive performance. It is reasonable to expect that asset classes with large allocations to active management would deviate further from benchmarks (in technical terms, have higher "tracking errors") than asset classes with large passive allocations.
- WM's data groups the Fund's conventional gilts and corporate bond holdings together, rather than separating them. In tables 1 and 2, we have shown the Funds' performance relative to both gilts and investment grade corporate bonds, reflecting the two main asset classes that are classified as "conventional" bonds.
- Funds may adjust their asset allocation from time to time. Depending on timing, this could have a positive or negative impact. To give an example, it would be possible for a Fund to outperform in every asset category but underperform its aggregate Fund index if its asset allocation positioning damaged returns to a significant extent (i.e. by being overweight in underperforming asset classes). The converse can also apply.

Table 23: Summary performance (performance shown gross of fees to 31 March 2013)

	One year %	Three years %p.a.	Five years %p.a.	Ten years %p.a.
UK equities	18.0	9.8	7.3	10.8
FTSE All Share	16.8	8.8	6.7	10.7
Relative	*+1.1*	*+0.9*	*+0.6*	*+0.1*
North American equities	19.0	11.4	10.5	8.4
FTSE North America	19.3	11.8	11.5	9.5
Relative	*-0.2*	*-0.4*	*-0.9*	*-0.9*
Europe ex UK	20.4	5.9	4.1	11.6
FTSE Europe ex UK	17.8	4.0	2.9	11.4
Relative	*+2.2*	*+1.8*	*+1.2*	*+0.2*
Japan	15.4	5.3	5.9	7.5
FTSE Japan	14.3	3.5	5.1	7.4
Relative	*+1.0*	*+1.8*	*+0.8*	*+0.1*
Asia Pacific ex Japan	*19.2*	*9.3*	*11.4*	*17.3*
FTSE Pacific ex Japan	*18.1*	*8.9*	*10.7*	*16.4*
Relative	*+0.9*	*+0.4*	*+0.6*	*+0.8*
Emerging Markets	10.5	4.3	6.8	17.1
FTSE Emerging	7.4	3.2	7.2	18.2
Relative	*+2.9*	*+1.1*	*-0.3*	*-0.9*
Conventional bonds	10.6	8.8	8.6	6.2
FTSE All Stocks	5.2	8.2	7.1	5.8
Relative	*+5.0*	*+0.6*	*+1.4*	*+0.4*
Conventional bonds	10.6	8.8	8.6	6.2
iBoxx Corp All Stocks	13.2	8.8	7.9	5.7
Relative	*-2.3*	0.0	+0.6	+0.5
Index-linked gilts	11.2	12.3	9.3	8.0
FTSE IL>5yr	11.8	13.0	9.1	8.3
Relative	*-0.5*	*-0.6*	*+0.1*	*-0.2*

Table 24: Additional performance (performance shown gross of fees to 31 March 2013)

	4 years to 31/03/07 % p.a.	2 years to 31/03/09 % p.a.	4 years to 31/03/13 % p.a
UK equities	21.1	-19.6	19.1
FTSE All Share	21.1	-19.3	18.3
Relative	*-0.1*	*-0.5*	*+0.6*
North American equities	10.0	-11.8	18.5
FTSE North America	10.8	-9.5	18.9
Relative	*-0.8*	*-2.5*	*-0.3*
Europe ex UK	24.7	-15.9	15.0
FTSE Europe ex UK	25.5	-15.6	13.6
Relative	*-0.6*	*-0.3*	*+1.2*
Japan	16.6	-15.2	11.6
FTSE Japan	17.0	-13.0	9.5
Relative	*-0.3*	*-2.4*	*+1.9*
Asia Pacific ex Japan	*26.7*	*-6.0*	*21.2*
FTSE Pacific ex Japan	*25.3*	*-7.5*	*21.2*
Relative	*+1.2*	*+1.7*	*-0.1*
Emerging Markets	31.6	-8.0	17.5
FTSE Emerging	32.9	-5.7	17.7
Relative	*-1.0*	*-2.4*	*-0.1*
Conventional bonds	4.0	1.9	10.7
iBoxx £ Overall	4.4	2.6	8.6
Relative	-0.4	-0.7	2.0
Index-linked gilts	5.6	4.9	12.2
FTSE IL>5yr	6.0	5.0	12.4
Relative	*-0.3*	*-0.1*	*-0.2*

Asset class and regional performance comments

Annual performance (12months ending 31 March of each year) and cumulative performance information are included later in this appendix (performance is shown for each asset class, relative to the underlying index over the past ten years). Points to note include:

- The Funds' information is based on aggregate performance. It does not show the level of dispersion between underlying Funds' and their managers' performance.
- Asset class performance has exhibited considerable volatility of recent years. This is reflected both in the absolute returns that have been generated, and in the relative returns.
- At a regional level, Funds' relative equity performance was poor during the build up to the credit crisis (2003-2007), with underperformance in UK, North America, Europe ex UK, Japan and emerging markets, and outperformance only being achieved in Asia Pacific. Part of this outperformance arises because funds can reclaim tax paid on dividends in some countries, whereas the benchmark assumes net dividends.
- Funds also struggled in the volatile markets witnessed during the credit crisis (i.e. 12month periods to 31 March 2008 and 31 March 2009). North America, Japan and emerging markets equities underperformed benchmark returns in both of these years and the UK and Europe underperformed in at least one of these years and over the two year period in aggregate.
- Over recent years there are signs of improved performance. Over the most recent 12 months, the analysis suggests there has been outperformance in the UK, Europe ex UK, Japan, Asia Pacific and Emerging markets. North American has continued to prove to be a difficult market for Funds to add value above the index.
- As a whole, Funds' index-linked gilts portfolios have struggled relative to the market return, under-performing in seven out of the past ten years and only outperforming in two years. There has also been underperformance in each of the three time periods shown in table 24 - reflecting the performance pre, during and post the financial crisis.
- Given the nature of WM's data, it is difficult to draw too many conclusions relating to Funds' conventional bonds. The WM data does not outline the precise mix of the underlying holdings are (they will be largely gilts and corporate bonds) or the proportions of assets that each category represents or the nature of these holdings e.g. duration, credit criteria, etc.

  Relative to the composite index (iBoxx £ Overall) that we have used in this appendix, Funds have tended to be overweight corporate bonds and underweight gilts; further, within corporate bonds, they have tended to be overweight in lower graded issues compared with the benchmark. This disposition explains benchmark outperformance in the last 4 years.

  We are also aware that Funds' corporate bond performance was very volatile during the credit crisis and the dispersion of returns achieved by Funds over that period was particularly wide.

Correlation analysis

The following three year Fund and index return correlations are shown below:

- Total equities (chart 2)
- Regional equities (chart 3)
- Bonds (chart 4).

Chart 2: Total equities

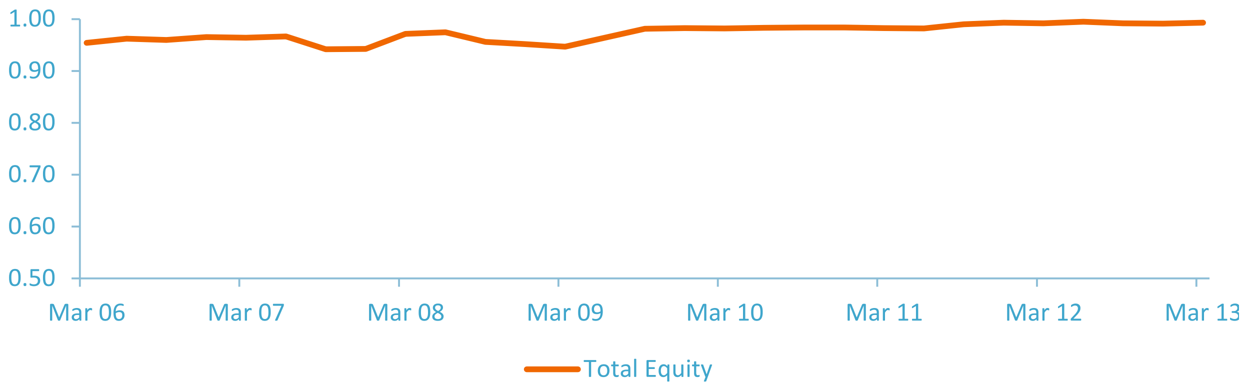


Chart 3: Overseas equities

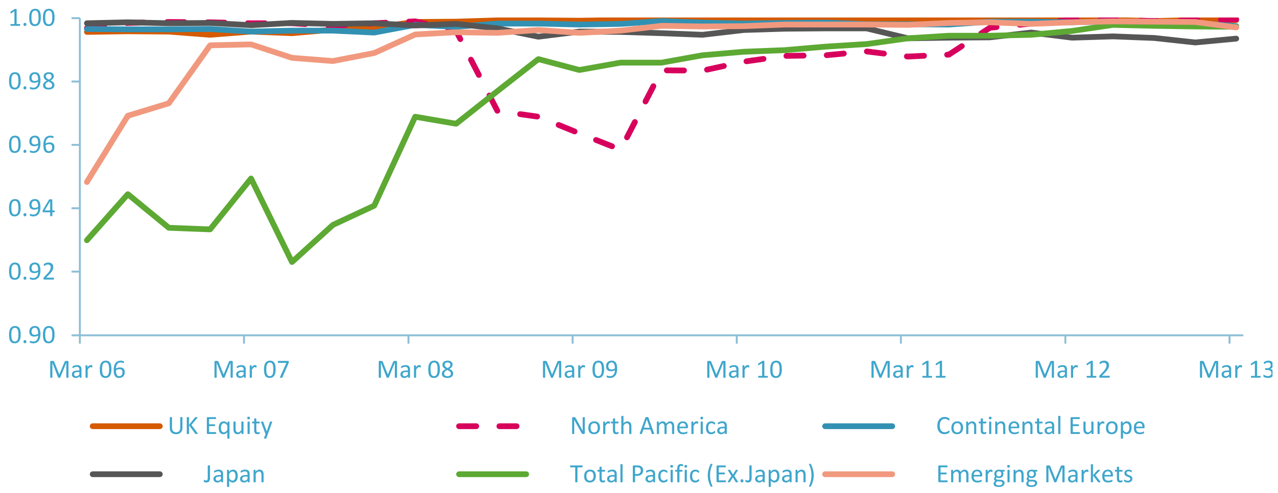
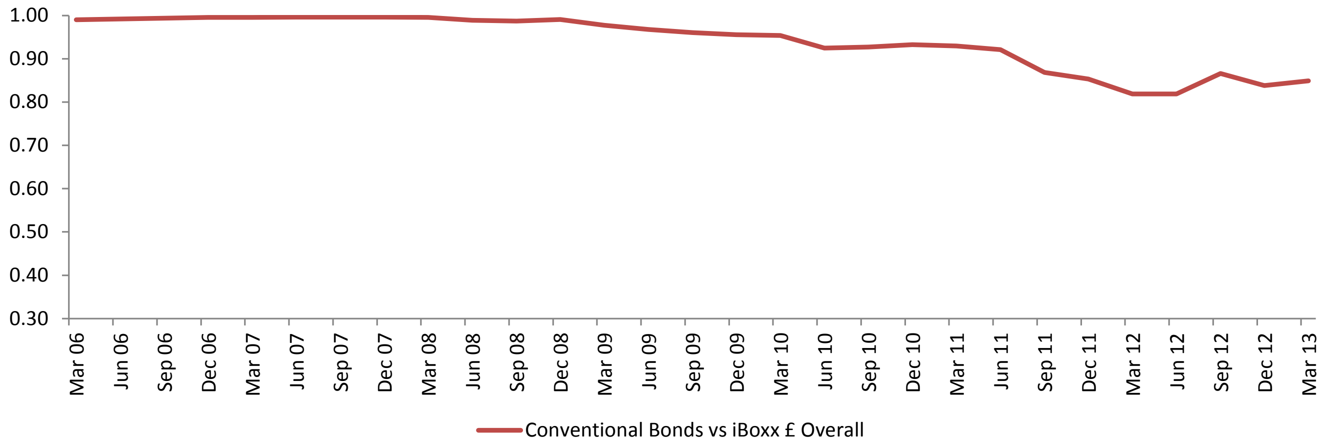


Chart 4: Conventional bonds and iBoxx £ Overall



- Correlation data provides an indication of strength of the relationship between the Funds' returns and underlying index returns. It does not provide any information of the scale of the relative moves. For example, even the returns of a highly active equity manager are likely to highly correlated with the broad market index, e.g. in excess of 0.8. Given this, we believe there are only limited conclusions that can be drawn from looking at the correlation data in isolation.
- The correlation of the Funds' aggregate equity returns, with the broad market index, tends to be very high (in excess of 0.9). This should be expected because:
  - There will be considerable overlap between the Funds' and index holdings, in particular the larger stocks that tend to be key drivers of risk and returns.
  - Regional equity markets tend to be highly correlated over time; therefore any regional differences between the Funds and the broad benchmark index should have limited impact on any correlation analysis.
- The correlation of the Funds' regional returns with the broad market indices also tends to be high. This is particularly notable for North American, Japanese, UK and European equities. This is again largely due to the high level of overlap between the Funds' and index holdings.
- Asia Pacific and emerging markets correlations tend to be lower than other regional markets. This is due largely to the more diverse nature of these mandates i.e. Funds use a number of different Asia Pacific and emerging markets benchmarks, each of which include different countries and stocks. These benchmark differences can have significant impacts on returns. Nevertheless, whilst the correlations are lower than other regions, they remain high, in excess of 0.9.
- Over recent years there has been a notable increase in correlations between regional markets and their underlying indices, suggesting that key drivers of the performances of Funds and indices are now more closely aligned.

In chart 4 we show the correlation of Funds' conventional bond returns, relative to an aggregate index (iBoxx £ Overall) of gilts and UK investment grade corporate bonds. As shown, the correlation has reduced following the Global Financial Crises as managers have moved underweight in gilts relative to the benchmark index and correspondingly overweight in corporate bonds, and more lowly-rated investment grade corporate bonds relative to the benchmark index.

Performance figures (12 months to 31 March, and 3, 5 and 10 years to 31 March 2013)

Chart 5: UK equities

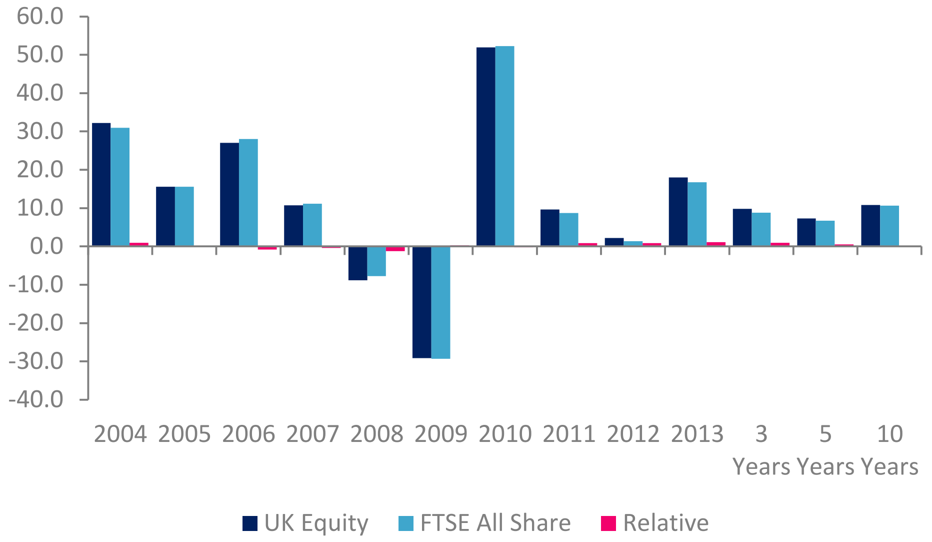


Chart 6: North American equities

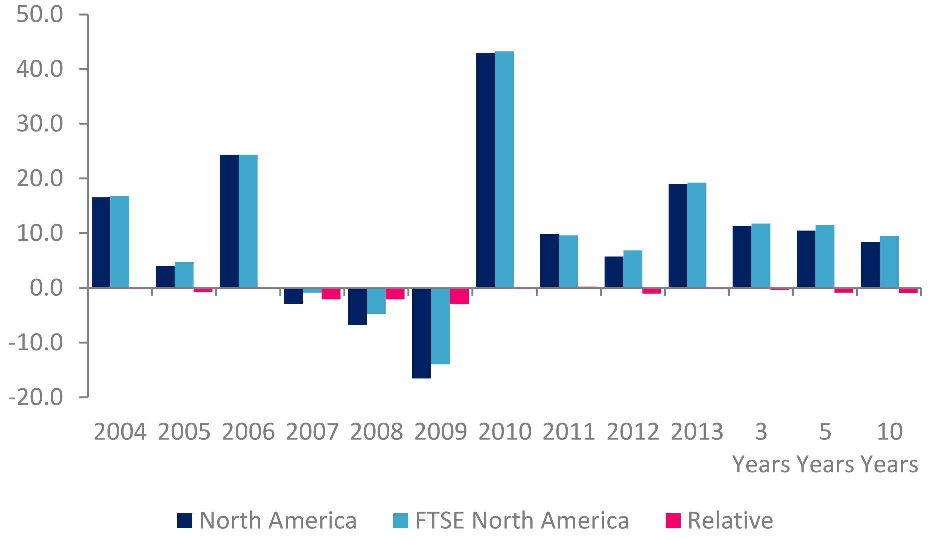


Chart 7: Europe ex UK equities

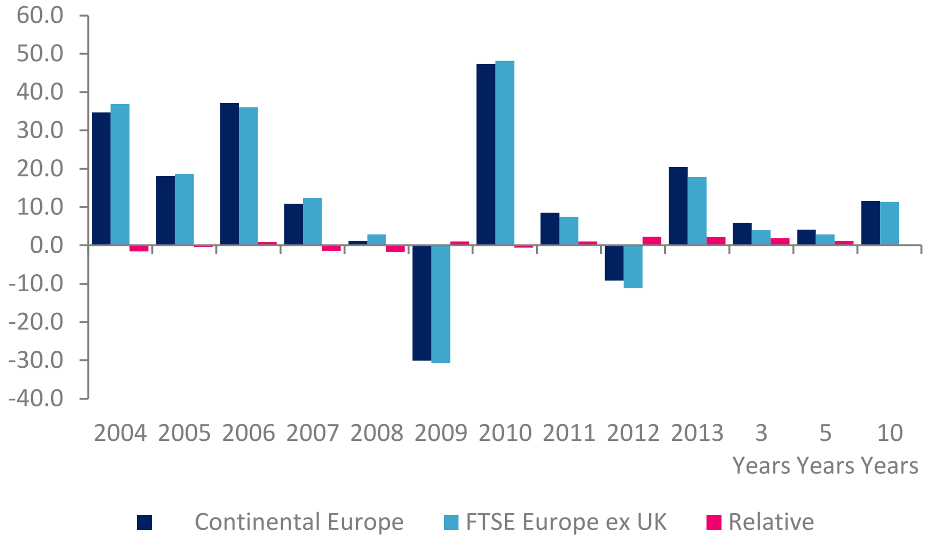


Chart 8: Japanese equities

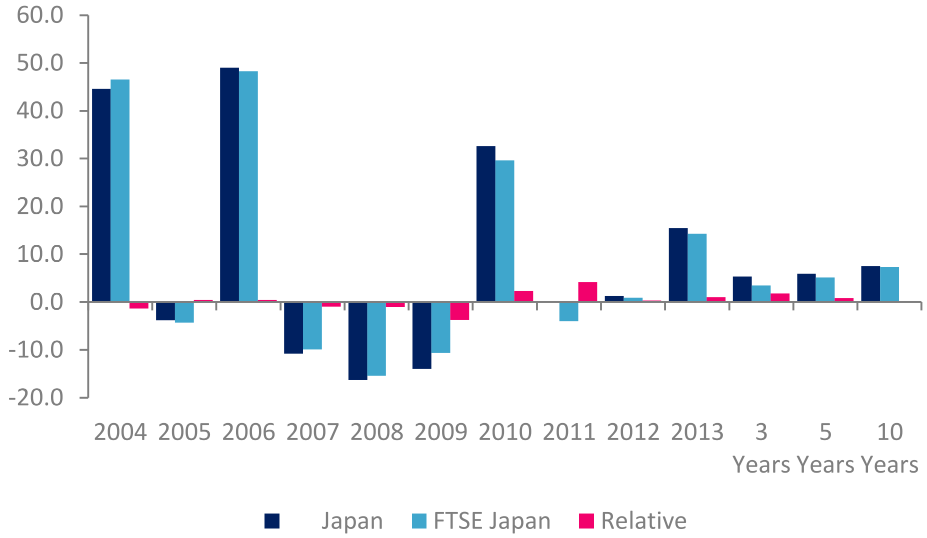


Chart 9: Asia Pacific equities

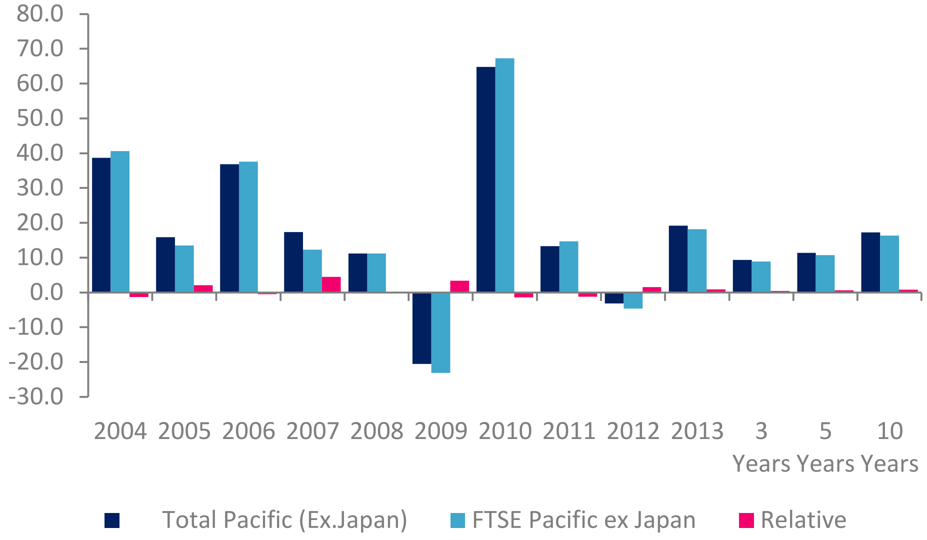


Chart 10: Emerging markets equities

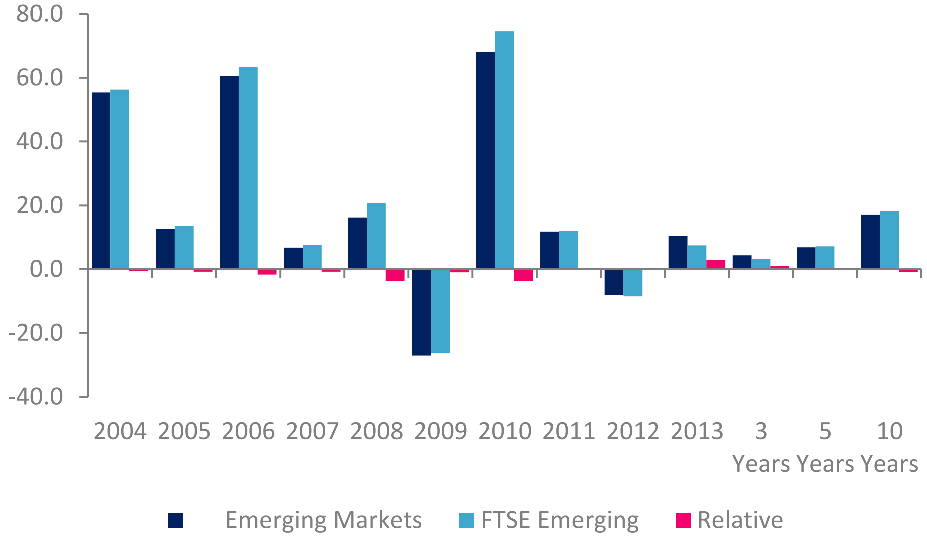


Chart 11: Conventional bonds versus composite UK bonds (iBoxx £ Overall)

Since mid-2009, funds have typically held less in gilts and more in corporate bonds than the benchmark index and have typically held lower grades of corporate bonds than the index

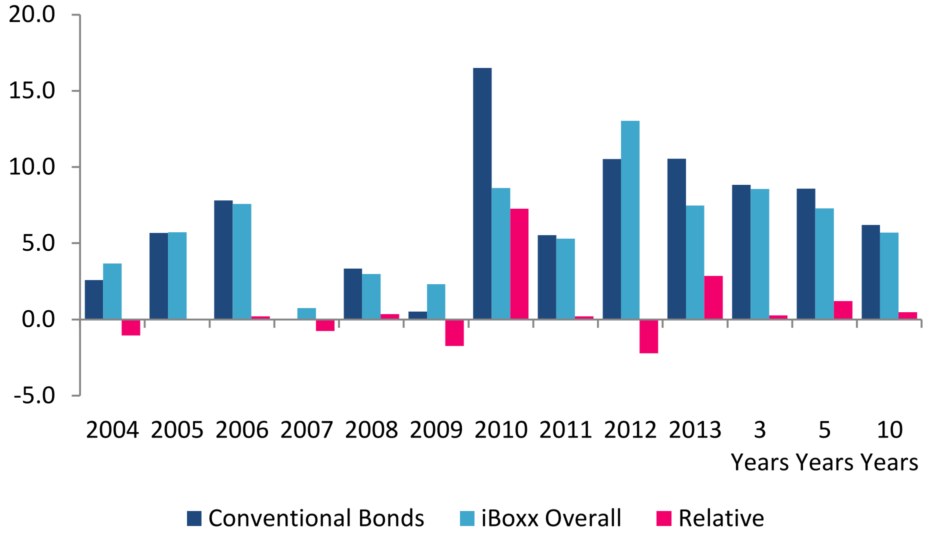
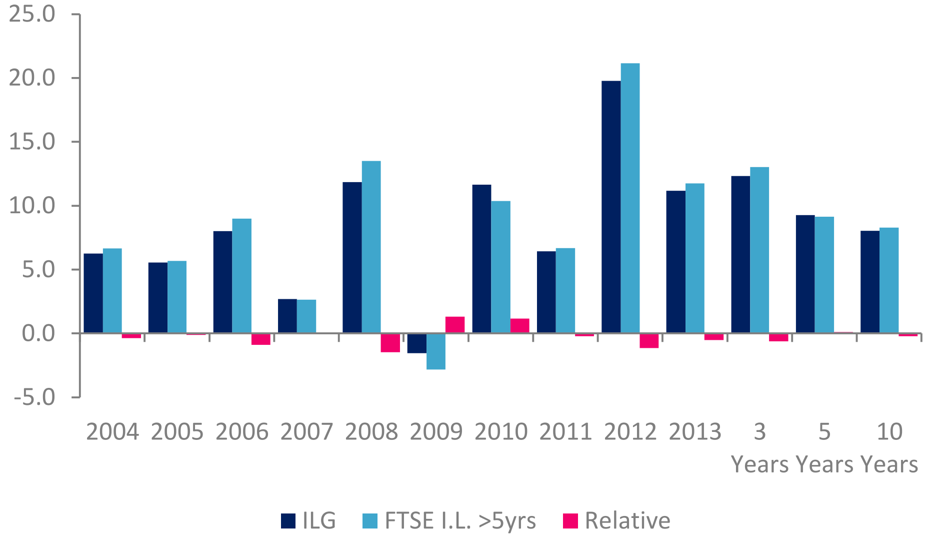


Chart 12: Index-linked bonds



Cumulative performance

Chart 13: UK equities

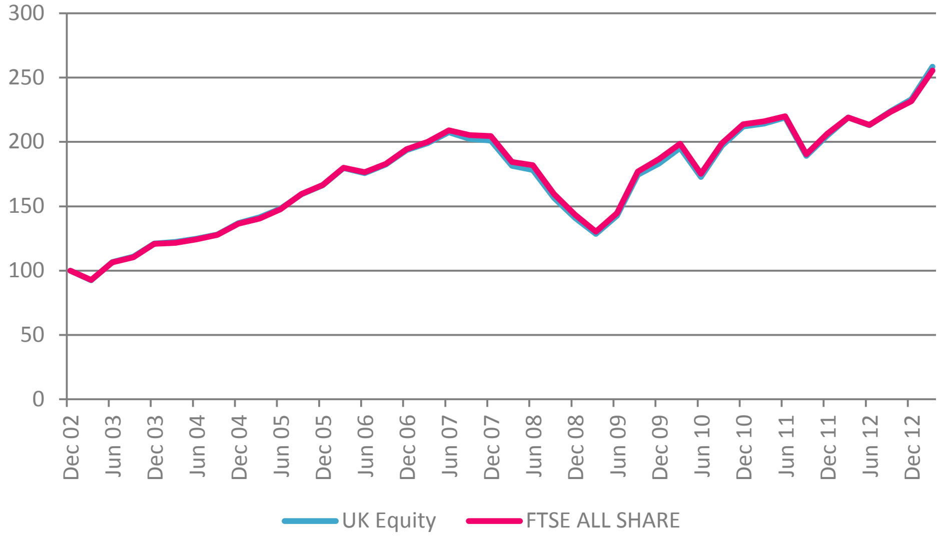


Chart 14: North American equities

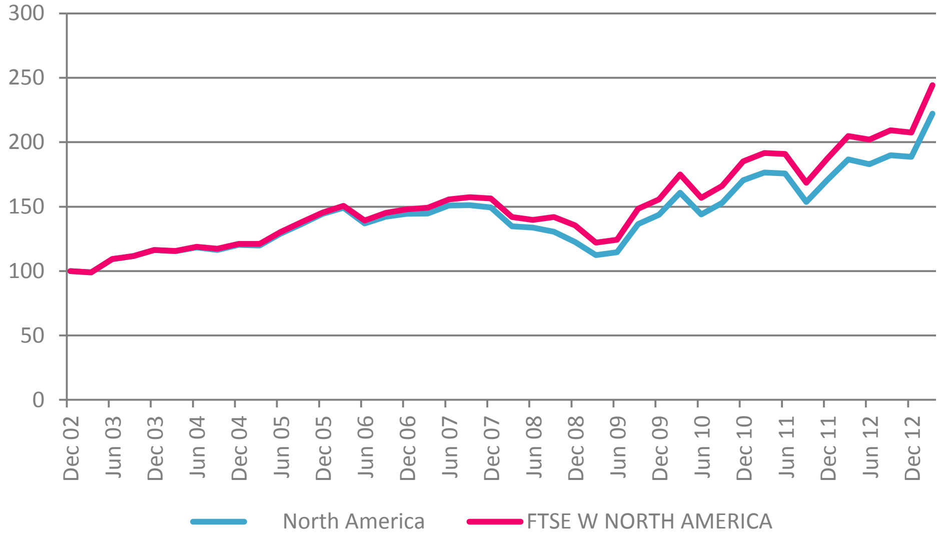


Chart A15: Europe ex UK equities

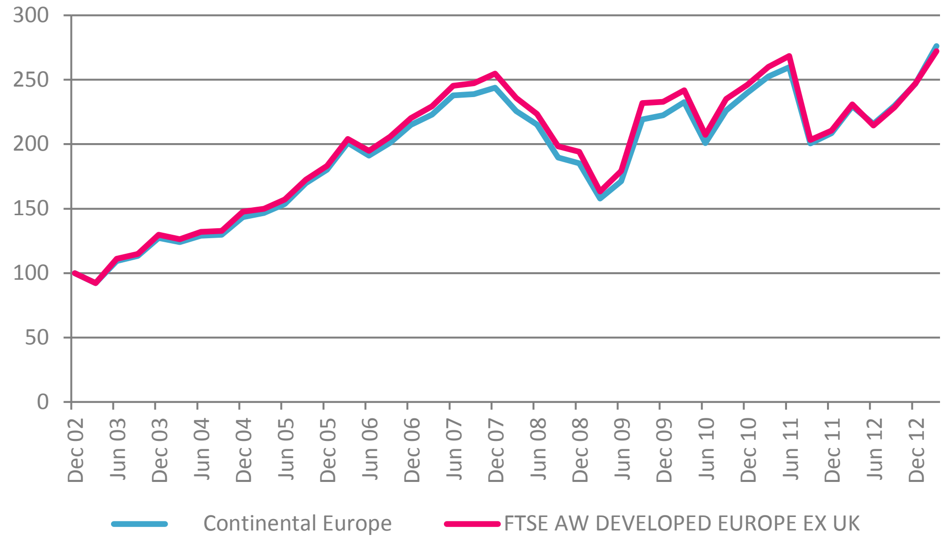


Chart A16: Japan equities

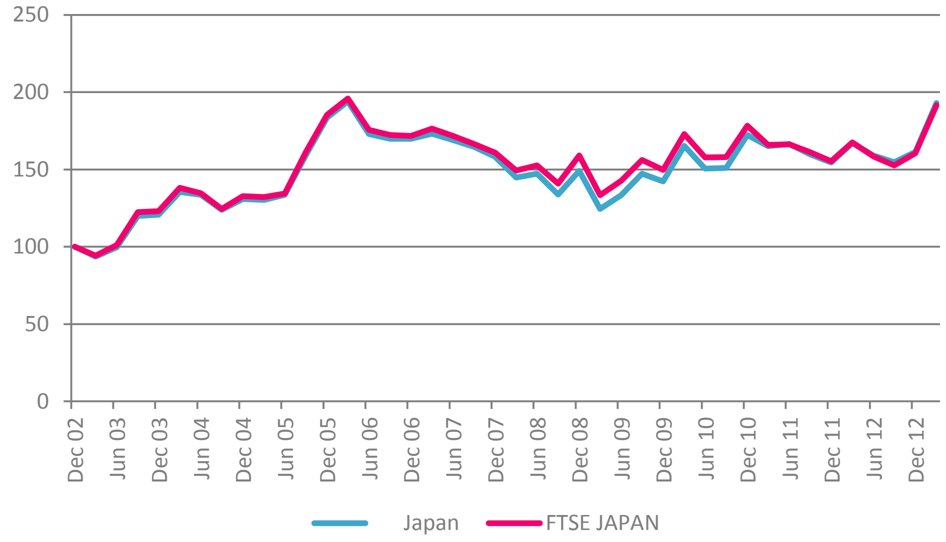


Chart A17: Asia Pacific ex Japan equities

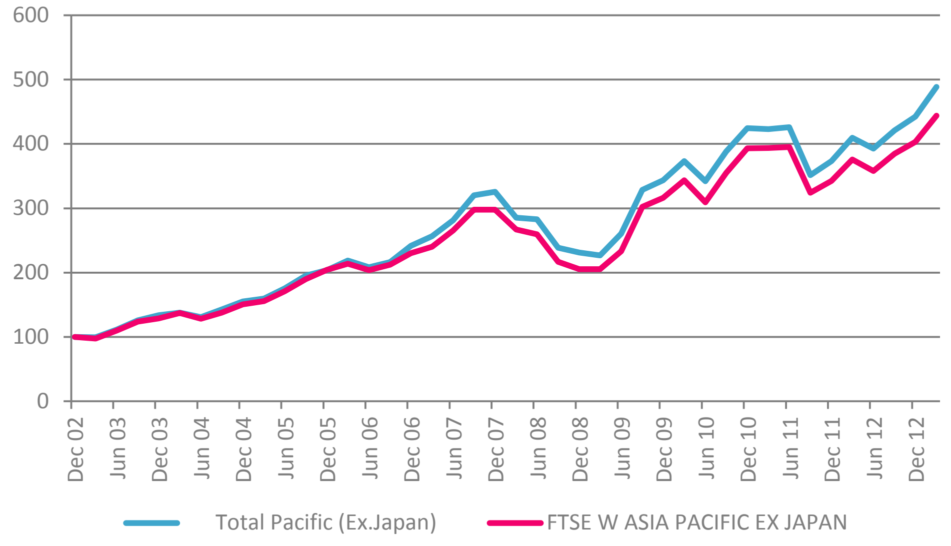


Chart A18: Emerging markets equities

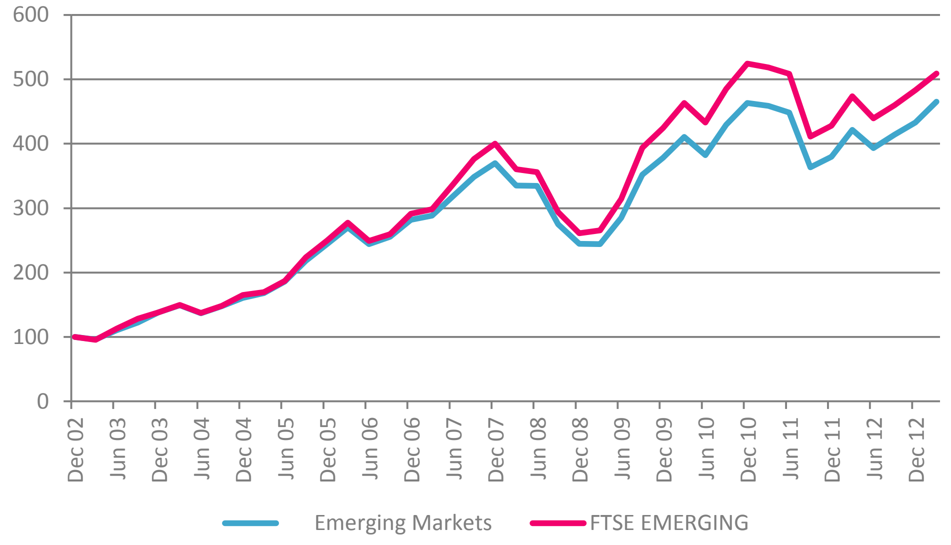


Chart A19: Conventional bonds versus government gilts and corporate bonds

Since mid-2009, funds have typically held less in gilts and more in corporate bonds than the benchmark index and have typically held lower grades of corporate bonds than the index

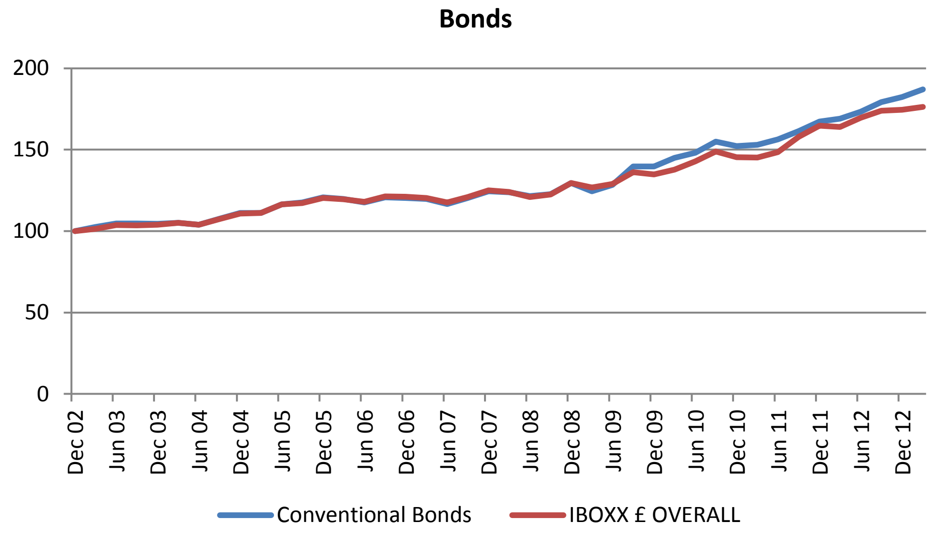
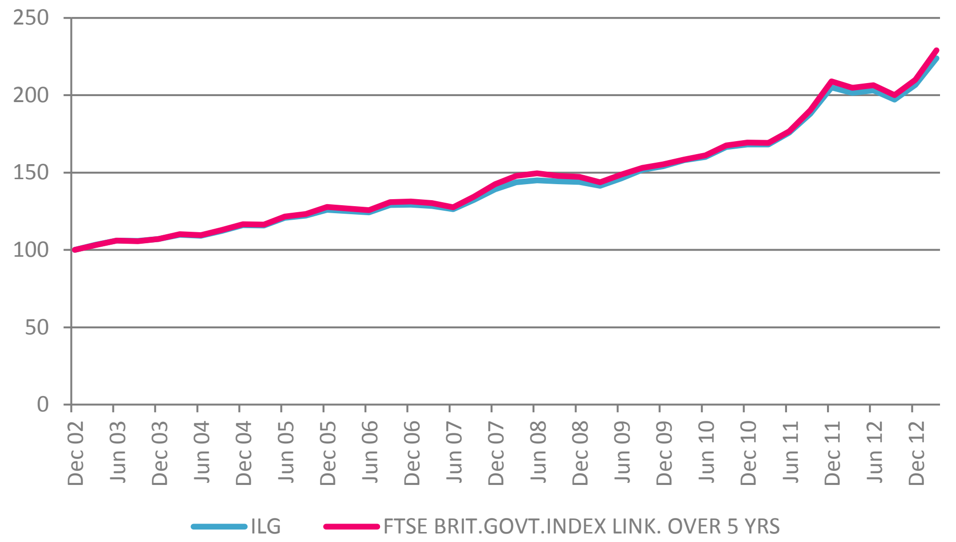


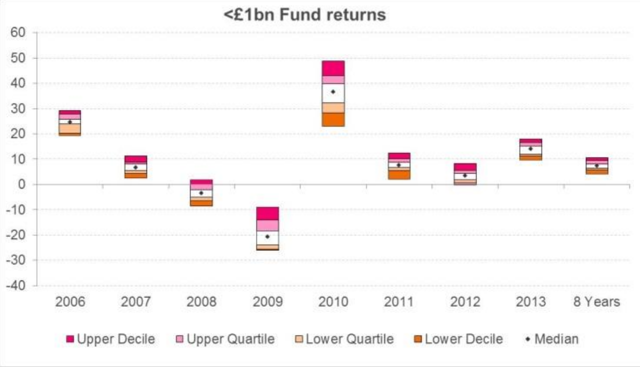
Chart A20: Index-linked gilts

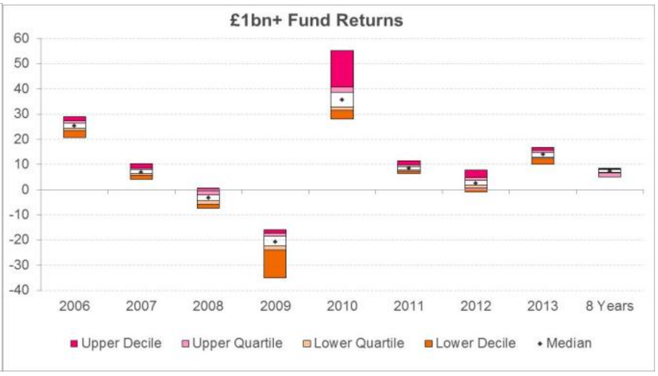


Appendix 2b LGPS performance dispersion, small and large

All of the Fund performance data used in this Appendix is based on data gathered by Hymans Robertson from data in the public domain (e.g. Funds' annual reports and accounts).

The leftmost bars in each of the charts below shows the spread of returns in each financial year from 2005-06 to 2012-13, indicating the top 10, top quartile, median, bottom quartile and bottom 10. The rightmost bar shows the spread of returns for the cumulative 8-year period. The chart on the left includes all of the LGPS funds that are less than £1bn and the chart on the right is the funds over £1bn.





The median return over eight years for the smaller funds was 7.2% p.a. and for the larger funds it was 7.4%. Although there is no strong evidence of better performance by larger funds there is evidence of a wider dispersion of returns for the smaller funds, particularly in the critical years, 2008/09 and 2009/10 around the credit crunch.

Characteristics of funds in the top 10

- These funds use a limited number of managers (typically 1-3 managers with balanced mandates focused on equities and bonds);
- They retain their managers for the long term, even through inevitable periods of underperformance;
- They adopt a simple structure focused on equities, bonds and property;
- They make limited use of alternatives;
- Some use internal management; and
- There is evidence they rebalanced assets back to benchmark over 2008/09 as equity markets collapsed; this enabled full participation in the equity market rebound in 2009/10

Appendix 6a Analysis of available fund structures for one or more common investment vehicles Squire Sanders

1 EXECUTIVE SUMMARY

1.1 This section of our Report is in three parts:

(a) a legal analysis of the Investment Regulations and the restrictions contained in them on five English law CIV structures which may be held by LGPS funds;

(b) an analysis of the key regulatory and tax features of those CIVs; and

(c) a summary of the procurement and potential competition law implications of LGPS funds subscribing for investments in new CIVs.

1.2 A Glossary of terms used in the Executive Summary and the analysis is found at the end of Section 1. It should be noted that our conclusions are based on the law as it currently stands at the date of this Report. The law may and no doubt will change and evolve and therefore care should be taken to ensure our conclusions remain valid in that event.

Investment Regulations

1.3 The Investment Regulations currently constrain LGPS funds' investment powers by reference to some but not all of the available structures and do so by reference to the legal form of the vehicle. Those Regulations impose maximum holding limits of between 30% and 35% and may limit investments in other vehicles which are not expressly mentioned in the Regulations by virtue of a single holding limit of 10%. These limits can be repealed or amended by secondary legislation under powers given to the Secretary of State by the Superannuation Act 1972.

1.4 The power of investment of an LGPS fund is vested in the administering authority ("AA"). As such, since there is no power for another person, such as the Secretary of State, to exercise that function or direct how the power is used. AAs cannot be compelled to exercise their discretion to invest in a CIV (or any other instrument). The legislative means by which such a power could be given to another body is also by secondary legislation under the same Act.

Summary of CIV key features

1.5 The key features of each of the five CIVs (a Unit Trust (UT), Open Ended Investment Company (OEIC), Limited Partnership (LP), Authorised Contractual Scheme (ACS) and Unit Linked Life Fund) have been analysed on the assumption that new vehicles might be set up which could be tailored to LGPS funds (and any private sector funds which chose to invest in such funds). It may be that an existing insurance company could offer existing unit linked life funds or create new unit linked life funds for these purposes, which would save time and potentially capital, especially since three of the major players in the passive management field (Legal & General, BlackRock and State Street Global Advisors) each have current LGPS assets under management in such funds. We have not considered the implications of using existing vehicles in this Report nor have we carried out any due diligence on any such vehicles, so this is no more than a factual observation. There are also potential competition and procurement law issues which need to be addressed.

1.6 Because of the way that the Investment Regulations currently require OEICs to be authorised as UCITS compliant funds to maximise an LGPS fund's holdings in any single OEIC, we have assumed that only such an authorised and UCITS compliant OEIC fund would be established. Although the regulatory régime is different, a comparable analysis necessarily applies to a unit linked life fund, because there is only one financial services model available.

1.7 The same regulatory hurdle of being UCITS compliant does not apply to the other vehicles (i.e. UTs, LPs or ACS), at least as far as the way the Investment Regulations restrict their usage. That is not to say that these vehicles can be used in a completely unregulated way, since the manager/operator and the depositary must be authorised under the AIFMD. The complexity of the financial services authorisation options for each of these vehicles is beyond the scope of this Report, but in summary, each collective investment scheme established under either section 235 or 235A of the Financial Services and Markets Act 2000 may be established on a number of different bases, broadly depending on the type of investor that the scheme is aimed at. UCITS may be marketed to retail investors but are accessible by professional investors also (i.e. including LGPS funds).

1.8 There are further categories of authorised fund which benefit from less rigorous rules which could be used for professional investors such as LGPS funds: these include the Non-UCITS Retail Scheme ("NURS") and the Qualified Investor Scheme ("QIS"). We have assumed for the purposes of this Report that the last of these vehicles, the QIS, is the most appropriate model to use for UTs, LPs and ACS, since it preserves the maximum flexibility and has the least regulatory burden. If further analysis of the UCITS and NURS options is required, we can of course revise our advice.

1.9 The broad parameters of our analysis are set out below; more detailed discussion is found in the table in the Annex.

1.10 There are, in the final analysis, a limited number of distinguishing features which would lead to the conclusion that a particular legal model is superior to the others.

(a) **Regulator** - under each CIV there is a need for authorisation under FSMA. For a unit trust, OEIC, LP and ACS the regulator will be the FCA. For unit linked life funds the prudential regulator, the PRA, supervises insurance companies. The life company regime is more complex than the supervisory regime for the other CIVs.

(b) **Timing** – whilst it is difficult to put an estimate on preparation time, the timescales for authorising an investment or fund manager are significantly shorter than establishing a new insurance company. Setting up a new unit-linked fund, however, involves comparable if not shorter timescales than for a new fund under the other structures. Use of existing vehicles (if appropriate) will of course reduce timing considerably.

(c) **Regulatory Capital** – regulatory capital requirements for life companies are significantly higher than for fund or investment managers. The regime is more complex and subject to change due to Solvency II in 2016 (with full implementation expected by 2019).

(d) **Ownership of the underlying assets** - of the five vehicles the OEIC and the life company vehicles each represent structures by which the legal and beneficial ownership of the underlying assets is separated from the investors (i.e. LGPS funds). In a UT, the trustee owns the assets on trust for the investors. In both the LP and the ACS legal ownership of the underlying assets remains with the CIV (because it has no separate legal personality from that of its investors). In all cases the CIV will contract with third parties through the operator of the CIV.

The retention of legal ownership under the LP and ACS models does not, however, mean that the investors control the underlying assets, since day to day control of the securities or other investments is a function which will need to be delegated to an authorised third party, ie a custodian bank (called a depositary). Indeed, partnership law prevents limited partners from playing any part in management of an LP without losing limited liability status.

(e) **Tax transparency on the underlying assets** – The LP and ACS models are the only vehicles that have tax transparency as a key feature of their design. Separate regimes exist for authorised UTs and OEICs. A life company owns its assets and benefits from a general exemption from tax on its pension fund business.

(f) **Stamp Duty/SDRT** – All vehicles have favourable stamp duty tax treatment on transfers within the CIV. There is no distinction between stamp duty liability on purchases of equities and real estate by the CIV: all are subject to stamp duty although the initial transfer of securities into an ACS has been granted a specific exemption.

(g) **VAT** – Authorised OEICs have favourable VAT regimes with no VAT on management fees. Insurance services are VAT exempt and irrelevant to an internally managed unit-linked life fund in any event. The UT, LP and ACS models also have favourable VAT exemptions.

(h) **Withholding taxes (WHT) -** a detailed analysis of the efficiency of each vehicle to recover WHT on overseas investments is beyond the scope of this Report because it will depend on where the underlying assets are held. There may be differences in certain jurisdictions because of the recognition of the legal form of the CIV.

(i) **Counterparty risk**- a key consideration is what rights investors have in the event of insolvency of the provider/operator of the CIV since that is the counterparty (the insolvency risk attaching to underlying issuers of securities held by the vehicle is of course the same regardless of the vehicle). The only CIV that has a separate insolvency regime is that which applies to insurance companies, by which eligible policyholders are given priority over unsecured creditors. None of the other vehicles offers this preferential creditor status as the LGPS investor would be unsecured in the absence of express security being granted by the CIV (this would not legally be possible in an LP or ACS anyway, given that those vehicles have no separate legal personality) . In a UT, OEIC, LP or ACS where the assets are held by a depositary, the counterparty exposure is really therefore to the depositary holding the assets.

Note that the Financial Services Compensation Scheme is not available to LGPS investors.

(j) **Segregation of liability at a sub-fund level** – UTs, LPs and unit linked life funds do not offer segregated cells or sub-funds, meaning that the assets and liabilities of one sub-fund could suffer contagion if another sub-fund were to default. OEICs and ACS contractual schemes offer sub-fund options and segregation recognised under insolvency laws.

(k) **Investment objectives and restrictions** – because of the manner in which the Investment Regulations treat an OEIC (i.e. as a UCITS which has a maximum investment holding of 35% by an LGPS fund), that vehicle is disadvantaged in terms of its investment restrictions. Unit-linked life funds may only be provided on a regulated basis and so are also subject to permitted links rules which prescribe the assets that can be used to count against the solvency capital of the insurer. The UT, LP and ACS can all therefore benefit from more investment freedom than is prescribed under the UCITS directive.

1.11 **Procurement** – The potential concentration of assets under a new CIV or CIVs needs careful analysis to ensure that the procurement law impact of the establishment of new CIVs is not under-estimated. The identity of the operators of any new CIVs and the nature of the vehicles will determine these questions. We have therefore described in outline the parameters of public procurement by reference to the CIVs discussed in this Report.

GLOSSARY

ACD	**Authorised Corporate Director (of an ICVC or OEIC)**
ACS	**Authorised Contractual Scheme established pursuant to the ACS Regulations**
ACS Operator	**the person authorised under FSMA to manage an ACS**
ACS Regulations	**Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013**
AFM	**Authorised Fund Manager (meaning a legal entity authorised under FSMA to manage a fund)**
AIFM	**Alternative Investment Fund Manager (to be authorised by FCA effective 22 July 2014)**
AIFM Regulations	**Alternative Investment Fund Managers Regulations 2013**
AIFMD	**Alternative Investment Fund Managers Directive**
AUT	**Authorised Unit Trust (meaning authorised by FCA)**
CIS	**a collective investment scheme under section 235 FSMA (including OEIC, UT, ACS, UCITS and UCIS)**
CIV	**a CIS and unit-linked life fund or pension fund management insurance contract**
COLL	**FCA's Collective Investment Schemes handbook of rules and guidance**
Depositary	**the name for the custodian of the ICVC (FCA and/or PRA authorised)**
FCA	**Financial Conduct Authority**
FSMA	**Financial Services and Markets Act 2000**
Investment Regulations	**LGPS (Management and Investment of Funds) Regulations 2009**
ICVC	**Investment company with variable capital established pursuant to the Open-ended Investment Companies Regulations 1997**
LP	**Limited Partnership**
NAV	**Net Asset Value**
NURS	**Non-UCITS Retail Scheme (which can be either an ICVC or UT)**
OEIC	**generic name for ICVC**
PAIF	**Property Authorised Investment Fund, a regulated ICVC principally intended for property investment (structured as a NURS – not a UCITS)**

PRA	**Prudential Regulation Authority**
QIS	**Qualified Investor Scheme, being an FCA regulated fund for professional investors and not falling under UCITS or NURS regimes**
Solvency II	**the EU measures to enhance insurer capital requirements, governance and disclosure obligations**
Trustee	**the name of the trustee of a unit trust (FCA and/or PRA authorised) including a trustee of a UCIS structured as a trust**
TR13/8	**the FCA's report on unit-linked life fund governance**
UCIS	**generic term meaning Unregulated Collective Investment Scheme (falls within section 235 FSMA)**
UCITS	**ICVC or UT scheme meeting the requirements of the Undertakings for Collective Investment in Transferable Securities Directive (as amended)**
UT	**Unit Trust**

2 IMPACT OF THE INVESTMENT REGULATIONS ON CIV STRUCTURES

INTRODUCTION

The Investment Regulations impose, under Regulation 14(2) and Schedule 1, various restrictions on different types of investment vehicle. Those limits may be increased if the AA complies with Regulations 14(3) and 15. For the purposes of this report and all of the options, the collective investment vehicles ("**CIVs**") that most readily allow for pooling of assets are as follows.

Vehicle	**Maximum Limit** **% of Fund**
Limited Partnerships ("**LP**")	30%
UTs managed by one body	35%
OEICs managed by one body	35%
UT/OEIC managed by the same body	35%
Any single unit-linked or pension fund management insurance contract	35%

Notes:

1 The 35% restriction does not apply if the unit trust or OEIC invests, inter alia, in gilts.

2 An OEIC is defined by reference to the UCITS Directive, so an unauthorised investment company which does not comply with that Directive is subject to a separate lower limit which applies to unlisted securities of 15%.

3 In reality, a life insurance contract would have to be unit linked rather than a pension fund management contract as the latter is designed to be used for a discretionary investment management portfolio and would not be capable easily (if at all) of being issued in joint names of such investors.

4 All of the above limits apply at the time of the original investment. There is no comparable ongoing maximum requirement if, for example, the value of the holding increases by reference to other asset classes.

5 The Investment Regulations also make reference to the ability for LGPS funds to coinvest in a scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961 "without any restriction as to quantity". To our knowledge only one such scheme has ever been approved (a CCLA property fund which holds approximately £80m of assets). We have not considered this apparently arcane power further as the regulatory framework is unclear.

3 IMPLICATIONS

3.1 The practical implications of the Investment Regulations remaining in place with the above limits for all three Options under consideration are as follows.

3.2 Notwithstanding the general power of competence under section 1 of the Localism Act 2011, the existence of the Schedule 1 limits operate as restrictions on LGPS funds.

3.3 The limits apply asset allocation limits (and thus diversification) by reference to legal vehicle types; they do not therefore directly apply to asset allocation by reference to, say, strategic allocation to global equities. Thus, it is possible to comply with the limits without diversification, e.g. a 100% listed equity portfolio which is directly invested only carries a single but separate holding limit of 10% in any one stock. However, even that limit is removed (by note 2 to the table in Schedule 1) if the investment is made by an investment manager appointed by the Authority and the single holding is in units of a unit trust.

3.4 Several forms of collective investment vehicle are not defined or listed expressly under Schedule 1. These include the new contractual co-ownership scheme model that came into force under theACS Regulations, although the limited partnership model available under those Regulations is, of course, already catered for. Other undefined vehicles missing from Schedule 1 and not otherwise defined expressly in the rest of the Investment Regulations include Luxembourg vehicles (SICAV, SICAR and FCP) and Irish common contractual schemes. All of these are used already by LGPS funds.

3.5 To the extent that such undefined vehicles do not fall within the named categories of restricted investments in Schedule 1, it may be possible to characterise them under an existing heading. This is the case for an ACS established as an LP. If there is no appropriate characterisation for an ACS established on a tenants in common basis[7], it may be capable of being held in an unrestricted way (as described in paragraph 3.3 above). There is an argument that such an ACS may, however, be subject to the 10% single holding limit. "Single holding" is defined in the notes to the table in Schedule 1 as "investments" [itself an undefined term]:

(a) in securities of, or in loans to or deposits with, any one body;

(b) in units or other shares of the investments subject to the trust of any one unit trust scheme; or

(c) in transactions involving any one piece of land or other property.

3.6 Given the novelty of the ACS as a vehicle (none has yet been established or authorised by the FCA) it is not possible to be definitive that, despite its clear status under section 235A of FSMA as a collective investment scheme (which clearly is an investment under any normal meaning), an ACS itself satisfies any of the above three categories which apply to single holdings. It would depend in large part on the form of the documentation constituting the ACS.

3.7 If an ACS can be constructed so as to avoid any of these single holding definitions applying, it would be necessary to consider whether the transparency of the vehicle means that the single holding test requires one to look through the ACS (which after all has no separate legal personality, so does not block a look through approach) to any underlying securities, units or land/property. If, in keeping with the approach taken elsewhere in the Investment Regulations, a look through is not necessary, it may be possible to invest in an ACS without limit.

[7] For the purposes of this appendix , references to an ACS are, unless otherwise stated, to a tenants in common structure.

3.8 The consequence of this requirement to categorise investment vehicles by legal type and whether or not the investment is listed or not will of course have a direct bearing on the number of different CIVs that an individual LGPS fund may invest in. The lowest number of CIVs that an LGPS fund may already currently invest in is three (using the 35% limit applicable to unit trusts, OEICS and life company funds).

Conclusion

3.9 In conclusion, it is possible to circumvent the limits and have an undiversified portfolio, with heavy concentration of asset and counterparty risk under the current regulatory framework. Whatever outcome is decided upon as a result of this Report, one key recommendation we would make is to reconsider the efficiency of the Investment Regulations in controlling risk, as the asset allocation limits in Schedule 1 do not do this in any sophisticated way and lead to additional expenses in many instances to use vehicles which circumvent Schedule 1 limits.

4 ANALYSIS OF CIV STRUCTURES

4.1 Leaving aside the maximum limits imposed by the Regulations, not all CIVs have the same governance, capital or tax features. A number of more fundamental complex factors are set out in the matrix in the table below. For instance, is it more important to have CIVs which have maximum investment freedom or is the governance and tax structure more important? Is it important for investors to own the underlying assets and not have to assert a contractual right against the CIV in the event of an insolvency of an underlying investment? Such questions need to be tempered by a realistic understanding of the legal rights on counterparty default.

4.2 We have not attempted to score the factors that we have identified as applying to each vehicle in terms of investor suitability but that could of course be done.

4.3 We have limited the analysis to those CIVs referenced in the Investment Regulations and the ACS alternatives. This is not because other CIVs are not eligible investments for LGPS, but simply because their treatment under the Investment Regulations is that the lower 15% investment limit applies for such entities if they have to be regarded as investments in unlisted securities (where the limit is 15% in aggregate) or the 10% single holding limit (unless they fall outside the Investment Regulations altogether).

5 IMPACT OF THE AIFMD

5.1 AIFMD was implemented in the UK with effect from 22 July 2013 by the AIFM Regulations. It effectively implements a new regulatory (EU-wide) regime for alternative investment funds, where previously regulation had either not existed at all or had focussed on certain activities of certain participants involved in the setting up and running of an alternative investment fund.

5.2 An AIF is very broadly defined in the AIFM Regulations. It includes all alternative investment funds other than UCITS. Therefore, it would include all of the CIVs considered in the Table, save for an OEIC established as a UCITS fund and a life company fund. The consequences of each of the non-UCITS funds falling within AIFMD's remit are that detailed new regulation of the vehicle, manager and third parties will apply (through FCA's "FUND" sourcebook) with effect from 22 July 2013. It is not possible to evaluate whether the costs associated with the new regime will outweigh those attributable to existing UCITS or life company regimes. The extent to which these new rules may cause significant extra cost will also depend on whether the supporting parties are AIFMD compliant at their own cost or whether AIFMD compliance becomes part of the set up cost of a new CIV.

5.3 There is a pension specific exclusion in recital 8 of AIFMD which provides that it "should not apply to the management of pension funds… [by] local governments and bodies or institutions which manage funds supporting social security and pension systems…". This means that although AIFMD does not apply to the LGPS funds themselves, it does apply to any CIV which is not a UCITS (and not a unit-linked life fund).

6 PROCUREMENT LAW ASPECTS

Introduction

6.1 Public procurement of investment-related services will obviously add time and cost to the establishment of any new CIV. For that reason alone it is necessary to assess how the procurement rules apply, let alone the risk of challenge that either the procurement rules have not been applied properly or that they have simply been ignored when they should have been applied. This is a complex area of the law on which Counsel's opinion should be sought.

6.2 The administering authorities of LGPS funds are covered by the Public Contracts Regulations 2006 ("PCR") as contracting authorities. They are therefore subject to EU procurement rules. This means that, unless there is a relevant exemption in the PCR, the appointment of any new investment manager or the entering into a new investment arrangement requires a public procurement exercise to take place in accordance with those rules[8].

Application to investing in a CIV

6.3 There is, however, a widely used exemption in Regulation 6(2)(h) of the PCR which provides that, where a contracting authority enters into a contract which is: "for financial services in connection with the issue, purchase, sale or transfer of securities or other financial instruments, in particular transactions by the contracting authorities to raise money or capital", then no public procurement exercise needs to be followed. This exemption merely applies to the direct purchase of investments by a contracting authority, not where a discretionary investment management service is provided.

6.4 The word "securities" is not defined in the PCR, nor is it defined in the European Directive on procurement (2004/18/EC). However, the natural meaning of "securities" when used in other contexts is a wide one and we do not believe that it should be construed narrowly in a technical sense. Hence the fact that a unit trust, for example, does not issue shares, but units, should not be taken to mean that a subscription for units in a unit trust would not fall within the exemption. Shares issued by an OEIC are more obviously to be regarded as securities. Even if the relevant financial services contract is to purchase "other financial instruments", (a phrase which is also not defined) rather than securities, those words should be wide enough to capture unitised investments and would therefore apply to unit trusts as well as unit linked life assurance contracts.

6.5 In principle, we see no reason why this analysis should not also apply to the tax transparent forms of CIV, i.e. the limited partnership and the authorised contractual scheme established on a tenants in common basis. If all the AA is doing is buying an interest in such a CIV, the analysis should be the same as for the other forms of CIV, despite the fact that it is less clear that the limited partnership or ACS either issues or sells "securities" or "other financial instruments".

6.6 It is a completely separate consideration whether, notwithstanding any technical argument that Regulation 6(2)(h) removes the need for a procurement exercise on subscribing for interests in a CIV, it might nonetheless be desirable to do so in the interests of public transparency.

Services procured by and provided to the CIV

6.7 The legal structure and ownership of the CIV will determine whether it or its investors (i.e. the administering authorities of LGPS funds) are also involved in procuring additional services which are

[8] There is a general exemption which applies a de minimis threshold which would be irrelevant in the current circumstances, given the value of potential investments in a new CIV.

caught by the PCR. As stated above, the PCR only applies to public bodies which are contracting authorities. Therefore, this governance feature of the CIV is extremely important. If the operator of the CIV procures all of the external services and that operator is a private sector body, then the PCR will not apply to it and accordingly the full extent of public procurement rules will also be excluded. However, to the extent that the administering authorities retain control over the provision of services to the CIV via the governance structure of the CIV, there is a clear risk that each of the parties exercising that control will be subject to procurement rules. The services to be procured by a CIV could include those of a discretionary fund manager, the depository (custodian) and the administrator (if that is a different party from the depository), and other advisers such as auditors.

Governance/ownership issues

6.8 There is one other consequential issue which relates to the governance structure and who provides services to the CIV. This concerns the ability to apply "internal" or "in house" procurement exemptions, which derive a line of European Court judgements beginning with the Teckal case. This is a growing and developing area of the law which may also be affected by the new European Directive on procurement which is due to come into force in 2014. Without further understanding of exactly how a CIV might be established and the degree to which any private sector party might play a role in that structure is impossible to comment on the application of any such exemption, but a further analysis of the procurement implications may be necessary in due course.

7 STATE AID / EU LAW

State aid

7.1 Article 107 (1) of the Treaty on the Functioning of the European Union ("**TFEU**") establishes a general prohibition on State aid within the EU. A State measure will constitute State aid, and will in principle be prohibited, if it satisfies all four of the following criteria:

(i) The aid is granted by a Member State or through State resources;

(ii) The aid confers an advantage on the recipient by favouring certain undertakings or the production of certain goods;

(iii) The aid distorts or threatens to distort competition; and

(iv) The aid affects trade between Member States.

The four criteria are cumulative, i.e., all four must be met for the measure to constitute State aid. In the absence of any one of them, the measure is not classified as State aid pursuant to Article 107(1) TFEU.

7.2 Investment in the CIVs can therefore not give rise to State aid in the absence of an element of selectivity, i.e., the grant of a selective advantage within the meaning of the second limb of the State aid test (above). In addition, any selective advantage that could be identified would also have to be capable of distorting competition. In the scenarios envisaged, it is unclear whether any actual or potential competition in the market could be distorted. This would depend on the choice of an ultimate CIV model or models.

Fundamental principles of EU law

7.3 The implementation of Options 1 or 2 must not infringe fundamental principles of EU law, including in particular the prohibition on discrimination (Article 18 TFEU) and the free movement of goods, services, persons and capital within the internal market of the European Union (Article 26 (2) TFEU). Further detailed analysis may be required in order to ensure that the use of CIVs in practice does not give rise to potential claims that non-UK investment vehicles are suffering discrimination or exclusion in breach of these principles.

Annex: Detailed Comparison of CIVs

Note: Please see Executive Summary for an explanation of why we have concluded that the Qualified Investor Schemes (QIS) model would be the optimum vehicle for each of the UT and ACS models, whether established (on an LP or tenants in common basis).

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
Nature of Legal Structure (relevant to features such as ownership of assets, who contracts on behalf of CIV, who is able to sue/be sued)	Trust established by trust deed, entered into by the manager and the trustee. Established under trust law.	Corporate established by instrument of incorporation under the OEIC Regulations.	Partnership deed established under Limited Partnerships Act 1907 and COLL.	Contractual Scheme established by deed and COLL.	Corporate under Companies Act 2006 or alternative mutual structures.
Ownership of Assets	Assets owned by trustee. Investors have beneficial interest as unitholders. Trustee contracts on behalf of unitholders.	Assets owned by depositary. Investors are shareholders. ACD as director of OEIC enters into contracts.	Assets held by depositary. Investors are limited partners acting through general partner (GP) as legal owners. NB - Investors lose limited liability if they become involved in management.	Assets held by depositary; beneficially by investors as tenants in common.	Insurer is legal and beneficial owner of property and contracts with third parties. Investors have contractual rights as policyholders.

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
AUTHORISATION ISSUES					
Collective Investment Scheme for FSMA purposes?	Yes	Yes	Yes	Yes	No
Which parties require authorisation by FCA?	Manager Trustee	Manager/ACD Depositary	Operator/Manager Depositary	Operator/Manager Depositary	Insurer (may delegate to separately authorised Manager).
Threshold conditions requirement for authorisation of Manager/Operator by FCA?	COND 2: Location of offices, effective supervision, appropriate resources, suitability, adequate business model	As UT	As UT	As UT	As UT, but additional life company authorisation rules apply.
Required personnel/ controlled functions for Manager/Operator.	Personnel performing controlled functions (e.g. director, investment manager, compliance officer, money laundering reporting officer) must be fit and proper (includes financial solvency, honesty and	As UT	As UT	As UT	As UT, although insurance company personnel will have different skill set requirements.

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
	competence/ capability). Personnel to be in place on authorisation. Significant requirements on competence from regulators where advising / managing activities undertaken (effectively degree level plus ongoing CPD requirements).				
Does CIV (and any sub-fund) require authorisation?	No	Yes	Yes	Yes	Only at insurance company level but substantial regulatory oversight and attention (e.g. see TR13/8 thematic review by FCA into governance of unit linked funds).
Other authorisation features		Depositary must be independent of the OEIC (and the ACD).	Depositary must be independent of the Manager.	Depositary must be independent of the Manager.	Full regulatory oversight of capital, systems and controls and conduct of business.

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
Timescales for CIV authorisation NB need to factor in time to recruit staff with appropriate qualifications for all CIVs if starting from scratch	Timescales extended depending on nature of QIS – can be 3-4 months.	As UT NB ACD authorisation likely to take longer as specific roles and responsibilities under COLL and OEIC regulations require specific expertise.	As UT	As UT	6 to 12 months from submission of completed FCA application pack, considerable preparation time, so 12-18 months in total.
Timescale for sub-fund from authorisation	4-6 weeks	As UT	N/A. No sub-fund permissible – need separate LP	As UT	N/A. In practice sub-funds operate at an accounting level only by the insurer creating separate sections of their pension fund management business.
Capital requirements for establishment?	**AIFM:** • Initial capital of at least Eur 125k; and • If value of assets under management greater than Eur 250m then additional own funds requirement equalto 0.02% of the excess over Eur 250m	**UCITS/NURS:** • Initial capital of at least Eur 50k/125k (if holding client money) or • Credit risk plus market risk calculation • Fixed overheads	As UT	As UT	Capital resources requirement made up of: • base capital requirement (between Eur 700k and Eur 3.7m) • risk-based capital requirements based on credit

Criterion/Feature	UT (QIS)	OEIC	LP (includes LP ACS) (QIS)	ACS (tenants in common) (QIS)	Unit Linked Life Fund
	(subject to a Eur 10m cap) • Own funds must not be less than 25% of annual expenditure • Own funds may be reduced by bank guarantee or PI insurance in certain cases.	25% relevant annual expenditure			risk, market risk, liquidity risk, operational risk and insurance liability risk
INSOLVENCY ISSUES					
Segregation of sub-funds' liabilities?	Umbrella schemes possible but not legally segregated at sub-fund level protection.	Protected cell regime provides that individual sub- funds can be legally segregated and protected from other sub-funds.	Not possible to have umbrella schemes, so no sub-funds segregation.	Umbrella schemes with sub-funds possible (see OEIC comments).	Segregation achieved at accounting level only.
Rights on Insolvency of CIV	Unsecured creditor	Unsecured creditor	Unsecured creditor (of underlying assets).	Unsecured creditor (of underlying assets).	Special creditor regime under Insurance Insolvency Directive gives policyholder preference over unsecured creditors.

INVESTMENT RESTRICTIONS					
Investment restrictions on the vehicle? **NB: Table contains a summary of the most relevant and important limitations for authorised CIVs (OEIC and life fund).**	There is a basic requirement for a spread of risk consistent with the investment objective and policy but there are no specific spread or concentration limits, except in relation to property. The following are permitted investments for a QIS: • Shares. • Debt instruments. • Deposits. • CISs. • Derivatives. • Contracts of insurance. • Government and public securities. • Property. • Precious metals (gold, silver and platinum). • Commodity contracts.	UCITS: • May invest no more than 10% of its assets in transferable securities or approved money-market instruments which are issued by any single body and all holdings in excess of 5% of its assets may not, in aggregate, exceed 40% of the assets. • No more than 20% of scheme property may be in transferable securities or approved money-market instruments issued by entities in the same group. • No more than 20% of assets may be invested in any one single CIS (UCITS or non-UCITS), with a general restriction of a maximum of 30% of assets invested in non-UCITS schemes.	As UT	As UT	Permitted links rules apply: • Must have in place appropriate valuation procedures • Permitted links must be via approved indices only Permitted links include: • Approved securities • Listed securities • permitted unlisted securities • permitted land and property • permitted loans • permitted deposits • permitted scheme interests • cash • permitted units • permitted stock lending • permitted derivatives

		• Maximum OTC derivatives, counterparty exposure is limited to 5% (10% in the case of approved banks). • No more than 20% of assets may be invested in a combination of transferable securities and approved money-market instruments issued by, and deposits or OTC derivative transactions made with, a single body. • No more than 35% of assets may be invested in the government or public securities of a single body (subject to the point below). • Over 35% of scheme property may be invested in a single government or public securities body, but there is a restriction that no more than 30% of			Note: the terms above have specific meaning in the FCA glossary. The detailed rules are designed to protect policyholders.

		the scheme property consists of securities of any single issuer and a requirement that the securities must come from at least six different issuers			
VALUATION ISSUES					
Valuation rules for investor interests specified by FCA?	• The manager should exercise due diligence in connection with valuation and pricing, and show that it has complied with the minimum control requirements set out in the FCA rules. • The Manager has a duty to ensure that prices used to value investments are correct and to take action to rectify any incorrect (including reimbursing or compensating investors).	• See UT for valuation rules for specified investor interests. • Under the FCA rules, there is a set of minimum checks that a depositary must perform to satisfy itself that the ACD's pricing operation is adequately controlled and the risk of incorrect prices is minimised.	As UT	As UT	Specific insurance company rules relating to valuation of assets.

Valuation and Pricing of Assets	AIFM: at NAV Dual or single pricing Forward or historic pricing	At NAV Dual or single pricing Forward or historic pricing	At NAV Dual or single pricing Forward or historic pricing	At NAV Dual or single pricing Forward or historic pricing	At NAV Varied practices, including Forward or Historic pricing and priced on Dual or single basis FCA TR13/8 comments on pricing and valuation practices in unit-linked funds.
GOVERNANCE					
Governance Disclosure and reporting requirements	• Legal and regulatory reporting requirements. • A prospectus – must comply with COLL content requirements. • AFM must publish the annual reports and accounts within four months of the end of the fund's annual accounting period and the interim, or half-yearly, report and accounts within two months of the interim accounting date.	• Changes to funds subject to COLL rules which determine how changes should be treated, and as a consequence, whether they require approval of FCA, unit holders or notifications. • Materiality of their impact will determine whether the change is to be treated as a pre- or post-notifiable, significant (pre-event notification) or fundamental (shareholder vote)	As UT	As UT	PRA / FCA oversight of governance regime. Substantial PRA reporting and preparation of ongoing capital, solvency, investment and general corporate governance.

	• Long and short form report requirements • Changes to funds subject to COLL rules which determine how changes should be treated, and as a consequence, whether they require approval of FCA, unit holders or notifications. • Materiality of impact will determine whether the change is to be treated as a pre- or post-notifiable, significant (pre-event notification) or fundamental (shareholder vote) change. • Regime for merger and winding-up subject to regulator consent	change.			
TAX ISSUES					
VAT Fund management charges	VAT exemption for management fees.	VAT exempt for management fees.	VAT exemption for management fees.	VAT exemption for management fees.	VAT exempt.

Stamp Duty/SDRT on unit/interest/share purchases	Schedule 19 Finance Act 1999 imposes a stamp duty reserve tax; - the tax is charged on surrenders of a unit in an AUT to the manager. Schedule 19 is to be abolished by the Finance Bill 2014 and the tax will be payable until then.	See UT	The Stamp Duty and Stamp Duty Reserve Tax (Collective Investment Schemes) (Exemptions) Regulations 2013 provides specific exemptions from Stamp Duty and SDRT for transfer units within an ACS and transfers of securities to an ACS.	As ACS LP.	No SDRT or stamp duty on life funds – no change in beneficial ownership.
Withholding tax at CIV level on overseas securities **NB Detailed analysis will depend on double-tax treaties to mitigate withholding taxes.**	The UT may be subject to non UK withholding tax on its investments in non UK equities and debt securities.	As UT OEIC is beneficial owner hence similar to life company and may be able to rely on double-tax treaties.	Tax transparent so should be able to rely on treaty relief, but will depend on recognition of vehicle's tax transparency.	Tax transparent so should be able to rely on treaty relief, but will depend on recognition of vehicle's tax transparency.	Life company as beneficial owner may be able to rely on some quite long standing double-tax treaties.

Appendix 6b Legal issues – option 3 Squire Sanders

1 INTRODUCTION/SCOPE

1.1 This section of our report identifies actual and potential barriers to merging LGPS Funds and to consider ways in which those barriers might be overcome. This analysis necessarily involves detailed construction of statutory language and therefore statutory powers. It should also be noted that the legislation governing the LGPS was not drafted with the original intention of facilitating a merger of funds so the construction of the language used needs also to be overlaid with an understanding of what the aim of Parliament was in agreeing on particular terminology in the way that it has.

1.2 Where we have concluded that additional primary legislation may or may not be required, that conclusion is necessarily based on our interpretation of statute, but our views could be challenged by other stakeholders. To add weight to the more complex areas of analysis we strongly recommend engaging leading Counsel to confirm our conclusions.

1.3 The mechanics of any merger of pension funds is a complex matter. However, the key dependencies are simply whether assets and liabilities can be transferred effectively, with the result that members' entitlements are kept whole and that there is a clear allocation of responsibilities before and, more importantly perhaps, after the merger. In the context of the LGPS where there is a complex inter-relationship between the roles of the Secretary of State, the administering authorities ("AA"), scheme employers, scheme members (to say nothing of third parties), these dependencies have many different aspects. The table in section [3] below summarises these dependencies but must be read in conjunction with the detailed commentary in section 4 below.

1.4 **Glossary of defined terms**

"AA" means Administering Authority

"Investment Regulations" means the Local Government (Management and Investment of Funds) Regulations 2009 (as amended)

"1972 Act" means the Superannuation Act 1972

"2008 Regulations" means the Local Government Pension Scheme (Administration) 2008 Regulations

"2013 Act" means the Public Service Pensions Act 2013

"2013 Regulations" means the Local Government Pension Scheme Regulations 2013

2 SUMMARY OF RESEARCH APPROACH

2.1 In order to establish whether the legislative framework would enable the Secretary of State to order the transfer of assets and/or liabilities from existing LGPS funds to other vehicles, it is necessary to confirm both the existence and range of the Secretary of State's current powers, as well as how those powers relate to the statutory responsibilities and functions of both administering authorities and scheme employers. In turn, this requires consideration of primary legislation covering both the existing LGPS benefit structure and that which will apply from April 2014 for each of these parties.

2.2 A variety of different business models could be used as the receiving entity for a fully merged new fund structure, although there are "political" as well as legal drawbacks with using any of the existing LGPS AAs' funds as such a vehicle, given that they were established to cover specific geographical areas (regardless of the political issues associated with local accountability and different funding levels) and the statutory alignment of funds to AAs is set out in primarily legislation so can only be amended by further primary legislation.

2.3 It is important to distinguish between the terminology here: the body that is responsible for discharging the benefit obligation to the members (i.e. the AA) has a fund" or "funds" which is designed to be sufficient to do so. The AA has an obligation to invest the monies it receives and can do so, subject to the Investment Regulations, in a range of different vehicles or directly. The "fund" is therefore separate from the underlying investment vehicle and is an asset owned by the AA. In turn, the power of investment (and in fact duty to do so) is vested in the AA for its fund; it does not belong to nor is it delegated by the Secretary of State.

2.4 The key issues relate to whether:

(a) the assets supporting current liabilities can be transferred under the control of other AAs or new statutory bodies; and

(b) whether scheme liabilities may be transferred in the same way.

2.5 In turn this leads to the following questions:

(a) does the Secretary of State have the power to compel mergers of assets and liabilities within existing vehicles only or would it be necessary and/or desirable to create new funds and/or AAs?

(b) if the Secretary of State does not have the requisite powers and primary legislation is necessary, is there a suitable precedent that exists?

2.6 It is also necessary to look at other powers than those which govern the mere transfer of assets and liabilities. These include the degree of prescription which applies to current AAs under the existing LGPS and how scheme employers are mandated to adhere to a particular one of the 89 current LGPS Funds.

2.7 If the Secretary of State does possess the above powers already, or can reserve them to himself by means of making new regulations made under existing primary legislation, the next level of analysis is whether third parties, whose rights and obligations are not expressly covered under the statutory framework, can also have their obligations and rights transferred or assigned to apply to a new structure. We consider each of those issues in turn.

3 SUMMARY OF LEGAL DEPENDENCIES

Pre-condition to merger of funds	**Pre-2014 legislative power (Primary or Secondary)**	**Post-2014 legislative power (Primary or Secondary)**	**Potential Legislative solution**
Establishment of new Fund and new Authority	N/A	Section 3(1), 2013 Act	Regulations
Alignment of statutory functions of Act and requirement to maintain a fund	The "Appropriate Fund" is designated by Regulation 29 and Schedule 4 of the 2008 Regulations	Regulation 53 and Schedule 3 of the 2013 Regulations identify the bodies who are required to maintain a pension fund and are therefore AAs	Regulations - would be required to amend these provisions if the AAs were to change.
Allocation of employers to the new fund	The "Appropriate Fund" is designated by Regulation 29 and Schedule 4 of the 2008 Regulations	Scheme employers are designated by Part 2 of Schedule 4 of 2013 Regulations	Regulations -would be required to amend these provisions if scheme employers were reallocated.
Transfer of existing fund (assets only) to new Authority	"Amalgamation" under Schedule 3, (Para 2) 1972 Act	Section 3(1), 2013 Act and Schedule 3 Broad power to make regulations in relation to schemes - not specific	Regulations
Transfer of past liabilities to the new Authority	"Amalgamation" under Schedule 3, (Para 2) 1972 Act	Schedule 3, paragraphs 11 and 12 of the 2013 Act permits regulations for administration, management and winding up and for nominating who must provide benefits.	TBC. Regulations may be made by the Secretary of State
Novating existing admission agreements and supplier contracts (these will include the current AA as a party)	N/A [*Existing Admission Agreements saved by Transitional Regulations*]	Section 3(2) 2013 Act consequential etc power, may be sufficient.	Regulations would be needed to novate all admission agreements wholesale and any supplier contracts to the new fund.

4 POWERS TO FACILITATE THE MERGER OF LOCAL GOVERNMENT PENSION FUNDS

4.1 The 1972 Act gives the Secretary of State the power to make regulations to provide pension arrangements for persons employed in local government service. Regulations were subsequently made to confirm the then applicable and subsequent benefit structures.

4.2 The 2013 Act (which applies to all public service pension funds, not just the LGPS) changed the benefit structure for the LGPS from 1 April 2014 and created new powers in respect of contributions from scheme employers and employees, albeit that those funding powers largely replicated the 1972 Act powers.

4.3 It should be noted that the investment powers of the LGPS funds have not been changed by the 2013 Act, so the only powers and duties AAs have are given under the 1972 Act.

4.4 This means that there is no pre and post 2014 distinction between the funds held by the AA and the benefit obligations due to the members. Where an AA decides to use its statutory powers to establish a separate fund for particular employers by virtue of Regulation 32 of the 2008 Regulations and/or Regulation 54 of the 2013 Regulations, it is within the AA's discretion to do so. This is the only mechanism by which liabilities for particular employers are separately identified and hypothecated. The legislation does not operate so as to ringfence the affected members' rights to benefits[9].

4.5 This principle is reinforced by the language of Regulation 86 of the 2008 Regulations (mirrored in Regulation 103 of the 2013 Regulations) which makes it very clear that any given member is to be identified, for funding purposes, as having an "appropriate fund".

4.6 A further nuance of this lack of correlation between a member's benefits and funding is that while the benefits are effectively guaranteed at the level of the LGPS as a whole, the rights of the member can only be asserted against the responsible AA for the relevant fund. For example, a member who paid contributions to a London borough fund cannot bring a claim against a metropolitan AA (and nor can the London borough fund itself). As evidence of this principle see Regulation 96 of the 2013 Regulations ("*the relevant transfer (to another scheme) may only be paid by the administering authority from its pension fund*"). This issue was examined in a judicial review brought by South Tyneside Metropolitan Borough Council where it was held that liability of the employer to contribute to a deficit in the Northumbria CC Pension Fund had not been transferred as a result of a restructuring (see further below).

<u>1972 Act powers: detailed analysis</u>

4.7 The general power to establish superannuation schemes for employees in local government service is set out in section 7 of the 1972 Act in the following terms:

"The Secretary of State may by regulations make provision with respect to the pensions, allowances or gratuities which, subject to the fulfilment of such requirements and conditions as may be prescribed by the regulations, are to be, or may be, paid to or in respect of such persons, or classes of persons, as may be so prescribed"

This power does not appear to place any limits on the scope of regulations that may be made under the Section 7 power. In fact, virtually all of the secondary legislation passed for the purposes of the reorganisation examples we cite below, was made under this Section.

4.8 Notwithstanding the power in Section 7, Schedule 3 of the 1972 Act details the specific provisions which may be included in regulations for local government pension arrangements.

(a) Paragraph 2 of Schedule 3 provides that:

"Regulations may [provide] for the establishment and administration of superannuation funds, the management and application of the assets of such funds, the amalgamation of all or any of such funds, and the winding-up, or other dealing with, any such fund."

The terms "amalgamation" and "winding-up" are not defined in the 1972 Act and do not appear to have been considered further by the Courts in this context, nor has the definition been clarified in other legislation. Consequently, we have to apply an ordinary construction to those words. The word "fund" is not defined and would, we suggest, normally refer to the assets only of the relevant arrangement, without including the concept of the liabilities. This is a vital point

9 As an aside, members' rights to benefits are not hypothecated by reference to particular assets(with the exception of AVCs) although even where, legally, any money purchase AVCs will be held in the name of the AA, not the member.

of construction and is not free from doubt. However, because benefits are guaranteed and not dependent on a given level of funding, there is no reason to suggest otherwise.

"Amalgamation" would suggest the merger of such funds, and "winding-up" would, in our view, generally imply termination of a fund. Whether such a winding up would necessarily include a discharge of liabilities is not clear from the context. We would suggest, for the reasons given above that there would have been no need to specify that a discharge of liabilities would necessarily follow on the exercise of the power, given that, again, from the member's point of view, the benefits are guaranteed.

Notwithstanding this uncertainty, the specific enabling power in paragraph 2 of Schedule 3 is also very broad, particularly in the phrase "or other dealing with" which would imply any other action the Secretary of State may wish to take, subject to the general principles that statutory functions and discretions can only be exercised within the judicial test colloquially known as "Wednesbury reasonableness", established in Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948]. In that case the judge held that "*if a decision on a competent matter is so unreasonable that no reasonable authority could ever have come to it, then the courts can interfere.*"

(b) Paragraph 3 of Schedule 3 specifies provisions relating to the transfer of benefits:

"Regulations may [provide] for the payment and receipt of transfer values or in lieu thereof for the transfer or receipt of any fund or part of a fund or policy of insurance".

We understand the reference to the payment of transfer values here to apply to individual members although there is nothing to prevent that power applying on a bulk basis. Both assets and liabilities can therefore be transferred under this power, but, when read in conjunction with the powers above, it does not seem to add anything that is not already covered.

4.9 Finally, Schedule 3 also contains a general provision (under paragraph 13) to allow the Secretary of State to make "such incidental, supplementary, consequential and transitional provisions as appear to the Secretary of State to be necessary or expedient". However, this would be restricted by the scope of the original powers under the 1972 Act . As established by similar wording in s.111 of the Local Government Act 1972 (which has been the subject of detailed judicial authority in a line of cases on vires issues), a public body can only exercise powers that are within the framework of being incidental etc to the original power and not for some completely different purpose.

Conclusion

4.10 From the analysis above, we believe that there is a clear statutory power to amalgamate funds (i.e. assets only). We do not believe there is such a clear power to transfer liabilities without looking at the way that those liabilities attach to AAs and/or scheme employers, as to which see below.

Future regime (post 2013 Act)

4.11 We now need to examine the different ways in which the 2013 Act and the 2013 Regulations deal with these powers.

4.12 Section 1 of the 2013 Act provides a power to make "scheme regulations" to establish schemes for payment of pensions and other benefits for local government workers.

4.13 It is interesting to note the use of the word "scheme" and the word "fund" in the 2013 Act, a complexity that is not present in the 1972 Act (which uses the word "fund" throughout).

"Scheme" is defined in the 2013 Act as meaning "*includes arrangements of any description*". In context, therefore, this would not necessarily be limited to new pension schemes (which would be "new public body pension schemes" covered by section 30). It is clear elsewhere that such an arrangement can be connected with another scheme (see section 4(6)). The term "scheme" is widely used in the 2013 Act. In general it can be taken as referring to the new benefit structures established under existing public sector pension arrangements.

It appears that the 2013 Act uses the word "fund" (although it is not defined) to refer to the assets supporting the "scheme".

4.14 From 31 March 2014 no further benefits can be provided under the existing regulations relating to the LGPS made under the 1972 Act except where the benefits can also be provided under the provisions of the 2013 Act (Section 18). However, to that extent, existing LGPS funds are treated as if they had been established under the 2013 Act (see Section 28(3)). In essence, Section 28 creates a bridging power to link pre 2014 and post 2014 LGPS benefits. However we note that section 28(2) preserves regulations made under section 7 of the 1972 Act:

"*to the extent that:*

(a) *such regulations make <u>provision for the payment of pensions and other benefits</u> [for post 1 April 2014 Service], <u>and</u>*

(b) *that provision could be made under scheme regulations."* [emphasis added].

4.15 This power is restricted in its scope to regulations which are for the purpose of "payment of pensions and other benefits", which would not encompass a power to amalgamate funds nor alter the Investment Regulations.

4.16 Section 3 provides for a broad power for regulations to be made by the Secretary of State(as the "responsible authority" under Schedule 2) in relation to schemes under the 2013 Act:

"3 Scheme regulations

(1) Scheme regulations may, subject to this Act, make such provision in relation to a scheme under section 1 as the responsible authority considers appropriate.

(2) That includes in particular-

(a) provision as to any of the matters specified in Schedule 3;

(b) consequential, supplementary, incidental or transitional provision in relation to the scheme or any provision of this Act.

(3) Scheme regulations may-

(a) make different provision for different purposes or cases (including different provision for different descriptions of persons);

(b) make retrospective provision (but see section 23);

(c) allow any person to exercise a discretion.

(4) The consequential provision referred to in subsection (2)(b) includes consequential provision amending any primary legislation passed before or in the same session as this Act (as well as consequential provision amending any secondary legislation).

(5) Scheme regulations require the consent of the Treasury before being made, unless one of the following exceptions applies.

(6) The exceptions are-

(a) scheme regulations of the Scottish Ministers relating to local government workers, fire and rescue workers and members of a police force;

(b) scheme regulations of the Welsh Ministers relating to fire and rescue workers."

4.17 On the face of it, this gives the Secretary of State very broad powers to legislate for anything connected to the LGPS, albeit subject to the 2013 Act. The general rules discussed in section 4.8 above about the reasonableness of the Secretary of State's decision-making powers would therefore also apply. The

Explanatory Notes to the Act give examples of what is meant by the limits prescribed by the phrase "subject to this Act", eg the scheme manager provisions in section 4.

4.18 Construing the rest of the language in Section 3 of Schedule 2 and the scope of the Secretary of State's powers is complex because of the following factors.

(a) The list of matters in Schedule 3, in Section 3(2)(a) which, as noted above, includes no reference to merger or amalgamation, is prefaced by the non-exhaustive words "in particular". The Explanatory Notes (para 20) reinforce this point: "If a matter is not mentioned in Schedule 3 this does not prevent it from forming part of such a scheme, provided it is within the powers given by sections 1(1) and 3(1)". (emphasis added albeit this is merely a note, not the statute itself) .

(b) The terminology in sub-Section 3(3) is also clearly very broad. The Explanatory Notes (para 22) are less helpful here: "This is a common provision in regulation-making powers to ensure that they are appropriately flexible." Of itself, however, the "purposes" or "cases" must still be referable to the scheme as envisaged by section 1.

(c) Finally, para 24 comments on the references to the "consequential provision" in Section 3(4): "only primary legislation passed before or in the same parliamentary session[10] as this Act can be amended. This power may be necessary where legislation is inconsistent with or requires modification as a consequence of scheme regulations or a provision of this Act. Section 24(1)(a) further requires that any amendment to primary legislation must be made by the affirmative procedure. The meaning of "affirmative procedure" is given in section 38(2)", which essentially says that any regulations have to be laid before both Houses of Parliament and approved by both Houses.

4.19 Taking all of these points together, there is a multiple test to establish whether "scheme regulations" can or cannot be made within the ambit of Section 3:

(a) they must be "appropriate" for the Secretary of State, acting reasonably, to make in relation to the LGPS;

(b) the list of matters in Schedule 3 is non-exhaustive and scheme regulations may be made for "different purposes or cases", but again must in some way attach to the LGPS as a scheme; and

(c) if a consequential provision is encapsulated within a regulation made under Section 3, it can only be passed by the affirmative resolution procedure, i.e. by both Houses of Parliament.

4.20 Applying these principles to the Act as drafted, the following conclusions can be reached. Section 3(2)(a) provides that regulations may be made in relation to the matters set out in Schedule 3. The provisions relevant to a transfer of benefits and the potential merger of funds are as follows.

(a) *"The payment or receipt of transfer values or other lump sum payments for the purpose of creating or restoring rights to benefits (under the scheme or otherwise)"* (paragraph 10 – emphasis added).

(b) *"Pension funds (for schemes that have them). This includes the administration, management and winding-up of any pension funds" (*paragraph 11 – emphasis added*).*

[10] **This is an annual period running from the first Thursday of May, the 2013 Act received Royal Assent on 25 April 2013 so the relevant session has now apparently passed.**

4.21 There is therefore no equivalent specific power under the 2013 Act allowing regulations to be made for the "amalgamation" of pension funds as under paragraph 2 of Schedule 3 of the 1972 Act. Notwithstanding this lack of a reference, we need to confirm whether the very broad power under Section 3 is sufficient to allow for amalgamation of funds, given the hurdles set out above. It is certainly odd that the wording was not carried over from the 1972 Act.

4.22 A contrary argument to the lack of an express reference to the power to amalgamate funds can be found in the wording of paragraph 11 to Schedule 3 of the 2013 Act. That paragraph, as quoted above, includes the words "*This includes*". Applying a general principle of construction, this would suggest that the activities which can be made the subject of regulations under Schedule 3 paragraph 11 is not exclusive and it might be argued that the amalgamation and merger of pension funds is necessarily to be implied in the phrase "*administration, management and winding-up*". We would recommend seeking Counsel's opinion on this argument.

4.23 We now need to consider whether the power to make regulations governing LGPS Funds themselves and the appointment of AAs could be used to transfer both the assets and the liabilities on an amalgamation (if that power could be exercised under regulations made under section 3(1)). Clearly, the assets of a particular LGPS Fund, on a merger or amalgamation, would then become assets of the new merged entity.

5 POWER TO SUBSTITUTE ADMINISTERING AUTHORITIES

5.1 The provisions relevant to the admission of "participants" (i.e. employers) into the LGPS are currently found in part 4 of the 2008 Regulations. There are two broad groups of participants (termed "employing authorities") whose employees may join the LGPS: Scheme Employers and Admission Bodies.

5.2 In each case the 2008 Regulations dictate the "appropriate fund" that the employees of each employing authority will be eligible to join (see below). The 2013 Regulations provide for a similar mechanism at Part 2 of Schedule 3.

5.3 Schedule 4, part 1 of the 2008 Regulations sets out a table of appropriate authorities. However, broadly:

(a) employees of an AA are members of the fund maintained by that authority;

(b) employees of an admission body are members of the AA's fund with which the admission body entered into an admission agreement; and

(c) where an authority does not have its own fund, the 2008 Regulations refer back to the Local Government Pension Scheme Regulations 1997 which, at Part 3 of Schedule 5, contains a list of authorities participating in other funds.

5.4 Schedule 2 of the 2013 Regulations contains the corresponding list of AAs to the 2008 Regulations. In order to sever the linkage between scheme employers and the appropriate AA that would necessarily happen on a merger, it would be necessary to amend these provisions to allocate an alternative fund to each scheme employer. Such an amendment could be made by "consequential" regulations under section 3(2)(b), which, as noted above, brings into play the affirmative procedure.

5.5 Schedule 4 of the 2008 Regulations further states that where an employing authority "merges or amalgamates" with another employing authority, or the members would be required to contribute to more than one fund, then the employing authority can make an application to the Secretary of State to direct to substitute the fund to which its employees are allocated. Note that it is the employing authority which must merge or amalgamate, not the fund itself, to trigger such a reorganisation.

Before making such a direction, the Secretary of State must consult with any affected bodies, but ultimately may:

"…require the making of financial adjustments between the funds, whether by way of payment to the substituted fund or a transfer of assets or both.

It may also contain provision as to the transfer of liabilities to the substituted fund, may require a revised rates and adjustment certificate in respect of each employing authority concerned, to take account of the effect of the direction and may make provision for any other consequential or incidental matters."

5.6 Consequently, since an "employing authority" is defined as "a body employing an employee who is eligible to be a member" any scheme employer or admitted body can make an application to the Secretary of State for a direction to substitute the fund in relation to its participation in the LGPS.

5.7 The power is dependent on each AA making an appropriate application and is not within the gift of the Secretary of State. Further, although these legislative provisions apply directly to substitute any fund applicable to a scheme employer or admission body, there is no specific provision for an automatic substitution of AA for the purposes of an admission agreement. Consequently, the admission body would have to enter into a new admission agreement with the new relevant AA on each substitution of fund.

5.8 Schedule 3 of the 2013 Regulations contain comparable but not precisely the same powers in relation to transfers. The relevant powers of the Secretary of State have been simplified in the language but again operate on application by the scheme employer, not as a reserved power:

"*3 The Secretary of State may, on application by a Scheme employer, by a written direction substitute a different administering authority as the appropriate administering authority for a person or class of person.*

4 A direction under paragraph 3-

(a) may only be given after the Secretary of State has consulted any bodies appearing to be affected by a proposed direction, and

(b) may include provision as to the making of adjustments between funds, the transfer of assets and liabilities, and any other consequential or incidental matters."

Note that, in order for these powers to be used, the Secretary of State must consult with the "bodies" affected by the proposed transfer.

Further on in Schedule 3, under paragraph 12, there is scope for regulations to be made in relation to:

"*The administration and management of the scheme, including –*

(a) the giving of guidance or directions by the responsible authority to the scheme manager (where those persons are different);

(b) <u>the person by whom benefits under the scheme are to be provided</u>;

(c) the provision or publication of the information about the Scheme." (Emphasis added)

From the above, it will be seen that paragraph 12(b) does allow the Secretary of State to make regulations in relation to changing an AA, given that that is the "*person by whom benefits...are to be provided*".

Transfer of statutory functions of current AAs to new bodies

5.9 In order to implement and administer a merger of funds successfully it would be necessary to transfer certain powers, including the administration and investment powers, from the current AAs to new AAs or to create one or more separate bodies to exercise those powers. In the past, this has always been done by primary legislation (see Section 7 below). No doubt that was because other non-pension powers were being transferred also.

It may be, if the conclusion is reached that the powers in Section 3 and Schedule 3 are broad enough, secondary legislation could be provided to achieve the same result.

5.10 Whichever route might be adopted, care would need to be taken if any transfers of funds and liabilities were to be made, in light of the South Tyneside[11] case.

5.11 In the South Tyneside case certain committees of five magistrates' courts were abolished and the liabilities transferred to a new body, after certain court reforms, the Lord Chancellor became successor to those liabilities. Despite the transfer, the Lord Chancellor refused to fund a deficit relating to former employees of the abolished magistrate's court committees. The Court of Appeal found that, on proper construction of the LGPS regulations then in force, there was no obligation on the Lord Chancellor to contribute to the fund in question as the employing authority's employees no longer made contributions to that fund.

5.12 This raises, in particular, the issue that making any transfers without clear legislative authority could have unintended consequences and that, on a transfer, contributions (including deficit payments) from "former" employers that are owed to the current AAs should be addressed before rather than after the event.

6 WHAT ARE THE POWERS TO TRANSFER ADMISSION AGREEMENTS AND/OR SUPPLY CONTRACTS?

6.1 One of the potential consequences of Option 3 would be the lack of a contractual relationship between the scheme employers and the relevant new AA that would assume responsibility for administering the merged fund. Existing contractual relationships are evidenced by an admission agreement. The terms of admission agreements are prescribed only as to their minimum content by regulations (Schedule 3 to the 2008 Regulations and Part 3 of Schedule 2 to the 2013 Regulations). These include certain automatic termination events, which are as follows:

(a) if the admission body ceases to be such a body (note that, under paragraph 8 of Schedule 3 of the 2008 Regulations, admission bodies must notify the AA of anything which may be a termination event. This includes a take-over, reconstruction or amalgamation of the employer, liquidation or receivership or a change in the nature of the body's business or constitution).

(b) on three months' notice (paragraph 9 to Schedule 3); and

(c) the parties to the admission agreement may also make such other provision about its termination as they consider appropriate.

[11] South Tyneside Metropolitan Borough Council, R (on the application of) v The Lord Chancellor and Secretary of State for Justice & Anor EWCA Civ 299

6.2 The requirements for the terms of an admission agreement do not envisage the possibility of merging funds or the novation/ assignment/transfer of the agreement where one party, the AA, simply disappears. It may be, of course, that individual agreements do cater for such events but in our experience, administering authorities do not draft their admission agreements to cater for anything other than the bare minimum requirements set out in statute.

6.3 Part 3 of Schedule 2 to the 2013 Regulations contains similar provisions at paragraph 9:

"*An admission agreement must include-*

(a) provision for it to terminate if the admission body ceases to be such a body;

(b) a requirement that the admission body notify the administering authority of any matter which may affect its participation in the Scheme;

(c) a requirement that the admission body notify the administering authority of any actual or proposed change in its status, including a take-over, reconstruction or amalgamation, insolvency, winding up, receivership or liquidation and a material change to the body's business or constitution;

(d) a right for the administering authority to terminate the agreement in the event of:

(i) the insolvency, winding up or liquidation of the admission body;

(ii) a material breach by the admission body of any of its obligations under the admission agreement or these Regulations which has not been remedied within a reasonable time;

(iii) a failure by the admission body to pay any sums due to the fund within a reasonable period after receipt of a notice from the administering authority requiring it to do so."

It will be noted that, again, there is no provision requiring automatic termination of admission agreements triggered by a merger of LGPS funds.

6.4 There are other provisions of admission agreements which would also need to be novated or assigned to the new AA on a merger under Option 3. These include the requirement for the admission body to pay contributions to the AA, which will be named specifically in the agreement and so will be the "wrong" party.

6.5 Any changes to admission agreements and, more widely, any supply contracts, will need to be made individually to each agreement under its specific amendment terms or by way of overriding legislation. Without an overriding statutory power, such as that used on the reorganisation of Welsh local government in 1995, this would be a very significant undertaking.

7 EXAMPLES OF TRANSFER OF OBLIGATIONS AND LIABILITIES OF ADMINISTERING AUTHORITIES

7.1 In this section we briefly examine three precedents for reorganisations of LGPS funds, which each followed on from wider local government changes. In two cases (the GLC and Welsh authorities) primary legislation was used. We have not considered in detail whether it would have been possible to avoid the use of primary legislation, but given the wider ambit of each reform the question may be academic.

7.2 Abolition of the Greater London Council (GLC).

(a) The Local Government Act 1985 (LGA 1985) provided for the abolition of both the GLC and the Metropolitan County Councils, with effect from 1 April 1986. A number of the functions of the GLC were transferred to the London Residuary Body set up for that purpose.

(b) Section 60 of the LGA 1985 provided for the automatic transfer of the GLC's position as an AA to the London Residuary Body. This included, specifically:

(i) functions as an AA under Regulations made under Section 7 of the 1972 Act; and

(ii) all liabilities of the GLC in respect of pensions payable by it or otherwise.

(c) These functions and liabilities were then transferred to the LPFA on the winding up of the London Residuary Body at the end of October 1989.

(d) Since the GLC had a number of statutory functions other than acting as an AA, and Government was also abolishing other Metropolitan County Councils, it is not unexpected to find that Government chose to use primary legislation Act to transfer the AA functions of the GLC.

7.3 Local Government Reorganisation in Wales

(a) The Local Government (Wales) Act 1994 (the 1994 Act) contains, at Section 17, a general provision to transfer the functions of the councils being abolished. It has the effect of amending all legislation that referred to the previous council so that it instead refers to the new principal area (post re-organisation).

(b) The Act does not, however, deal with the specifics of the transfer of LGPS functions. This was enacted by the Local Government Pension Scheme (Local Government Reorganisation in Wales) Regulations 1995, which were made under section 7 of the 1972 Act (and not under the 1994 Act).

(c) These Regulations provide for the wholesale transfer of each previous council's functions and obligations as an AA to the successor authority.

(i) Transfer of functions as AA, along with rights and liabilities:

"*all the functions of a previous fund authority as AA under the principal Regulations then in force shall become functions of the successor authority and the pension fund maintained by the previous fund authority, together with all rights and liabilities in respect of it, shall on that date vest in the successor authority*."

(ii) Employing authorities and admission bodies' obligations to contribute to that fund are moved:

"*any liability of any body or person to make payments into a pension fund maintained immediately before 1st April 1996 by a previous fund authority shall become a liability to make payments into the pension fund maintained by the successor authority*"

(iii) Contracts in place for the purposes of the pension fund were novated:

"*All contracts, deeds, bonds, agreements and other instruments subsisting in favour of, or against, and all notices in force which were given by or to a previous fund authority (or any other body on their behalf) for the purposes of the pension fund maintained by them shall after 31st March 1996 be of force [sic] in favour of, or against, the successor authority*"

(iv) Admission agreements:

"*Without prejudice to the generality of paragraph (3), any admission agreement in force immediately before 1st April 1996 between a body and a previous fund authority whereby employees of that body were, or could be, admitted to participate in the benefits of a pension fund shall after 31st March 1996, have effect as an agreement under regulation B7 of the principal Regulations between the body and the successor authority*".

(v) The obligation to contribute in respect of previous employees was also moved to the successor authority:

"*Where a person-*

(a) has ceased to contribute to a pension fund before 1st April 1996; and

(b) has not become a contributor to any other fund maintained under the principal Regulations

the pension fund maintained by the successor authority for the previous fund authority who maintained that fund until 31st March 1996 shall after that date be deemed to be the fund to which he was last a contributor."

7.4 South Yorkshire Pensions Authority

The Residuary Body

(a) The Local Government Reorganisation (Pensions etc) (South Yorkshire) Order 1987 (the "SY Order") was made under powers in section 67(1)(a) of the LGA 1985:

"*The Secretary of State may by order provide for any such transfer or disposal as is mentioned in subsection (1) or (2) above, whether as proposed by the residuary body or otherwise, and for giving effect (with or without modifications) to any scheme submitted to him under subsection (1) above; and, without prejudice to the generality of that power, any such order may contain such supplementary and transitional provisions as the Secretary of State thinks necessary or expedient, including provisions amending any enactment or any instrument made under any enactment or establishing new bodies corporate to receive any functions, property, rights or liabilities transferred by the order*."

(b) The above power is a general one for the Secretary of State to make orders to implement an arrangement for the wind up of residuary bodies, and transfer of powers to the new authority (this arrangement is referred to in the power as a "*transfer or disposal as is mentioned in subsection (1) or (2) above"*). The residuary body in question was created by the LGA 1985 as a result of the abolition of the Metropolitan County Councils ("MCCs").

(c) These powers are clearly specific to the circumstances provided for by the LGA 1985 (i.e. the abolition of the GLC and the MCCs) which depend on there being a "residuary body" and the removal or abolition of the powers of that body. However, it provides a precedent for a broad provision in primary legislation to be used to transfer pensions rights and obligations.

(d) As an aside, the Residuary Body was not given fund raising powers in its own right; it was granted the power by Section 74 of the LGA 1985 to make levies on the rating authorities in its areas to "*meet all liabilities falling to be discharged by it*".

Transfer of pension functions

(e) The SY Order established the South Yorkshire Pension Authority as a body corporate specifically to receive "*functions, property, rights and liabilities transferred by this Order*". The SY Order then went on to make the transfer of all the obligations and liabilities of the residual body in relation to pensions (as specified in Schedule 2):

"(a) the functions of the Residuary Body as [AA] under the Local Government Superannuation Regulations 1986, together with the superannuation fund maintained by the Residuary Body and all property, rights and liabilities in respect of it;

(b) the functions, rights and liabilities of the Residuary Body in respect of pensions payable by it otherwise than under those Regulations;

(c) without prejudice to the foregoing, the functions, rights and liabilities which are vested in or fall to be discharged by the Residuary Body under or by virtue of section 61 of the 1985 Act (payment of pensions increases); and

(d) any moneys or other property forming a fund maintained by the Residuary Body for the purposes of the functions referred to in sub-paragraphs (b) or (c)."

(f) The SY Order also made provision for the funding of the South Yorkshire Pension Authority. Article 4 provides:

"*The net expenditure of the Authority in any financial year shall be apportioned between the district councils in the county of South Yorkshire in proportion to the population of their districts, as that population is certified for the making of levies with respect to that year under section 74(2) of the 1985 Act (levies by residuary bodies); and the appropriate portions shall be recoverable by the Authority from each of those councils on written demand*."

8 HOW WOULD THE PROPOSAL AFFECT PUBLIC SCHEMES OTHER THAN THE LGPS?

8.1 The proposal to include non-LGPS schemes in any of the three Options under consideration raises completely different and, in our opinion, insuperable problems which cannot be addressed simply by legislative means (whether primary or secondary). The problems relate to the fact that the trustees of each of the schemes under consideration are bound by the powers that are given to them under their respective trust instruments and also by private sector pensions legislation which reserves to those trustees the following key powers, which can only be exercised unilaterally:

(a) the power of investment ; and

(b) the power to transfer assets to another registered pension scheme.

We have not considered any of the trust deeds and rules of the schemes listed in the schedule provided by DCLG and therefore the following analysis draws on general points of principle.

Investment Powers

8.2 In relation to the power of investment, section 34(1) of the Pensions Act 1995, which applies to all occupational pension schemes set up under trust, provides that the trustees of such a scheme shall have the powers of an absolute and beneficial owner. Section 34 provides that trustees may delegate decisions about investments and, in fact, they are required to delegate all day to day decisions to an authorised fund manager if they are not authorised under the Financial Services and Markets Act 2000 for the purposes of investment management activity themselves. This points to the fundamental difference between trustees and AAs in the LGPS context, because trustees are deemed to be acting on behalf of other persons (ie the members and, on some analysis, the scheme employer) in managing the investments subject to their trust. AAs, on the other hand, although absolutely entitled to the assets held within their funds, are acting as principals and not engaged in the activity of managing investments for another person.

8.3 Section 35(4) contains an express reference to the freedom of trustees that is encapsulated in section 34, as follows: "neither the trust scheme nor the statement [of investment principles] may impose restrictions (however expressed) on any power to make investments by reference to the consent of the employer."

8.4 In further support of the principle that trustees' powers of investment must be unfettered, there is a body of case law which comments on attempts to restrict or manipulate trustees' investments powers where they are not exercised for the best interests of the beneficiaries of their scheme.

8.5 In conclusion, although it would be possible, subject to the constitutional framework under which a common investment vehicle was established under options 1 and 2, for the trustees of occupational pension schemes to participate in such a vehicle, there is no mechanism by which trustees could be forced to do so. The fact that the trustees of the schemes under question are responsible for discharging liabilities that may in the past have stemmed from public sector schemes does not alter this analysis.

Merger

8.6 There are similar considerations relating to the power to merge schemes to those which apply to the powers of investment discussed above. Although there is no statutory framework for limiting or circumscribing the powers of trustees to transfer out assets and liabilities (or to receive them when a merger takes place), the trust deed and rules will contain the relevant powers which have to be relied upon by the trustees of both the receiving and the transferring schemes. Again, there is a considerable body of case law describing how those powers ought to be exercised, but in brief they must be exercised, as with other fiduciary powers, in the best interests of the members of the relevant scheme and not for some ulterior purpose. It is possible under private sector legislation (The Occupational Pension Schemes (Preservation of Benefits) Regulations 1991) for members' benefits to be transferred without their consent, subject to both giving the members one month's notice of a proposed transfer and obtaining a certificate from the transferring scheme actuary that the benefits to be provided by the receiving scheme are "broadly no less favourable" than those to be transferred.

8.7 Funding considerations are also obviously key, as is a consideration of the potential differences in the balance of powers between the trustees and the sponsoring employer of the receiving vehicle.

8.8 In summary, the ability of trustees of private sector schemes, again without limitation as to their origin and linkage to public sector benefit structures, is governed by the trust deed and rules of the relevant schemes and there is no overriding statutory basis on which such schemes could be forced to transfer their assets and liabilities into another receiving scheme.

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AGENDA ITEM 6C

Essex Pension Fund Board	**EPB/11/14**
date: 9 July 2014	

Local Government Pension Scheme (LGPS) Reform
Draft Regulations on Scheme Governance

Report by the Director for Essex Pension Fund and the Independent Governance & Administration Adviser

Enquiries to Kevin McDonald 01245 431301, Ext: 21301

1. Purpose of the Report

To allow the Board to:

1.1 be updated on the draft Regulations on Scheme Governance

2. Recommendations

It is recommended that the Board consider its approach to:

2.1 responding to the Consultation on the draft Regulations; and

2.2 planning the implementation of a Local Pension Board.

3. Draft Regulations on Scheme Governance

3.1 These draft Regulations were issued shortly before the agenda papers for the 9 July Board were to be finalised. As such it has not been possible for officers and advisers to produce a full paper on this matter. Instead a presentation will be given at the Board meeting on the major features of the consultation, the issues raised and areas for consideration.

3.2 The 2013 Public Sector Pension Act included provision for the establishment of:

- at a national level, of a Scheme Advisory Board with responsibility to provide advice to DCLG; and

- at a local scheme level, of a Local Pension Board (LPB) to assist administering authorities with effective management of the scheme

3.3 A shadow national Scheme Advisory Board was established in the summer of 2013

3.4 Under the terms of the 2013 Public Sector Pension Act, a Local Pension Board will be required to be established by 1 April 2015.

3.5 The draft Regulations and associated consultation is set out in Annex A to this report. The deadline for responses is 15 August 2014.

4. Link to Essex Pension Fund Objectives

4.1 Maintaining awareness of current issues with regard to LGPS reform will assist the Board in achieving the following Fund objectives:

- Ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise
- Act with integrity and be accountable to our stakeholders for our decisions, ensuring they are robust and well based
- To ensure the Fund is properly managed

5. Risk Implications

5.1 Failure to maintain an awareness of current issues with regard to LGPS reform and respond to consultations would mean that the Fund's views were not taken into account when changes are proposed.

5.2 Failure to administer the scheme in line with Regulations.

6. Communication Implications

6.1 When consultations on structural reform and revised governance requirements commence, responses will be produced for the Board to consider.

7. Finance and Resources Implications

7.1 Large scale changes to the investment structures of the LGPS will come at significant cost.

8. Background Papers

8.1 Fund response to Local Government Pension Scheme (England & Wales) new governance arrangements – discussion paper, September 2013 (annex b)

8.2 Training session on Governance by Independent Governance & Administration Adviser 22 January 2014.

Department for Communities and Local Government

The Local Government Pension Scheme (Amendment) Regulations 2014

Draft Regulations on Scheme Governance

Consultation

This document/publication is also available on our website at www.gov.uk

Any enquiries regarding this document/publication should be sent to us at:

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
Telephone: 030 3444 0000

ISBN : 978-1-4098-4254-5

The Consultation Process and How to Respond

Scope of the consultation

Topic of this consultation:	The Local Government Pension Scheme (Amendment) Regulations 2014
Scope of this consultation:	This consultation seeks responses from interested parties on draft scheme governance regulations for the new Local Government Pension Scheme which came into force on 1 April 2014.
Geographical scope:	England and Wales.
Impact Assessment:	These Regulations have no impact on business or the voluntary sector.

Basic Information

To:	This consultation is aimed at all Local Government Pension Scheme interested parties.
Body responsible for the consultation:	The Secretary of State for Communities and Local Government is responsible for policy and the consultation exercise.
Duration:	8 weeks. As timing allows, account will be taken of representations made after the close of the consultation.
Compliance with the Code of Practice on Consultation:	This consultation complies with the Code and it will be for 8 weeks. The consultation is aimed at all parties with an interest in the Local Government Pension Scheme and in particular those listed on the Government's website: https://www.gov.uk/government/publications/local-government-pension-scheme-regulations-information-on-who-should-be-consulted

Background

Getting to this stage:	The Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission to review public service pensions and to make recommendations on how they can be made sustainable and affordable in the long term, and fair to both public sector workers and the taxpayer. Lord Hutton's final report was published on 10 March 2011. In that report he made clear that change is needed to "make public service pension schemes simpler and more transparent, fairer to those on low and

	moderate earnings”. The recommendations made by Lord Hutton were accepted by the Government and were carried forward into the Public Service Pensions Act 2013. The Act included a requirement for DCLG as a responsible authority to make regulations establishing a national scheme advisory board and enabling each LGPS administering authority to establish local pension boards. In June 2013, the Department published an informal discussion paper inviting comment from a wide range of interested parties on how the requirements of the 2013 Act should be taken forward into the new 2014 Scheme. The outcome of that exercise and comments from the Shadow Scheme Advisory Board has been fully taken into account in the preparation of the draft regulations. These draft regulations carry forward these requirements into the 2014 Scheme

How to respond

1. You should respond to this consultation by **15 August 2014**.

2. You can respond by email to Sandra.layne@communities.gsi.gov.uk. When responding, please ensure you have the words “LGPS Governance Regulations 2014” in the email subject line.

Alternately you can write to:

LGPS Governance Regulations 2014
Department for Communities and Local Government
Zone 5/F5 Eland House
Bressenden Place
LONDON SW1E 5DU

3. When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please give a summary of the people and organisations it represents and, where relevant, who else you have consulted in reaching your conclusions.

Additional copies

4. This consultation paper is available on the Department for Communities and Local Government website at: https://www.gov.uk/government/organisations/department-for-communities-and-local-government

Confidentiality and data protection

5. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

6. If you want the information that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act 2000, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, in itself, be regarded as binding on the department.

7. DCLG will process your personal data in accordance with the Data Protection Act 1998 and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties. Individual responses will not be acknowledged unless specifically requested.

Help with queries

8. Questions about the policy issues raised in the document can be sent to the address given at paragraph 2 above.

9. A copy of the consultation criteria from the Code of Practice on Consultation is at http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance. Are you satisfied that this consultation has followed these criteria? If not or you have any other observations about how we can improve the process please email: consultationcoordinator@communities.gsi.gov.uk

or write to:

DCLG Consultation Co-ordinator, Zone 8/J6, Eland House, Bressenden Place London SW1E 5DU.

Contents

Chapter 1

Introduction

1.1 This document commences a period of statutory consultation on the new governance arrangements for the 2014 Local Government Pension Scheme ("LGPS") which came into effect on 1 April 2014. Your comments are invited on the set of draft regulations at **Annex A**. and also on the separate policy issues included at Chapter 3 below.

1.2 **The closing date for responses is 15 August 2014**.

Background and context

1.3 This consultation on the Local Government Pension Scheme (Amendment) Regulations 2014 represents a key step in the process of reform that began with the commitment given in the Coalition Government's programme to review the efficiency, effectiveness and sustainability of public service pension schemes.

1.4 A key aim of the reform process is to raise the standard of management and administration of public service pension schemes and to achieve more effective representation of employer and employee interests in that process.

1.5 The Public Service Pensions Act 2013 included two main provisions to achieve this policy objective. Firstly, a requirement for responsible authorities such as DCLG to establish at national level a Scheme Advisory Board with responsibility to provide advice to the Department on the desirability of changes to the Scheme. And secondly, in cases where schemes like the Local Government Pension Scheme are subject to local administration, for scheme regulations to provide for the establishment of local pension boards to assist administering authorities with the effective and efficient management and administration of the Scheme.

Consultation responses

1.6 In view of the need to give administering authorities and other interested parties sufficient lead-in time to establish local pension boards, Ministers have agreed to a consultation period of 8 weeks.

1.7 To allow for the fullest response to proposed Scheme regulations, every attempt will be made to include any late submissions.

1.8 Your comments should therefore be sent by 15 August 2014 to LGPS Governance Regulations 2014, Department for Communities and Local Government, Zone 5/G6, Eland House, Bressenden Place, London SW1E 5DU. Electronic responses can be sent to Sandra.layne@communities.gsi.gov.uk.

Chapter 2

Proposals for consultation

2.1. The Regulations are being made under the powers conferred by the Public Service Pensions Act 2013. Under Section 3(5) of the 2013 Act, the Regulations require the consent of Treasury before being made.

Preliminary Provisions

2.2 **Regulation 1** covers the citation, commencement, interpretation and extent of the Regulations. The Regulations will apply to the Scheme in England and Wales and, for the most part, will come into operation on 1 October 2014 to allow sufficient time for the new Scheme Advisory Board and local pension boards to become operational on 1 April 2015.

2.3 **Regulation 2** amends the Principal 2013 Regulations in accordance with regulations 3 to 5.

2.4 **Regulation 3** deletes Regulation 53(4) from the Principal 2013 Regulations because that provision becomes obsolete in view of the amendments introduced by these Regulations.

2.5 **Regulation 4** amends Schedule 1 to the Principal 2013 Regulations to include definitions of "Local Government Pensions Scheme Advisory Board" and "local pension board".

2.6 **Regulation 5** inserts new regulations 105, 106,107, 108, 109, 110, 111, 112 and 113 into the Principal 2013 Regulations. These provisions are described in detail immediately below.

Main Provisions

2.7 **New Regulation 105** confers power on the Secretary of State to delegate functions under the Principal 2013 Regulations and administering authorities to delegate their functions. It also allows for any delegated function by an administering authority to be sub-delegated.

Local pension boards : establishment

2.8 **New Regulation 106** concerns the establishment of local pension boards.

2.9. **Regulation 106(1)** provides that each administering authority must establish a local pension board no later than 1 April 2015. This would not prevent a board being established before that date.

2.10 **Regulation 106(1)(a) and (b)** sets out the role of a local pension board as being to assist the administering authority in securing compliance with (i) the Principal 2013 Regulations, (ii) any other legislation, and (iii) requirements imposed by the Pensions Regulator in relation to the Scheme. The role is further extended by **Regulation 106(1)(b)** to assist the administering authority in ensuring the effective and efficient governance and administration of the Scheme. These provisions mirror those set out in section 5(2) and (3) of the Public Service Pensions Act 2013.

2.11**. Regulation 106(2)** carries forward into the Principal 2013 Regulations, section 5(7) of the Public Service Pensions Act 2013. This provides that where the scheme manager of a Scheme under section 1 of the Act is a committee of a local authority, the scheme regulations may provide for that committee also to be the board for the purposes of this section. This is discussed in more detail in Chapter 3.

To ensure that any proposal to combine the committee and local pension board into a single, dual-function body is appropriate and practicable, **Regulation 106(2)** requires such proposals to be approved by the Secretary of State. Where appropriate, the Department may seek advice from relevant interested parties, in particular, the Scheme Advisory Board and Pensions Regulator.

2.12 **Regulation 106(3)** provides that the Secretary of State may, in giving such approval, impose any such conditions that he thinks fit.

2.13 **Regulation 106(4)** enables the Secretary of State to withdraw any approval given under Regulation 106(2) if any of the conditions given under Regulation 106(3) are not met or, more generally, that there is evidence to suggest that the combined body is no longer working as intended.

2.14 **Regulation 106(5)** sets out the means by which an administering authority establishes its local pension board but the draft offers two different alternatives of the regulations as described later in Chapter 3 (Other connected policy issues). Consultees are specifically invited to indicate and comment on their preference.

2.15. **Regulation 106(6)** provides that the costs of local pension boards are to be regarded as administration costs charged to the fund.

Local pension boards : membership

2.16. **Regulation 107(1) –** requires each administering authority to determine the membership of the local pension board; the manner in which such members may be appointed and removed and the terms of their appointment.

2.17**. Regulation 107(2)** provides that in determining membership of their local pension board, an administering authority must include employer representatives and member representatives in equal numbers, the total of which cannot be less than four.

2.18**. Regulation 107(2(a)** prevents a councillor member of a local authority being included either as an employer or member representative, but this does not prevent an administering authority from appointing councillor members of a local authority (or any other person) to the local pension board over and above the required equal number of employer and member representatives.

2.19**. Regulation 107(2)(b)** requires an administering authority to be satisfied that employer and member representatives appointed to a local pension board have the relevant experience and the capacity to perform their respective roles. There is a risk that could act as an unhelpful barrier to people putting themselves up as pension board nominees but we believe that this pre-condition is necessary to ensure that appointees to the board have the background and capacity to undertake the duties and responsibilities required of pension board members. The Department will work closely with all relevant interested parties in preparing and publishing guidance on the experience and capacity required of local pension board nominees.

(It is important to note that Regulation 107(2)(b) and the pre-condition of "relevant experience and capacity" is not to be confused with the requirement for pension boards members to acquire "knowledge and understanding" under section 248A of the Pensions Act 2004 as introduced by paragraph 19 of Schedule 4 (Regulatory oversight) to the Public Service Pensions Act 2013.

2.20**. Regulation 107(3)** ensures that the number of employer and member representatives appointed to a local board must represent a majority of total members.

Local pension boards : conflict of interest

2.21. **Regulation 108(1)** carries forward section 5(4) of the Public Service Pensions Act 2013 and requires each administering authority to be satisfied that any person appointed to a local pension board does not have a conflict of interest as defined in section 5(5) of that Act.

2.22**. Regulation 108(2)** requires an administering authority to monitor conflict of interests over time.

2.23**. Regulations 108(3) and (4)** impose requirements on persons to provide relevant information to the administering authority on nomination as a member of a local pension board and, if appointed, during membership.

Local pension boards : guidance

2.24**. Regulation 109** requires an administering authority to have regard to guidance issued by the Secretary of State in relation to local pension boards. In formulating such guidance, the Department will work closely with all relevant interested parties, including the Scheme Advisory Board and the Pensions Regulator.

Scheme advisory board : establishment

2.25**. Regulation 110(1)** provides that a scheme advisory board is established.

2.26**. Regulation 110(2)** sets out the responsibility of the scheme advisory board to provide advice to the Secretary of State on the desirability of making changes to the Scheme in accordance with section 7(1) of the Public Service Pensions Act 2013. But note that we are not proposing to carry forward the provision in the Act that such advice is to be at the Secretary of State's request. We believe that the interaction between the Department and the scheme advisory board should be open and transparent and that scheme regulations should not prevent the scheme advisory board from initiating its own advice or recommendations to the Secretary of State.

2.27**. Regulation 110(3)** extends the scope of the scheme advisory board to include advice and assistance to administering authorities and local pension boards in relation to the effective and efficient administration and management of the Scheme and its pension funds.

2.28**. Regulation 110(4)** permits the scheme advisory board to establish its own procedures.

Scheme advisory board : membership

2.29**. Regulation 111(1)** sets out the membership requirements of the scheme advisory board. The Chair of the scheme advisory board is to be appointed by the Secretary of State and the Department will work closely with the Shadow scheme advisory board in formulating and organising the nomination and appointment process. Membership of the board must comprise at least 2 and no more than 12 persons appointed by the Chair with the approval of the Secretary of State.

2.30**. Regulation 111(2)** confers a duty on the Secretary of State to ensure that approval under Regulation 111(1)(b) is subject to consideration of how fair the Chair has been in nominating employer and scheme members to the board for approval.

2.31. **Regulation 111(3)** requires the constitution of the scheme advisory board to include details of the terms and conditions of members' appointments.

2.32. **Regulation 111(4)** permits persons who are not members of the scheme advisory board to be appointed as members of any sub-committee to the board.

2.33. **Regulation 111(5)** applies the same provision in Regulation 111(3) to members of any sub-committee to the board.

Scheme advisory board : conflict of interest

2.34. **Regulation 112** applies the provision in sections 7(4) and (5) of the Public Service Pensions Act regarding conflict of interest to nominees and members of the scheme advisory board.

Scheme advisory board : funding

2.35. **Regulation 113(1)** provides that the expenses of the scheme advisory board are to be treated as administration costs to the Scheme and recharged to administering authorities in such proportions as are determined by the board.

2.36. **Regulation 113(2)** ensures that safeguards are in place to ensure value for money. Before any monies can be levied on administering authorities by the scheme advisory board, the board's annual budget must first have been approved by the Secretary of State.

2.37. **Regulation 113(3)** requires an administering authority to pay the amount determined by the scheme advisory board under Regulation 113(2).

Chapter 3

Other connected policy issues

Combined Section 101 committee and local pension board (Regulation 106(2)).

3.1. Draft **Regulation 106(2**) enables a single, dual function body to carry out the functions of both a section 101 committee established by the administering authority to manage and administer the Scheme and those of a local pension board.

3.2. In practice, a combined body would be subject to two separate legal codes under both the Local Government Act 1972 and associated legislation, and the Public Service Pensions Act 2013. A combined body might also have difficulty in ensuring that all members had both knowledge and understanding that is currently expected of elected members and the experience and capacity required of local pension board members. There could also be difficult and different issues about conferring voting rights and compliance with local government law on the political composition of committees.

3.3. The Public Service Pensions Act 2013 does allow for this facility in scheme regulations but we are not compelled to introduce it. Comments are therefore invited on whether the Regulations should include such provision.

Establishment of local pension boards (Regulation 106(5)}

3.4. The draft regulations offer two alternatives to the way in which an administering authority could establish their local pension board.

3.5. The first version of **Regulation 106(5)** offers a simple solution by proposing that establishment of a local board should be undertaken as if it was a committee under section 101 of the Local Government Act 1972. This would automatically apply the section 101 regime to the way in which local boards are to be established. Although this option would provide administering authorities with a ready-made set of provisions to help them establish local pension boards, it is arguable that local pension boards should be established on a bespoke basis best suited to their own role and responsibilities.

3.6. The alternative version of **Regulation 106(5)** confers a wide discretion on administering authorities to establish the procedures applicable to a local pension board such as voting rights, the establishment of sub-committees, the formation of joint committees and payment of expenses. This list is not exhaustive, and could include some of the features of the section 101 regime, such as voting rights, political composition, etc. Although this option would represent more of a burden to administering authorities, it would allow greater flexibility and choice at local level in the way that local pension boards are established.

3.7. Consultees are therefore invited to state their preference for option 1, option 2, or any other proposal. Where option 2 is preferred, it would be helpful if the response could also set out those elements which should either be specifically excluded or included from the wide discretion afforded by the second version of Regulation 106(5).

Funding of the Scheme Advisory Board (Regulation 113)

3.8. It is accepted that funding the Scheme Advisory Board will be a complex and difficult matter. **Regulation 113** has been drafted on the basis of informal discussions with interested parties but we acknowledge that more work needs to be done to both ensure that the board is adequately funded to enable them to carry out their agreed work plans and that the cost of the board to each administering authority is fair and represents value for money.

3.9. Comments are therefore invited on what additional provision we need to make to Regulation 113 to achieve both objectives and regarding any other aspect of the scheme advisory board's funding.

Joint pension boards

3.10. As currently drafted, these Regulations require each administering authority to establish a local pension board. However, the extent to which administering authorities are either already sharing, or planning to share, their administration with other administrating authorities, suggests that provision ought to be made in these Regulations for a single pension board to serve more than the one administering authority.

3.11. On the other hand, it would run counter to the spirit of the primary legislation if a single board ended up serving a significant number of administering authorities. We believe therefore, that the default position must be one local pension board for each administering authority, but that exceptions where administration and management is mainly or wholly shared between two or more administering authorities should be catered for. This could be demonstrated by the management and administration being undertaken by a joint committee of the participating administering authorities.

3.12. Comments are invited on whether the Regulations need to provide for shared local pension boards and, if so, what test, if any, should be applied. For example, should provision be made for either the scheme advisory board or the Secretary of State to approve any proposal for a shared pension board?

Annual general meetings, Employer forums, etc

3.13. The staging of AGMs, employer forums, etc, is currently a recommendation in the Department's statutory guidance on governance compliance. There is evidence to suggest that a significant minority of administering authorities do neither and also that those that do, receive positive feedback from employers and scheme members alike.

3.14. Comments are invited on whether the Regulations should require administering authorities to facilitate a forum for both employers and employees on at least an annual basis.

Public Sector Equality Duty

3.15. The Equality Duty is a duty on all public bodies and others carrying out public functions to ensure that public bodies consider the needs of all individuals in their day to day work. It also encourages public bodies to ensure that their policies and services are appropriate and accessible to all and meet different people's needs.

3.16. This raises the question of whether these Regulations should extend the role of the scheme advisory board to have regard to the Equality Duty in making recommendations to the Secretary of State on the desirability of making scheme changes and extending the scrutiny/.compliance role of local pension boards to include the Equality Duty.

3.17. Comments are invited on the appropriateness and practicality of this proposal.

Knowledge and Understanding

3.18. These regulations would require members of local pension boards to have the knowledge and capacity to undertake that role. This contrasts with members of committees established by the administering authority to discharge its pension functions who, although recommended to have regard to the Knowledge and Skills Framework published by CIPFA, are under no regulatory requirement to do so. Whilst recognising that the knowledge and training needs of section 101 and local pension boards are not identical, it is open to question whether the same level of regulatory requirement ought to apply to both bodies.

3.19. Comments are invited on whether either in these Regulations or at some stage in the future, provision should be made in the Principal 2013 Regulations to require members of committees established by the administering authority to discharge its pension functions to comply with the Knowledge and Understanding Framework and other relevant training.

Annex A

STATUTORY INSTRUMENTS

2014 No. 0000

PUBLIC SERVICE PENSIONS, ENGLAND AND WALES

The Local Government Pension Scheme (Amendment) Regulations 2014

Made - - - -	*2014*
Laid before Parliament	*2014*
Coming into force - -	*2015*

These Regulations are made in exercise of the powers conferred by sections 1 and 3 of, and Schedule 3 to, the Public Service Pensions Act 2013(**1**).

In accordance with section 21 of that Act, the Secretary of State has consulted the representatives of such persons as appeared to the Secretary of State to be likely to be affected by these Regulations.

In accordance with section 3(5) of that Act, these Regulations are made with the consent of the Treasury.

The Secretary of State makes the following Regulations:

Citation, commencement interpretation and extent

1.—(1) These Regulations may be cited as the Local Government Pension Scheme (Amendment) Regulations 2014.

(2) In these Regulations "the Principal Regulations" means the Local Government Pension Scheme Regulations 2013(**2**)

(3) These Regulations come in to force as follows—

(a) on 1st October 2014, regulations 2, 4 and 5—

(i) so far as they insert regulation 105 (delegation) into the Principal Regulations,

(**1**) 2013 c. 25
(**2**) S.I. 2013/2356.

(ii) so far as they insert regulation 106 (local pension boards: establishment) into the Principal Regulations for the purposes of the obtaining of approval from the Secretary of State under paragraph (2) of that regulation, and

(iii) so far as they insert regulations 107 (local pensions boards: membership), 108 (local pensions boards: conflicts of interest), 111 (scheme advisory board: membership) and 112 (scheme advisory board: conflict of interest) for the purposes of appointment of members of local pension boards and the Local Government Pension Scheme Advisory Board; and

(b) on 1st January 2015—

(i) regulations 2, 4 and 5 so far as not already commenced, and

(ii) the remainder of these Regulations.

(4) These Regulations extend to England and Wales.

Amendment of the Local Government Pension Scheme Regulations 2013

2. The Principal Regulations 2013 are amended in accordance with regulations 3 to 5.

3. Omit regulation 53(4) (scheme managers: establishment of pension board).

4. In Schedule 1 (interpretation) after the entry for "local government service" insert—

""Local Government Pensions Scheme Advisory Board" means a board established under regulation 110 (Scheme advisory board: establishment);

"local pension board" means a board established under regulation 106 (local pension boards: establishment);"

5. After regulation 104(**3**) insert—

"PART 3

Governance

Delegation

105.—(1) The Secretary of State may delegate any functions under these Regulations.

(2) Administering authorities may delegate any functions under these Regulations including this power to delegate.

Local pension boards: establishment

106.—(1) Each administering authority shall no later than 1st April 2015 establish a pension board ("a local pension board") responsible for assisting it—

(a) to secure compliance with—

(i) these Regulations,

(ii) any other legislation relating to the governance and administration of the Scheme, and

(iii) requirements imposed by the Pensions Regulator in relation to the Scheme; and

(b) to ensure the effective and efficient governance and administration of the Scheme.

(2) Where the Scheme manager is a committee of a local authority the local pension board may be the same committee if approval in writing has been obtained from the Secretary of State.

(3) Approval under paragraph (2) may be given subject to such conditions as the Secretary of State thinks fit.

(**3**) Regulation 104 was inserted by S.I. 2014/1146.

(4) The Secretary of State may withdraw an approval if such conditions are not met or if in the opinion of the Secretary of State it is no longer appropriate for the local pension board to be the same committee.

(5) [Where a local pension board is established by a local authority within the meaning of section 270 of the Local Government Act 1972(**4**), Part 6 of that Act applies to the board as if it were a committee established under section 101 of that Act].

(5) [An administering authority may determine the procedures applicable to a local pension board, including as to voting rights, the establishment of sub-committees, formation of joint committees and payment of expenses].

(6) The expenses of a local pension board are to be regarded as part of the costs of administration of the fund held by the administering authority.

Local pension boards: membership

107.—(1) Subject to paragraphs (2) and (3) each administering authority shall determine—

(a) the membership of the local pension board;

(b) the manner in which members of the local pension board may be appointed and removed;

(c) the terms of appointment of members of the local pension board.

(2) A local pension board must include an equal number, which is no less than 4 in total, of employer representatives and member representatives (**5**) and for these purposes—

(a) a member of a local authority is not to be appointed as an employer or member representative; and

(b) the administering authority must be satisfied that—

(i) a person to be appointed as an employer representative has relevant experience and the capacity to represent employers on the local pension board; and

(ii) a person to be appointed as a member representative has relevant experience and the capacity to represent members on the local pension board.

(3) The number of members appointed under paragraph (2) must exceed the number of members otherwise appointed to a local pension board.

Local pension boards: conflict of interest

108.—(1) Each administering authority must be satisfied that any person to be appointed as a member of a local pension board does not have a conflict of interest(**6**).

(2) An administering authority must be satisfied from time to time that none of the members of a local pension board has a conflict of interest.

(3) A person who is to be appointed as a member of a local pension board by an administering authority must provide that authority with such information as the authority reasonably requires for the purposes of paragraph (1).

(4) A person who is a member of a local pension board must provide the administering authority which made the appointment with such information as that authority reasonably requires for the purposes of paragraph (2).

Local pension boards: guidance

109. An administering authority must have regard to guidance issued by the Secretary of State in relation to local pension boards.

(**4**) 1972 c. 70.
(**5**) See section 5(6) of the Public Service Pensions Act 2013 for definitions of these terms.
(**6**) See section 5(5) of the Public Service Pensions Act 2013 for the meaning of "conflict of interest".

Scheme advisory board: establishment

110.—(1) A scheme advisory board ("the Local Government Pension Scheme Advisory Board") is established.

(2) The Local Government Pension Scheme Advisory Board is responsible for providing advice to the Secretary of State on the desirability of making changes to the Scheme.

(3) The Local Government Pension Scheme Advisory Board is also responsible for providing advice to administering authorities and local pension boards in relation to the effective and efficient administration and management of the Scheme and its pension funds.

(4) Subject to these Regulations, the Local Government Pension Scheme Advisory Board may determine its own procedures including as to voting rights, the establishment of sub-committees, formation of joint committees and the payment of remuneration and expenses.

Scheme advisory board: membership

111.—(1) The Local Government Pension Scheme Advisory Board is to consist of the following members—

(a) the Chair appointed by the Secretary of State; and

(b) at least 2, and no more than 12, persons appointed by the Chair with the approval of the Secretary of State.

(2) When deciding whether to give or withhold approval to appointments under paragraph (1)(b) the Secretary of State must have regard to the desirability of there being equal representation of persons representing the interests of Scheme employers and persons representing the interests of members.

(3) A member of the Local Government Pension Scheme Advisory Board is to hold and vacate office in accordance with the terms of that member's appointment.

(4) The Chair of the Local Government Pension Scheme Advisory Board may appoint persons who are not members of the Local Government Pension Scheme Advisory Board to be members of sub-committees of that Board.

(5) A member of a sub-committee of the Local Government Pension Scheme Advisory Board is to hold and vacate office in accordance with the terms of that member's appointment.

Scheme advisory board: conflict of interest

112.—(1) Before appointing, or approving the appointment of any person to be a member of the Local Government Pension Scheme Advisory Board, the Secretary of State must be satisfied that the person does not have a conflict of interest(**7**).

(2) The Secretary of State must be satisfied from time to time that none of the members of the Local Government Pension Scheme Advisory Board has a conflict of interest.

(3) A person who is to be appointed as a member of the Local Government Pension Scheme Advisory Board must provide the Secretary of State with such information as the Secretary of State reasonably requires for the purposes of paragraph (1).

(4) A person who is a member of the Local Government Pension Scheme Advisory Board must provide the Secretary of State with such information as the Secretary of State reasonably requires for the purposes of paragraph (2).

Scheme advisory board: funding

113.—(1) The expenses of the Local Government Pension Scheme Advisory Board are to be treated as administration costs of the Scheme and are to be defrayed by the administering authorities within the Scheme in such proportions as are determined by the Board.

(**7**) See section 7(5) of the Public Service Pensions Act 2013 for the meaning of "conflict of interest".

(2) The Local Government Pension Scheme Advisory Board must identify the amount to be paid by each administering authority towards its annual costs based on—

(a) its annual budget approved by the Secretary of State; and

(b) the number of persons for which the administering authority is the appropriate administering authority.

(3) An administering authority must pay the amount it is required to pay under this regulation at such time or times as the Local Government Pension Scheme Advisory Board may determine.”.

We consent to the making of these Regulations

Names
Date Two of the Lords Commissioners of Her Majesty’s Treasury

Signed by authority of the Secretary of State for Communities and Local Government

Name
Parliamentary Under Secretary of State
Date Department for Communities and Local Government

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend the Local Government Pension Scheme Regulations 2013 (“the 2013 Regulations”) to make provision in respect of governance of the Scheme.

Regulation 1 commences the substantive provisions from 1st January 2015 for the purposes of making appointments to local pension boards and the Scheme Advisory Board, and brings the provisions fully into force from 1st April 2015.

Regulations 3 and 4 make minor amendments to the 2013 Regulations consequential to the substantive provisions.

Regulation 5 inserts a new Part 3 into the 2013 Regulations.

New regulation 105 permits the Secretary of State to delegate functions under the 2013 Regulations. It permits administering authorities to delegate their functions and also for any delegated function to be sub-delegated.

New regulations 106 to 109 make provision for each administering authority to establish a local pension board to assist it to comply with its legal obligations relating to the Scheme. Where a local authority discharges its pension functions through a committee, it can, with the approval of the Secretary of State appoint that existing committee to be the local pensions board. Local pensions boards must have equal representation of employer representatives and member representatives who must not be councillors of the administering authority and who must constitute the majority of members of the board.

Regulations 110 to 113 establish the Local Government Pension Scheme Advisory Board to advise the Secretary of State, administering authorities and local pension boards in relation to the Scheme. Provision is made for the appointment of members to the Board and for its funding.

Essex County Council
Essex Pension Fund
Corporate Services
County Hall
Chelmsford
Essex CM1 1LX

Essex County Council

Mr Philip Perry
Department for Communities and Local Government
Zone 5/G6 Eland House
Bressenden Place
LONDON
SW1E 5DU

Our ref: Penfund/kmcd
Date: 2 September 2013

Dear Mr Perry,

Local Government Pension Scheme (England & Wales) new governance arrangements – discussion paper

The Essex Pension Fund (“the Fund”) welcomes this opportunity to comment on the discussion paper issued regarding the new governance arrangements for the Local Government Pension Scheme (LGPS). It is felt that good governance reduces risks associated with running the LGPS.

Public Service Pensions Act 2013

The discussion paper stems from the Public Service Pensions Act 2013 (“the Act”). The Act which applies to the LGPS as well as other public sector schemes, requires the establishment of a local Pension Board. Under Section 5 of the Act, the local Pension Board’s role is defined as securing compliance with regulations and legislation. This has been widely interpreted to be a scrutiny function.

Also under Section 5 of the Act is the requirement that local Pension Boards “*include employer representatives and member representatives in equal numbers”.*

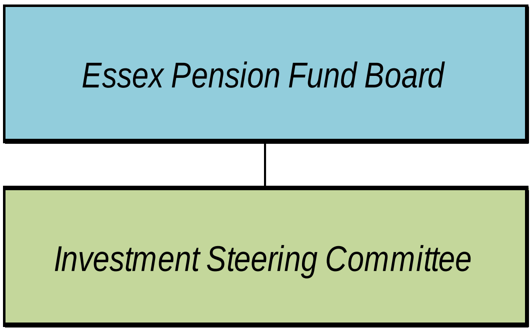
Essex Pension Fund - existing governance arrangements

In 2008 the Essex Pension Fund Board (“the Essex Board”) was established. This body fulfils the discharge of function under Section 101 of the Local Government Act 1972 and has overarching responsibility for the Essex Pension Fund. This is a broader remit than the scrutiny role referred to above.

Specific responsibility for the establishment and maintenance of the Fund’s investment strategy has been delegated to an Investment Steering Committee (“the ISC”).

/…

The ISC reports to the Essex Board as illustrated below.



Each body has its own Terms of Reference. The current workload of both the Essex Board and the ISC involves scrutiny. Membership details are set out below:

Essex Pension Board	Nominated by:	Investment Steering Committee
6	Essex County Council	6
2	Unitary Councils	
2	District, Borough & City Councils	1
1	UNISON	1
1	Essex Fire Authority	
1	Essex Police & Crime Commissioner	
1	Smaller Employers	
14		8

The Fund's responses to the key questions posed within DCLG's discussion paper are set out below:

Question: Should the new Scheme Regulations require local Pension Boards to be a body separate from the statutory committee or for it to be combined as a single body ?

Response: The Essex statutory committee is the Essex Board. Its establishment followed careful consideration of the size and profile of the Fund's employers and their responsibility to help fund the required benefits. It also includes one UNISON nominee who represents scheme members. This broad balance is felt to be appropriate and one with which the Fund would wish to continue.

The Act requires equal member and employer representation (highlighted above). As a consequence, combining the new local Pension Board with the current Essex statutory committee would require significant changes which would fundamentally alter the existing membership balance. In turn, this could present practical and logistical difficulties.

In light of the legislative framework, a local Pension Board that is separate from the statutory committee appears the only sensible way forward.

Question: Although not required by the Act, should Scheme regulations prescribe a minimum number of employer and employee representatives ?

Response: No. This should be determined locally.

Question: What period, after new governance regulations are on the statute book, should be given for scheme managers/administering authorities to set up and implement local pension boards ?

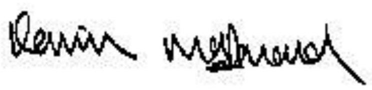
Response: Given the requirements of the Act, existing LGPS Boards and Committees will need appropriate time to both consider and implement the new governance arrangements. Between now and March 2014, LGPS Funds in England & Wales will be working through the 2013 Actuarial Valuation process. In April 2014, the new CARE scheme arrangements (for which regulations are awaited) are due to commence. It is therefore felt that the governance regulations should provide that the earliest date to implement local Pension Boards should be April 2015.

Question: How long after new governance regulations are on the statute book should the national scheme advisory board become operational ?

Response: The structure and membership of the *shadow* national Scheme Advisory Board are already known. It would be appropriate for the *shadow* national Scheme Advisory Board to become *the* national Scheme Advisory Board from April 2014. This would facilitate the provision of guidance to Administering Authorities in the build up to implementing local Pension Boards.

It is hoped that these comments will help inform the future governance arrangements for the LGPS.

Yours faithfully,



Director for the Essex Pension Fund
01245 431301
kevin.mcdonald@essex.gov.uk

Essex Pension Fund Board	EPB/12/14
Date: 9 July 2014	

Update on Pension Fund Activity

Joint Report by the Director for Essex Pension Fund & Head of Essex Pension Fund

Enquiries to Kevin McDonald on 01245 431301 and Jody Evans on 01245 431700

1. Purpose of the Report

1.1 To provide the Board with an update on the following:

A(i) 2014/15 business plan
A(ii) Three year business plan
B risk management
C scorecard (measurement against objectives)

2. Recommendations

2.1 That the Board notes:

- progress against the 2014/15 business plan
- the current risks with a residual score of six or above
- the latest scorecard measures

3. Background

3.1 The following documents accompany this report:

- an update on the 2014/15 business plan at Annex A(i);
- the 3 year business plan at Annex A(ii);
- risks with a residual score of six or above are detailed at Annex B;
- the full scorecard is attached at Annex C.

4. Related matters subject to separate agenda items

4.1 Matters subject to separate agenda items include:

- LGPS Reform
- External Audit programme of work & fees
- Internal Audit annual reports
- ISC Quarterly Report
- Employer Forum

5. Business Plan 2014/15

5.1 Progress is on track with the business plan shown at Annex A(i). Of the 23 actions for 2014/15:

- one has been completed;
- fourteen are in progress and
- the remaining eight are scheduled to commence later this year.

6. 3 year Business Plan

6.1 The 3 year Business Plan, providing a high level summary of key work streams is shown at Annex A (ii).

7. Risk Register

7.1 There remains one red rated risk – stemming from the delays associated with the issuance of the transitional regulations. Risk A1 covers the delivery of a high quality service to beneficiaries, potential beneficiaries and employers.

8. Scorecard

8.1 The scorecard showing the latest updated measures is detailed at Annex C.

9. Link to Essex Pension Fund Objectives

9.1 Monitoring Pension Fund activity via the business plan, risks and scorecard assists the Fund in achieving all of its objectives, and in particular:

- Provide a high quality service whilst maintaining value for money
- Understand and monitor risk and compliance
- Continually measure and monitor success against our objectives

10. Risk Implications

10.1 Key risks are identified at Annex B.

11. Communication Implications

11.1 Other than ongoing reporting to the Board, there are no communications implications.

12. Finance and Resources Implications

12.1 The business plan for 2014/15 is challenging and labour intensive and will require significant input by officers and advisers to bring some of the actions to conclusion.

13. Background Papers

13.1 None.

ANNEX A(i)

Essex Pension Fund Business Plan 2014/15

Governance

Objectives:

- Provide a high quality service whilst maintaining value for money
- Ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise
- Evolve and look for new opportunities that may be beneficial for our stakeholders, particularly the Fund's beneficiaries, ensuring efficiency at all times
- Act with integrity and be accountable to our stakeholders for our decisions, ensuring they are robust and well based
- Understand and monitor risk and compliance
- Continually measure and monitor success against our objectives

Actions:

Action	How will this be achieved?	Officer managing action*	Progress as at July 2014
1. Annual business plan will be put in place.	Proposed actions for 2014/15 business plan actions presented to 5 March 2014 Board for approval.	DfEPF & HoEPF	Complete

Action	How will this be achieved?	Officer managing action*	Progress as at July 2014
2. Further roll out of training and training needs assessments	Training & training needs assessments will continue in 2014/15. Specific provision will be made for any new Board Members.	IGAA	In progress - Pensions Accounting & Audit Standards training scheduled for 9 July 2014 Pension Board meeting.
3. Board members' knowledge centre	A web based facility for Members to replace the handbook will be identified and put in place.	HoEPF	Individual training to be offered to Board Members during 2014/2015 to maximise usage
4. Annual review of governance policy	Review governance policy to ensure it is relevant and up to date, including the governance compliance statement.	DfEPF,HoEPF & IGAA	Scheduled for 17th September 2014 Pension Board meeting
5. Annual review of Pension Fund Board	Review the effectiveness of the Pension Fund Board and the services supplied to it.	GTM and IGAA	In progress – A separate report appears elsewhere on the July agenda
6. Procurement of Independent Governance Adviser	The procurement will be completed during 2014/15	DfEPF & HoEPF	In progress – A separate report appears elsewhere on the July agenda
7. Implement the requirements of the Public Sector Pension Act 2013	Respond to consultation on draft Governance regulations Agree & implement required changes to Governance arrangements	DfEPF,HoEPF & IGAA	In progress – A separate report appears elsewhere on the July agenda

Investments

Objectives:

- To maximise the returns from investments within reasonable risk parameters
- To ensure the Fund is properly managed
- Ensure investment issues are communicated appropriately to the Fund's stakeholders

Actions:

Action	How will this be achieved?	Officer managing action*	Progress as at July 2014
8. Review of asset allocation	Review of asset allocation as part of the strategy & structure deliberations at the ISC strategy meetings. July 2014 and February 2015.	DfEPF	Scheduled for 23rd July 2014 ISC Strategy meeting.
9. Implement any review of investment allocation arrangement	Implement the decisions taken at the July 2014 ISC strategy meeting.	DfEPF	In progress • Bond mandate rebalancing completed May 2014 • Illiquid debt mandate procurement underway
10. To review investment management fees	Ensure that fee monitoring arrangements form part of the annual review of performance.	DfEPF	Scheduled for 23rd July 2014 ISC Strategy meeting.

Action	How will this be achieved?	Officer managing action*	Progress as at July 2014
11. Review the Statement of Investment Principles (SIP)	Annual Review of SIP – to include review of Statement of Compliance on Investment Decision Making	DfEPF	To be reviewed at 23rd July 2014 ISC Strategy meeting
12. Procurement of Independent Investment Adviser	The current arrangement ceases in July 2015. The ISC will consider its approach to this matter in 2014/2015	DfEPF	Scheduled to commence in early 2015.
13. Participate in the consultation on LGPS structural reform	Respond to consultation on draft options for the structure of LGPS in England & Wales	DfEPF	In progress – A separate report appears elsewhere on the July agenda

Funding

Objectives

- Within reasonable risk parameters, to achieve and then maintain assets equal to 100% of liabilities in the timescales determined in the Funding Strategy Statement
- To recognise in drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible
- To have consistency between the investment strategy and funding strategy
- To manage employers' liabilities effectively, having due consideration of each employer's strength of covenant, by the adoption of employer specific funding objectives
- Maintain liquidity in order to meet projected net cash-flow outgoings
- Minimise unrecoverable debt on termination of employer participation

Actions:

Action	**How will this be achieved?**	**Officer managing action***	**Progress as at July 2014**
14. Review Funding Strategy Statement	Consideration will be given to whether the Funding Strategy requires review in the light of the results of the Interim Review as at 31 March 2014.	DfEPF and HoEPF	This is scheduled for 17th September Pension Board meeting.
15. Interim Review as at 31 March 2014.	An interim review of the Fund as at 31 March 2014 will be commissioned from the Actuary.	DfEPF and HoEPF	The result of the interim review will be considered at 17th September Pension Board meeting.

16. Employer participation	Employer participation and membership of the Essex Pension Fund will be monitored on an on-going basis	DfEPF and HoEPF	In progress - To be monitored during 2014/15

Administration

Objectives:

- Deliver a high quality, friendly and informative service to all beneficiaries, potential beneficiaries and employers at the point of need
- Ensure benefits are paid to, and income collected from, the right people at the right time in the right amount
- Data is protected to ensure security and authorised use only

Actions:

Action	How will this be achieved	Officer managing action*	Progress as at July 2014
17. New 2014 LGPS	Pending outcomes review and put in place a plan to deliver any requirements (e.g. revised processes, systems, etc).	HoEPF	An upgrade release to the current administration system will be received in August 2014. A complete letter and process review is on-going and manual workarounds are in place.
18. Complete the annual end of year data exercise as at 31 March	Complete year end accounting, gather information from employer and update Axise, and produce annual benefit statements.	HoEPF	Required as part of the preparation for the 31 March 2014 interim review;
19. Administration Strategy	The Administration Strategy will be monitored during 2014/15.	HoEPF	To be monitored and reviewed during 2014/15

Action	How will this be achieved	Officer managing action*	Progress as at July 2014
20. Auto Enrolment – Work based Pensions	Monitor developments and maintain dialogue with Pension Fund employers throughout the process of auto enrolment implementation. (Staggered staging dates apply to all employers – depending on size – between 2012 and 2016)	HoEPF	In progress Monitoring of auto enrolment continues throughout 2014/2015
21. Implementation of new administration system	A project plan to be in place to deliver a new system by 31 December 2014	HoEPF	In progress – The project is proceeding to plan. First data cut took place June 14 Data cleanse currently on the way Dual running Sept – Oct 2014

Communications

Objectives:

- Communicate in a friendly, expert and direct way to our stakeholders, treating all our stakeholders equally
- Ensure our communications are simple, relevant and have impact
- Deliver information in a way that suits all types of stakeholder
- Aim for full appreciation of the pension scheme benefits and changes to the scheme by all scheme members, prospective scheme members and employers

Actions:

Action	How will this be achieved?	Officer managing action*	Progress as at July 2014
22. New 2014 LGPS	Pending outcomes, review and put in place a plan to deliver any communication requirements including delivery of key messages	HoEPF	In progress Communications continue during 2014/15
23. Monitor Communications Policy	The communications policy will be monitored during 2014/2015	HoEPF	In progress Monitoring will continue during 2014/15

Key:
DfEPF: Director for Essex Pension Fund
HoEPF: Head of Essex Pension Fund
GTM: Governance Team Manager
IGAA: Independent Governance & Administration Adviser

Essex Pension Fund
3 Year Business Plan
April 2014 to March 2017

Area of activity	2014/15	2015/16	2016/17
Governance			
Business plan	March for the following year	March for the following year	March for the following year
Members' knowledge and understanding			
• Prepare & implement training strategy	December (Review)	December (Review)	December
• Training needs assessment (TNA)	Ongoing	Ongoing	Ongoing
Governance review	December	December	December
Effectiveness of Pension Fund Board	September	September	September
Annual Statement of Accounts	July (draft) September (Final)	July (draft) September (Final)	July (draft) September (Final)
Employer Forum(s)	May February	February	October - March
Review scorecard (risk register)	Quarterly	Quarterly	Quarterly
Review performance	Quarterly	Quarterly	Quarterly
Administering Authority discretions and delegations review	July-December		
Employing Authority discretions and delegations review	July-December		
Communications policy review	September	September	September

Area of activity	2014/15	2015/16	2016/17
Investment (Steering Committee)			
Strategic asset allocation review	July & February	July & February	July & February
Asset/Liability study			February
Statement of Investment Principles review	July	July	July
Review investment management fees	July	July	July
Individual manager review	Quarterly	Quarterly	Quarterly
Funding			
Funding Strategy Statement	September	September	September
Actuarial Valuation 2013			September - March
Interim funding review	September	September	
Admission/employer participation/bulk transfer policy	Ongoing	Ongoing	Ongoing
Administration			
LGPS reform – planning for administration changes	April (go-live)	Follow up amendments	Ongoing
Review/Procurement of IT System	April onwards	Ongoing	
End of year data exercise	July	July	July
Auto-enrolment / workbased pensions	Rolling Employer staging dates	Rolling Employer staging dates	Rolling Employer staging dates
Communications			
LGPS reform	Ongoing	Ongoing	Ongoing
Implement communications policy	Ongoing	Ongoing	Ongoing
Introduce infoBOARD and develop usage	Ongoing	Ongoing	Ongoing

ANNEX B

Category	Objective	Risk Ref:	Description of Risk of not Achieving the Objective	Residual Impact	Residual Probability	Residual Risk	Previous Risk Score	Risk Owner	Comments, Actions and Recommendations
Governance	Ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise	G7	Failure of succession planning for key roles on PFB	3	2	6	6	Graham Hughes	The Board's approach to training, where members are working toward compliance with the CIPFA Knowledge & Skills Framework, should help minimise any adverse impacts of failure in succession planning because there should be a greater number of candidates for any position with appropriate knowledge and skills in depth.
Governance	Evolve and look for new opportunities that may be beneficial for our stakeholders, ensuring efficiency at all times	G12	Insufficient staff causes failure to free up time to look for other best practice areas then opportunities may be missed	2	3	6	6	Kevin McDonald /Jody Evans	Following a staff consulltation process, a revised officer structure was finalised in the first quarter of 2013. One appointment is ongoing.
Investments	To maximise the returns from investments within reasonable risk parameters	I1	If investment return is below that assumed by the Actuary in funding the plan this could lead to an increasing deficit and additional contribution requirements. The larger the level of mismatch between assets and liabilities the bigger this risk.	3	3	9	9	Kevin McDonald	Diversified portfolio; Annual Strategy Review; Asset Liability Study, extended recovery periods to smooth contribution increases.
Funding	Within reasonable risk parameters, to achieve and thenthen maintain assets equal to 100% of liabilities in the timescales determined by the Funding Strategy	F2	Markets move at variance with actuarial assumptions resulting in increases in deficits, reduced solvency levels and increased employer contributions	3	3	9	9	Kevin McDonald	Annual interim reviews to enable consideration of the position and the continued appropriateness of the funding/investment strategies and to monitor the exposure to unrewarded risks.
Funding	To recognise when drawing up its funding strategy the desirability of employer contribution rates that are as stable as possible	F7	Mismatch in asset returns and liability movements result in increased employer contributions	3	2	6	6	Kevin McDonald	Diversified investment structure and frequent monitoring against targets to adjust funding plans accordingly through the FSS. Employers are kept informed as appropriate.

ANNEX B

Category	Objective	Risk Ref:	Description of Risk of not Achieving the Objective	Residual Impact	Residual Probability	Residual Risk	Previous Risk Score	Risk Owner	Comments, Actions and Recommendations
Funding	Minimise unrecoverable debt on termination of employer participation	F19	An employer ceasing to exist with insufficient funding, adequacy of bond or guarantee. In the absence of all of these, the shortfall will be attributed to the Fund as a whole with increases being required in all other employers' contributions	3	2	6	6	Kevin McDonald	Assess the strength of individual employer's covenant and/or require a guarantee when setting terms of admission agreement (including bonds) and in setting term of deficit recovery. Annual monitoring of risk profiles and officer dialogue with employers concerned (including guarantors as appropriate) through employer analysis. Positive dialogue with employers with a view to strengthening employer covenants wherever possible
Funding	Minimise unrecoverable debt on termination of employer participation	F20	Failure to monitor leading to inappropriate funding strategy and unrecovered debt on cessation of participation in the fund	3	2	6	6	Kevin McDonald	As above
Funding	Maintain liquidity in order to meet projected net cash-flow outgoings	F21	Employee participation in the Essex LGPS reduces (possibly in response to changes in contribution rate / benefit structure or changes in patterns of service delivery)	3	2	6	6	Kevin McDonald / Jody Evans	Communications with both Employers and Employees over the benefits of the LGPS, both before and after any structural change. In July 2011, following discussion on liquidity and fund maturity, the ISC set a 27% limit on exposure to alternative assets.
Administration	Deliver a high quality, friendly and informative service to all beneficiaries, potential beneficiaries and employers at the point of need	A1	Failure to administer scheme in line with Regulations and policies e. g. LGPS Reform – delays in the release of draft Regulations in sufficient detail could impact on the implementation of required system changes and staff training.	3	4	12	9	Jody Evans	The calculation of pensionable service and associated benefits could be undertaken on a manual basis, however this would not only impact on turnaround times / performance measures, but would also be the first such calculation undertaken on the new CARE basis.
Administration	Deliver a high quality, friendly and informative service to all beneficiaries, potential beneficiaries and employers at the point of need	A6	Lack or reduction of skilled resources. Significant increase in the number of employing bodies e.g. academies.	3	3	9	9	Kevin McDonald / Jody Evans	Continually monitor staffing position. Continually monitor the impact of the volume of employers admitted to the Fund.
Administration	Deliver a high quality, friendly and informative service to all beneficiaries, potential beneficiaries and employers at the point of need	A17	Failure to administer scheme in line with Regulations and policies - Brewster test case in Northern Ireland pave way for retrospective action re: surviving co-habiting partners with no nomination for surviving partners pension.	3	2	6	6	Jody Evans	In the event of revised LGPS Regulations on nomination arrangements for surviving co-habiting partners' pensions, a case by case review will be conducted.

Essex Pension Fund Scorecard - 9 JULY 2014

Guidance: Measures are grouped around key objectives identified by the Board. For some objectives there are several indicators monitoring progress. The number of measures which are red, amber and green for each objective are displayed on the scorecard. Details of individual measures, including performance, targets, contextual commentary, definition and scope are given in the attached drill down pack.

1. GOVERNANCE

Objective	R	A	G	Gy
1.1 - Provide a high quality service whilst maintaining value for money			5	
1.2 - Ensure the Pension Fund is managed by people who have the appropriate knowledge and expertise		2	2	3
1.3 - Evolve and look for new opportunities that may be beneficial for our stakeholders, particularly the Fund's beneficiaries, ensuring efficiency at all times. Continually measure and monitor success against our objectives.		1		
1.4 - Act with integrity and be accountable to our stakeholders for our decisions, ensuring they are robust and well based			2	
1.5 - Understand and monitor risk and compliance			4	

2. INVESTMENTS

Objective	R	A	G	Gy
2.1 - Maximise returns from investments within reasonable risk parameters		0	1	
2.2 - Ensure the Pension Fund is properly managed (ISC attendance, skills and governance arrangements)			2	3
2.3 - Ensure investment issues are communicated appropriately to the Fund's stakeholders			5	

3. FUNDING

Objective	R	A	G	Gy
3.1 - Within reasonable risk parameters, to achieve and then maintain assets equal to 100% of liabilities within reasonable risk parameters and Funding Strategy timescales			1	
3.2 - To recognise in drawing up its Funding Strategy, the desirability of employer contributions that are as stable as possible			2	
3.3 - To have consistency between Investment and Funding strategies			1	
3.4 - To manage employers liabilities effectively, having due consideration of each employer's strength of covenant, by the adoption of employer specific funding objectives.			1	
3.5 - Maintain liquidity in order to meet projected net cash flow outgoings		1		
3.6 - Minimise unrecoverable debt on termination of employer participation		1	1	

4. ADMINISTRATION

Objective	R	A	G	Gy
4.1 - Deliver a high quality, friendly and informative service to all beneficiaries, potential beneficiaries and employers at the point of need.	1	3	10	
4.2 - Data is protected to ensure security and authorised use only			1	
4.3 - Ensure proper administration of financial affairs		1	1	
4.4 - Compliance with Fund's governance arrangements	1		4	

5. COMMUNICATIONS

Objective	R	A	G	Gy
5.1 - Communicate in a friendly, expert and direct way to our stakeholders, treating all our stakeholders equally.			3	
5.2 - Ensure our communications are simple, relevant and have impact and deliver information in a way that suits all types of stakeholder.		2	4	
5.3 - Aim for full appreciation of the pension scheme benefits and changes to the Scheme by all scheme members, prospective scheme members and employers.			1	1

Key

G	= on or exceeding target
A	= missing target but within agreed tolerance
R	= missing target by more than agreed tolerance
Gy	= data not currently available / work in progress

1.1 - Provide a high quality service whilst maintaining value for money

Measure Purpose: To provide a high quality service whilst maintaining value for money

Scope: Cost, scheme member satisfaction and scheme member complaints and compliments

Measure Owner: Jody Evans **Data lead:** David Tucker/Matt Mott

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
1.1.1 Cost per scheme member	2nd	quartile	G	G	2nd/3rd quartile	2nd/3rd quartile	Low	Annual (Aug)
1.1.2 Number of scheme member complaints	1		G	G	5	20	Low	Quarterly
1.1.3 Number of scheme member compliments	15		G	G	15	60	High	Quarterly
1.1.4 Scheme member survey - % of positive answers	96.4%	%	G	G	95%	95%	High	Annual (Mar)
1.1.5 Employer survey - % of positive answers	97.3%	%	G	G	95%	95%	High	Annual (Mar)

Rationale for performance status and trend

1.1.1. Cost per member was £17.80 in 2012/13 (£18.57 in 2011/12) compared to the CIPFA Benchmarking average of £20.87 (£21.54 in 2011/12). This Fund remains in the second quartile.

1.1.2. The number of complaints received in the 3 months to 31 March 2014 was 1. (Previous quarter 5)

1.1.3. The number of compliments received in the 3 months to 31 March 2014 was 15. (Previous quarter 16)

1.1.4. 500 scheme members (employees) were invited to participate in a five question survey conducted in November 2013. 118 members returned completed survey's resulting in a total of 810 answers. Of which 29 were negative responses. The remainder 781 (96.4%) were positive. The 2012 scheme member survey was 97.3% positive.

1.1.5. 378 employers were invited to participate in a 10 question survey conducted in November 2013. Of 112 responses 3 were negative which resulted in a 97.3% positive response rate. The 2012 employer survey was 97.7% positive.

1.2 - Ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise

Measure Purpose: To ensure the Pension Fund is managed and its services delivered by people who have the appropriate knowledge and expertise

Scope: Training needs analysis, attendance of training. Progress against training plans and My Performance objectives.

Measure Owner: Kevin McDonald **Data lead:** Ian Myers/Jody Evans/Barry Mack

Status

	Value	Units	Previous Status	Current Status	Target	Annual target	Polarity	Frequency
1.2.1 Board Member attendance at training	75%	%	A	A	80%	80%	High	Quarterly
1.2.2 Board Members completing training needs analysis (TNA)	72%	%	Gy	G	65%	65%	High	Quarterly
1.2.3 Board Members with adequate skills - average scores for comprehensive training need analysis (TNA)	40%	%	Gy	R	90%	90%	High	Quarterly
1.2.4 Board Member attendance at Board meetings	75%	%	A	A	80%	80%	High	Quarterly
1.2.5 Officer training plans and My performance Objectives in place	100	%	G	G	100%	100%	High	Annual (May)

Rationale for performance status and trend

1.2.1. This measure reflects attendance by Board Members at training prior to the March, July , September, December 2013, the training session on 22 January 2014 and the 5 March 2014 Board, ISC Members at training prior to the June & July ISC meeting and ISC members attendance at the Baillie Gifford Investment Conference in October.

1.2.2. This represents the completion rate of TNA by board members.

1.2.3. This represent the score of the completed TNA forms.

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1.2.4. This represents attendance at Board meetings in March 2013 July 2013, September 2013 and December 2013.

1.2.5. My Performance objectives have been agreed for all Pension Administration & Pension Investment officers.

1.3 - Evolve and look for new opportunities, ensuring efficiency at all times

Measure Purpose: To evolve and look for new opportunities, ensuring efficiency at all times

Scope: Actions listed in Business Plan

Measure Owner: Kevin McDonald & Jody Evans **Data lead:** Kevin McDonald & Jody Evans

Status

	Value	Previous status	Current status	Target	Annual target	Polarity	Frequency
1.3.1 Fund Business Plan quarterly review - actions on track	4% Complete 61 % in progress 35% yet to start	A	A	15% Complete, 10% in progress	100% complete	High	Quarterly

Rationale for performance status and trend

1.3.1 Against a total of 23 actions or projects for the year:

1 (4%) complete
14 (61%) in progress
8 (35%) scheduled to commence later in the year

The business plan is detailed in Annex A of this report.

1.4 - Act with integrity and be accountable to our stakeholders

Measure Purpose: To act with integrity and be accountable to our stakeholders for our decisions, ensuring they are robust and well based

Scope: Formal complaints against Board Members relating to their role as member of the EPFB or ISC, with reference to Essex County Council's Code of Conduct. Formal complaints are those made to Standards Committee. The same complaint may be referred onto the Local Government Ombudsman or a third party may seek judicial review. Measure also includes annual review of key decisions and accountability and contract management measures currently in development

Measure Owner: Ian Myers **Data lead:** Ian Myers

Status

	Value	Units	Previous status	Current status	Target	Polarity	Frequency
1.4.1 Number of complaints made	0		G	G	0	Low	On-going
1.4.2 Number of complaints upheld	0		G	G	0	Low	On-going
1.4.3 The Board has provision for representatives of employers and scheme members. Appointees are currently in place.	No		G	R	Yes	High	Quarterly

Rationale for performance status and trend

1.4.1 Reflects performance over the previous 12 months as at 30 June 2014.

1.4.2 Reflects performance over the previous 12 months as at 30 June 2014.

1.4.3 This is measured on an on-going basis. Yes = green; No = red.

At the time the papers were finalised, nominations for representatives of Thurrock Council and the Essex Leader & Chief Executives Group were awaited.

1.5 - Understand and monitor risk and compliance

Measure Purpose: Understand and monitor risk and compliance

Scope: On-going reporting and discussion of key risks to the Fund. Output from internal audit reviews.

Measure Owner: Kevin McDonald & Jody Evans **Data lead**: Kevin McDonald & Jody Evans

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
1.5.1 Number of internal audit reviews finding limited/no assurance	0		G	G	0	0	Low	On-going
1.5.2 Number of internal audit recommendations outstanding	0		G	G	0	N/A	Low	On-going
1.5.3 Percentage of risks on the risk register with a residual score that is classified as amber	11.9	%	G	G	<20%	<20%	High	Quarterly
1.5.4 Percentage of risks on the risk register with a residual score that is classified as red	0.1	%	R	R	0%	0%	High	Quarterly
1.5.5 Number of matters raised by external auditors relating to Pensions Services	0		G	G	0	N/A	Low	Annually (Sep)

Rationale for performance status and trend

1.5.1 This includes all internal audits conducted in the last 12 months. The 2012/13 internal audit reports for both Pensions Administration and Pensions Investment received full assurance.

1.5.2 The 2012/13 internal audit reports for both Pensions Administration and Pensions Investment contained a total of three "advice & best practice" recommendations, all of which have been completed .

1.5.3 The Fund currently has 84 risks in its register, of which 10 have a residual score that is classified as amber. These are detailed at Annex B to this report. The previous quarter's score was 11 amber risks. Measurement: below 20% = green; between 20%-25% = amber; above 25% = red

1.5.4 The Fund currently has 81 risks in its register, one of which have a residual score that is classified as red. This relates to the delayed release of transitional regulations for the new Career Average benefit scheme which will apply to the LGPS w.e.f. 1 April 2014. The risk is detailed in Annex B to this report. There were no red risks in the previous quarter. Measurement: 0% = green; under 2% = amber; above 2% = red

1.5.5 There were no recommendations for Members to note in the 2012/13 Annual Governance Report from EY .

2.1 - Maximise returns from investments within reasonable risk parameters

Data as at: 31 March 2013

Measure Purpose: To maximise the returns from investments within reasonable risk parameters
Scope: All investments made by Pensions Fund: asset returns, liquidity and volatility risk

Measure Owner: Kevin McDonald **Data lead**: Samantha Andrews

Status

	Value	Units	Previous Status	Current Status	Target	Annual target	Polarity
2.1.1 Annual return compared to Peer Group	tbc	ranking	A	Gy	1st	1st	High
2.1.2 Annual Return compared to Benchmark	tbc	%	G	Gy	tbc	tbc	High
2.1.3 Five year (annualised) return compared to Benchmark	tbc	%	G	Gy	tbc	tbc	High
2.1.4 Five year (annualised) return compared to central expected return of current investment strategy	13.1	%	R	G	6.1%	6.1%	High

Rationale for performance status and trend

Benchmark and comparaison peer group data is awaited - when available, a full data set will be brought to the September 2014 Board.

2.2 - Ensure the Fund is properly managed

Measure Purpose: To ensure that the Fund is properly managed

Scope: Attendance at ISC and ISC member skills and knowledge

Measure Owner: Kevin McDonald **Data lead**: Samantha Andrews & Barry Mack

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
2.2.1 ISC Member attendance at ISC meetings	90.0	%	G	G	80%	80%	High	On-going
2.2.2 ISC Members completing training needs analysis (TNA)	88.0	%	Gy	G	65%	65%	High	Quarterly
2.2.3 ISC Members with adequate skills - average scores for comprehensive training need analysis (TNA)	55.0	%	Gy	A	90%	90%	High	Quarterly

Rationale for performance status and trend

2.2.1 . This represents attendance at ISC meetings in July 2013, November 2013., February 2014 , March 2014 & June 2014.

2.2.2 . This represents the completion rate of TNA by ISC members.

2.2.3. This represent the score of the completed TNA forms.

2.3 - Ensure investment issues are communicated appropriately to the Fund's stakeholders

Measure Purpose: To ensure all significant Fund investment issues are communicated properly to all interested parties

Scope: Publication of meeting minutes and agendas, communication governance arrangements agreed by Board and ISC

Measure Owner: Kevin McDonald **Data lead:** Kevin McDonald

Status

	Value	Units	Previous status	Current status	Target	Annual target	Frequency
2.3.1 % of ISC agendas sent out 5 working days before meetings	100	%	G	G	100%	High	Quarterly
2.3.2 % of ISC committee items sent out 5 working days before meetings	100	%	G	G	100%	High	Quarterly
2.3.3 % of draft ISC minutes sent out 7 working days after meetings	100	%	G	G	100%	High	Quarterly
2.3.4 % of draft ISC minutes uploaded to internet 12 working days after meetings	0	%	G	G	100%	High	Quarterly
2.3.5 Number of communication and governance arrangements for the ISC not in place	0		G	G	0	High	On-going

Rationale for performance status and trend

2.3.5 Measure will flag as red if one of the following communications arrangements is not in place:

- ISC Terms of Reference in place and noted at the beginning of the municipal year
- Pension Fund Business Plan in place and renewed at the beginning of the financial year
- SIP to be reviewed and published annually
- Annual Report & Accounts published by 30 November
- One independent adviser and one institutional investment consultant attended or were available to attend the last ISC meeting
- Briefing report provided to EPFB on the matters dealt with at the preceding ISC meeting
- Complete management information including asset values and returns made available for consideration at last ISC meeting

All arrangements are in place.

3.1 - Achieve and then maintain assets equal to 100% of liabilities within reasonable risk parameters and Funding Strategy timescales

Data as at: February 2014

Measure Purposes: To achieve and then maintain assets equal to 100% of liabilities within reasonable risk parameters.

Scope: Sources of funding: employer contributions and investments

Measure Owner: Kevin McDonald **Data leads:** Kevin McDonald

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
3.1.1 Probability of hitting funding target	61	%	G	G	50%	50%	High	Three yearly

Rationale for performance status and trend

3.1.1 . Following the Actuarial Valuation, an asset liability study was undertaken by the Fund's Institutional Investment Consultants , Hymans Robertson. This was to be considered by the Investment Steering Committee at its meeting on 24 February 2014.

Based on the assumptions and methodology in the investment consultant’s long term stochastic projection model, they have reported that the probability of being fully funded in 21 years’ time is 61%

3.2 - To recognise in drawing up its Funding Strategy the desirability of employer contributions that are as stable as possible

Measure Purposes: To recognise the desirability of employer contributions that are as stable as possible

Scope: Fund Employers

Measure Owner: Kevin McDonald **Data lead:** Sara Maxey

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
3.2.1 Stability mechanisms are included within the current Funding Strategy	Yes		G	G	Yes	Yes	High	3 yearly
3.2.2 Each of the 17 major precept raising bodies are were offered contributions which increased by no more than 1% per year or 3% per valuation.	Yes		G	G	Yes	Yes	High	3 yearly

Rationale for performance status and trend

3.2.1 The Funding Strategy Statement is reviewed at least every three years as part of the Valuation process to include suitable stability mechanisms.

3.2.2 During consultation on the 2013/14 Funding Strategy, each of the 17 major presenting bodies were offered five options for employer contributions. These included an option which would increase employer contributions by no more than 1% (of pensionable pay) in the first year and 3% (of pensionable pay) over the three year Valuation cycle. The 17 major precepting bodies are listed below:

Essex County Council
Basildon District Council
Braintree District Council
Brentwood Borough Council
Castle Point District Council
Chelmsford City Council
Colchester Borough Council
Epping Forest District Council
Harlow District Council
Maldon District Council
Rochford District Council
Southend-on-Sea Borough Council
Tendring District Council
Thurrock Borough Council
Uttlesford District Council
Essex Police Authority
Essex Fire Authority

3.3 - Consistency between the Investment and Funding strategies

Measure Purpose: To have consistency between the investment strategy and funding strategy
Scope: Long term investment return assumed by funding strategy and average expected return on investment portfolio
Measure Owner: Kevin McDonald **Data leads:** Samantha Andrews

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
3.3.1 Expected return of investment strategy	6.1	%	A	G	5.8%	5.8%	High	Annual
3.3.2 Investment strategy reviewed after Asset Liability Study	Yes		Gy	G	Yes	Yes	Yes	3 yearly

Rationale for performance status and trend

3.3.1 Long term return assumed by Funding Strategy

The 2013 Actuarial Valuation is currently underway.
For the 2013 Valuation t he Fund Actuary's assumption for investment return was 5.8%

Included within the draft Statement of Investment Principles approved by the ISC on 27 March 2013 was a central expectation, from the end December 2012, for the absolute return on the Fund assets of 6.1% p.a.

3.3.2 Investment Strategy reviewed

This new measure highlights that the ISC on 24 February 2014 was to review the Investment Strategy and its consistency with the Funding Strategy as part of its consideration of the Asset Liability Study, conducted by Hymans Robertson after the 2013 Actuarial Valuation.

3.4 - Manage employers' liabilities effectively

Measure Purpose: To manage employers' liabilities effectively by the adoption of employer specific funding objectives
Scope: All employers contributing to the scheme
Measure Owner: Kevin McDonald **Data leads:** Sara Maxey

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
3.4.1 Does the Funding Strategy incorporate different funding objectives for different groups of employers ?	Yes	%	G	G	Yes	Yes	High	3 Yearly

Rationale for performance status and trend

3.4.1 The draft Funding Strategy, agreed by the Board in September 2013 included different funding objectives for different groups of employers. This was also the case for the Funding Strategy that accompanied the previous Actuarial Valuation in 2010.

3.5 - Maintain liquidity in order to meet projected net cash flow outgoings

Measure Purpose: Maintain liquidity in order to meet projected net cash-flow outgoings
Measure Owner: Kevin McDonald **Data lead:** Kevin McDonald

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
3.5.1 Contribution income adequate to meet benefit payments.	Yes		A	A	Yes	Yes	High	On-going

Rationale for performance status and trend

3.5.1 This measure captures the most recent comparison of fund income (excluding investment income) and fund expenditure.
Fund expenditure is currently forecast to exceed fund income (excluding investment income) in 2015/16.
In that instance investment income would be used to fund part of the payment of Fund benefits.

Score criteria is based on the contribution income adequate to meet benefit payments for the following time periods

Green = more than two years
Amber = between one and two years
Red = less than one year

The next review of cash flow will take place in 2014/15.

3.6 - Minimise unrecoverable debt on termination of employer participation

Measure Purpose: To highlight unrecoverable, or potentially unrecoverable, deficit due to employers leaving the Fund
Scope: All employers contributing to the scheme
Measure Owner: Kevin McDonald **Data leads:** Sara Maxey

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
3.6.1 Potentially unrecoverable deficit due to employers leaving scheme (as a percentage of Total Fund deficit)	0.010	%	A	A	0.00%	0.00%	Low	Quarterly
3.6.2 Deficit unrecoverable due to employers leaving scheme (as a proportion of Total Fund deficit)	0	%	G	G	0.00%	0.00%	Low	Quarterly

Rationale for performance status and trend

3.6.1 Scoring:

0% = Green.
Below 0.02%(£250,000) = Amber.
Above 0.02% = Red

The Fund has been notified that an admitted body, Harlow Welfare Rights & Advice (HWRA) has been placed into liquidation. The Actuary's calculation of the termination deficit on a least risk basis is £95,000.

3.6.2 Scoring:

0% = Green.
Below 0.02%(£250,000) = Amber.
Above 0.02% = Red

There have been no unrecoverable deficits since the last Board meeting. The score is therefore green.

The Fund's total deficit as at 31 March 2013 Actuarial Valuation was £953m.

4.1 - Deliver a high quality, friendly and informative service

Measure Purpose: Deliver a high quality, friendly and informative service to all beneficiaries, potential beneficiaries and employers at the point of need

Scope: Communication and administration turnaround times, scheme member appeals, payment errors

Measure Owner: Jody Evans **Data lead:** David Tucker/Joel Ellner/Daniel Chessell/Matt Mott

Status

	Value	Units	Previous status	Current status	Annual Target	CIPFA Average	Polarity	Frequency
4.1.1 Letter detailing transfer in quote issued within 10 working days (394 cases)	90.4%	%	A	A	95.0%	87.9%	High	Annual (Aug)
4.1.2 Letter detailing transfer out quote issued within 10 working days (285 cases)	90.0%	%	A	A	95.0%	89.8%	High	Annual (Aug)
4.1.3 Letter detailing process of refund and payment made within 5 working days (359 cases)	85.8%	%	A	A	95.0%	87.6%	High	Annual (Aug)
4.1.4 Letter notifying estimated retirement benefit amount within 10 working days (6499 cases)	95.7%	%	G	G	95.0%	90.8%	High	Annual (Aug)
4.1.5 Letter notifying actual retirement benefits and payment made of lump sum retirement grant within 5 working days (1802 cases)	95.4%	%	G	G	95.0%	89.5%	High	Annual (Aug)
4.1.6 Letter acknowledging death of active /deferred / pensioner member within 5 working days (942 cases)	99.1%	%	G	G	95.0%	92.4%	High	Annual (Aug)
4.1.7 Letter notifying the amount of dependent's benefits within 5 working days (914 cases)	95.9%	%	G	G	95.0%	87.5%	High	Annual (Aug)
4.1.8 Calculate and notify deferred benefits within 10 working days (4908 cases)	83.3%	%	R	R	95.0%	81.9%	High	Annual (Aug)
4.1.9 Annual benefit statements issued to active members by 30 September.	Yes		G	G	Yes	N/A	High	Annual (Sep)
4.1.10 Annual benefit statements issued to deferred members by 30 June.	Yes		G	G	Yes	N/A	High	Annual (Jun)
4.1.11 Number of payments errors	0	number	G	G	0	N/A	Low	Quarterly
4.1.12 New IDRP appeals during the year	2		G	G	Below CIPFA average	Pending	Low	Annual (Aug)
4.1.13 IDRP appeals - number of lost cases	0		G	G	Below CIPFA average	Pending	Low	Annual (Aug)
4.1.14 Employer survey - feedback on training and educational materials - % of positive responses	99.1%		G	G	95.00%	N/A	Low	Annual (Mar)

4.1.1 - 4.1.8 The Fund is aiming for a target of 95%. Above 95% = green, above 85% = amber, below 85% equals red. It should be noted that the Fund already compares favourably with other funds and is aiming even higher. A new column showing draft 2012/2013 CIPFA Benchmarking averages has been included for the first time.

4.1.1 & 4.1.2 Changes to regulations and to factors required to calculate transfers were subject to a delay by the Government Actuarial Department this led officers to postpone processing and therefore impacted the turnaround times. Transfers is an area that is effected by regular factor amendments and have been subject to regular minor changes within the regulations over the last 2 years.

4.1.3 Turnaround times for processing and paying of refunds increased slightly from 85.5% (2011/12) to 85.8% (2012/2013) . However the numbers of refund cases has more than doubled from the previous year, due to more people claiming refunds.

4.1.4 Estimates of retirement benefits processed during 2011/2012 more than doubled to 4634 cases from the previous figure in 2010/2011 of 2233 cases. During 2012/2013 we have seen another significant increase to 6499.

4.1.8 Turnaround times for this measure improved from 78% (2010/11) to 82.6% (2011/12) to 83.3% (2012/2013) This is an area of high demand due to levels of employee turnover within our many employers. A new procedure is in place from 1 April 2013 and this is mention in a report on the September Board.

4.1.9 The 2012/13 Annual benefits statements for Active members were dispatched in late August 2013. The previous dispatch was in August 2012.

4.1.10 The last dispatch of these statements to Deferred members was in June 2014. The previous dispatch was in June 2013

4.1.11 Measure captures the number of errors made by Pensioner Payroll which have resulted in scheme members being paid the wrong amount. During last 3 months, 0 payments errors to scheme members. Procedural checks are in place to measure this on a quarterly basis.

4.1.14 In November 2013 an employer survey was issued, 378 employers were invited to participate and 112 responses were received when asked about feedback on training materials and educational materials. Only one negative response was received resulting in a 99.1% positive response. In 2012 the result showed a 95.3% positive response. 116 survey responses that were received 4 respondents chose not to answer this question.

4.2 - Data is protected to ensure security and authorised use only

Measure Purpose: Data is protected to ensure security and authorised use only

Scope: All service area budgets within the directorate

Measure Owner: Jody Evans **Data lead:** Anna Casbolt

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
4.2.1 Number of information security breaches	1		G	R	0	0	Low	**Quarterly**
4.2.2 Actions in place for all breaches	0		G	G	Actions in place for all	Actions in place for all	N/A	**Quarterly**

Rationale for performance status and trend

4.2.1 One breach occured this quarter. An investigation is ongoing and any actions will be implemented.

Green = 0 breaches
Amber = 1 or more medium or minor breaches
Red = 1 or more major or critical breaches

4.2.2 There were no required actions this quarter.

4.3 - Ensure proper administration of financial affairs

Measure Purpose: To ensure proper administration of the Fund's financial affairs
Scope: Investments and Contributions
Measure Owner: Kevin McDonald **Data leads:** Samantha Andrews & Sara Maxey

Status

	Value	Units	Previous status	Current status	Current target	Annual target	Polarity	Frequency
4.3.1 % of monthly reconciliations of equity and bond investment mandates which are timely	100	%	G	G	0%	100%	High	Quarterly
4.3.2 % of contributing employers submitting timely payments	95.7	%	A	A	100%	100%	High	Quarterly

Rationale for performance status and trend

4.3.1 Performance over quarter ending March 2014 was 100%:(Green).

The investment team's focus in the quarter ending June, is closing the accounts.

Quarter ending March 100%
Quarter ending June 0% (The work of the Investment Team at this time is focussed on year end closure)

4.3.2 For the quarter ending March 2014 the performance was amber as payments from **95.7%** of the 434 contributing employers were received within the month they fell due. In cash terms this equated to **99.4%** of a total employer contribution of £36.6m.

4.4 - Compliance with the Fund's governance arrangements

Measure Purpose: To ensure compliance with the Fund's governance arrangements agreed by the Council
Scope: Publication of Essex Pensions Funding Board agendas and minutes. Governance arrangements agreed by Board
Measure Owner: Ian Myers/Jody Evans/Kevin McDonald **Data lead:** Ian Myers/Jody Evans/Kevin McDonald

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
4.4.1 % of Board agendas sent out 5 working days before meetings	100	%	G	G	100%	100%	High	Quarterly
4.4.2 % of Board items sent out 5 working days before meetings	89	%	R	R	100%	100%	High	Quarterly
4.4.3 % of draft Board minutes sent out 7 working days after meetings	100	%	G	G	100%	100%	High	Quarterly
4.4.4 % of Board minutes uploaded to internet 12 working days after meetings	100	%	G	G	100%	100%	High	Quarterly
4.4.5 Compliance with governance arrangements - number of governance arrangements not in place	0	number	G	G	0	0	High	On-going

Rationale for performance status and trend

4.4.2 The ISC quarterly update for the 5 March Board (in respect of the 24 February ISC meeting) was a to follow item. The procurement frameworks paper for the Board meeting on 9 December 2013 was a to follow item.

4.4.5 Measure will flag as red if one of the following governance arrangements is not in place:

- An Employer Forum has taken place during the last year - Fund is compliant
- The last Employer Forum received reports and representation from the ISC and EPFB - Fund is compliant

NB: Compliance with Board Membership arrangements is covered at measure 1.4.4

5.1 - Communicate in a friendly, expert and direct way to our stakeholders, treating all our stakeholders equally.

Measure Purpose: Communicate in a friendly, expert and direct way to our stakeholders, treating all our stake holders equally.
Scope: All scheme members and employers
Measure Owner: David Tucker **Data lead:** Matt Mott

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
5.1.1. % of positive responses from the scheme member survey. - *Helpfulness of the Pensions Teams.*	99.1	%	G	G	95%	95%	High	Annual (Mar)
5.1.2. % of positive responses from the Employer Survey. - *Expertness of Pensions Teams* .	99.1	%	G	G	95%	95%	High	Annual (Mar)
5.1.3. % of positive responses from the Employer Survey. - *Pensions Teams are friendly and Informative.*	100	%	G	G	90%	90%	High	Annual (Mar)
5.1.4. A Communication Plan is in place for the current year.			G	GY	Yes	Yes	High	Annual (Sep)

Rationale for performance status and trend

5.1.1 In November 2013 a scheme member survey was issued, 500 scheme members were invited to participate and 111 responses were received to the question to 'How would you rate the Essex Pension Fund on helpfulness of staff?'. Only one negative response was received resulting in a 99.1% positive response. In 2012 the result showed a 100% positive response. 118 survey responses that were received 7 respondents chose not to answer this question

5.1.2 In November 2013 an employer survey was issued, 378 employers were invited to participate and 110 responses were received to the question to 'How would you rate Essex Pension Fund staff on their level of expertise?'. Only one negative response was received resulting in a 99.1% positive response. In 2012 the result showed a 100% positive response. 116 survey responses that were received 6 respondents chose not to answer this question.

5.1.3 In November 2013 an employer survey was issued, 378 employers were invited to participate and 111 responses were received to the question to 'How would you rate Essex Pension Fund staff on being friendly and informative?'. No negative response was received resulting in a 100% positive response. In 2012 the result showed a 100% positive response. 116 survey responses that were received 5 respondents chose not to answer this question.

5.1.4 The existing Communication Plan is currently subject to review in light of the new LGPS 2014 benefits structure.

5.2 - Ensure our communications are simple, relevant and have impact. To deliver information in a way that suits all types of stakeholder

Measure Purpose: Ensure our communications are simple, relevant and have impact. To deliver information in a way that suits all types of stakeholder

Scope: All Scheme members and employers

Measure Owner: David Tucker **Data lead:** Matt Mott

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
5.2.1. % of positive responses from the Scheme member Survey - *Clarity of website information.*	97.1%	%	G	G	95.0%	95.0%	High	Annual (Mar)
5.2.2. % of positive responses from the Scheme Member Survey - *Understandable Annual Benefit Statements.*	82.0%	%	A	A	95.0%	95.0%	High	Annual (Mar)
5.2.3. % of positive responses from the Scheme Member Survey - *Communications that suit needs, easy to understand and relevant.*	99.1%	%	A	G	95.0%	95.0%	High	Annual (Mar)
5.2.4. % of positive responses from the Employ**er** Survey - *Clarity of Website information.*	92.4%	%	G	A	95.0%	95.0%	High	Annual (Mar)
5.2.5. Increase in response of the Scheme Member Survey compared to last year.	143.9%	%	G	G	Increase	Increase	High	Annual (Mar)
5.2.6. Increase in response rate of the Employer Survey compared to last year.	269.8%	%	G	G	Increase	Increase	High	Annual (Mar)

5.2.1 - In November 2013 a scheme member survey was issued, 500 scheme members were invited to participate and 68 responses were received to the question to 'How clear is the information available on the Essex Pension Fund website?'. Only two negative response was received resulting in a 97.1% positive response. In 2012 the result showed a 95.1% positive response. 118 survey responses that were received 50 respondents chose not to answer this question.

5.2.2 - In November 2013 a scheme member survey was issued, 500 scheme members were invited to participate and 111 responses were received to the question to 'How easy was the information in your annual benefit statement to understand?'. 20 negative response was received resulting in a 82% positive response. In 2012 the result showed a 86.6% positive response. 118 survey responses that were received 7 respondents chose not to answer this question.

5.2.3 - In November 2013 a scheme member survey was issued, 500 scheme members were invited to participate and 114 responses were received. Only one negative response was received resulting in a 99.1% positive response. In 2012 the result showed a 91.4% positive response. 118 survey responses that were received 4 respondents chose not to answer this question.

5.2.4 - In November 2013 an employer survey was issued, 378 employers were invited to participate and 105 responses were received to the question to 'How clear is the information available on the Essex Pension Fund website?'. Eight negative responses was received resulting in a 92.4% positive response. In 2012 the result showed a 95.3% positive response. 116 survey responses that were received 11 respondents chose not to answer this question.

5.2.5 - In November 2013 a scheme member survey was issued, 500 scheme members were invited to participate and 118 responses were received. In 2012 82 responses were received. This is an increase in respondents of 36 (43.9%).

5.2.6 - In November 2013 an employer survey was issued, 378 scheme members were invited to participate and 116 responses were received. In 2012 43 responses were received. This is an increase in respondents of 73 (169.8%).

5.3 - Aim for a full appreciation of the pension scheme benefits and changes to the Scheme by all scheme members, prospective scheme members and employers

Measure Purpose: Aim for a full appreciation of the pension scheme benefits and changes to the Scheme by all scheme members, prospective scheme members

Scope: All scheme members and employers

Measure Owner: David Tucker **Data lead:** Matt Mott

Status

	Value	Units	Previous status	Current status	Target	Annual target	Polarity	Frequency
5.3.1. % of opt outs is within reasonable parameters		%	Gy	Gy	0.10%	0.10%	N/A	Quarterly
5.3.2. % of positive responses from the Employer Survey - *Information available is helpful in employers understanding their responsibilities*	97.3%	%	G	G	95%	95%		Annual(Mar)

Rationale for performance status and trend

5.3.1 This measure is under development.

5.3.2 In November 2013 an employer survey was issued, 378 employers were invited to participate and 112 responses were received when asked about feedback on information available is helpful to employers understanding their responsibilities. Only three negative response were received resulting in a 97.3% positive response. In 2012 the result showed a 95.3% positive response. 116 survey responses that were received 4 respondents chose not to answer this question.

Essex Pension Fund Board	EPB/13/14
date: 9 July 2014	

External Audit 2013/14: Audit Plan

Report by Peter O'Neill, Partner Ernst & Young LLP

Enquiries to Dean Bardrick on 0789 6684 728

1. Purpose of the Report

For External Audit to outline the Audit Plan in relation to the 2013/14 financial statements of the Essex Pension Fund.

2. Recommendation.

That the Board should note the report.

3. External Audit Plan

Peter O'Neill, on behalf of Ernst & Young has submitted the attached Essex Pension Fund Audit Plan which describes the approach that will be adopted for the external audit of the 2013/14 Essex Pension Fund Accounts.

This Audit Plan was reported to Essex County Council's Audit Committee on 17 March 2014

4. Link to Essex Pension Fund Objectives

4.1 Audit work assists the Fund in achieving a number of its objectives, including:

- to ensure that the Fund is properly managed
- understand and monitor risk and compliance
- to deliver a high quality, informative and friendly service to all beneficiaries, potential beneficiaries and employers

5. Risk Implications

5.1 Audit work is a means of both identifying and mitigating risk.

6. Communication Implications

6.1 Other than ongoing reporting to the Board and ECC's Audit Committee, there are no communications implications.

7. Finance and Resources Implications

7.1 As highlighted in the attached 2013/14 Audit Plan, the charge to the Fund in 2014/15 will be £31,266.

8. Background Papers

8.1 None.

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Audit Plan

Year end 31 March 2014

Essex County Council Pension Fund

February 2014

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INVESTOR IN PEOPLE

Audit Committee
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County Hall
Market Road
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27 February 2014

Dear Members

Audit Plan

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. The purpose of this report is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2014 audit, in accordance with the requirements of the Audit Commission Act 1998, the Code of Audit Practice, the Standing Guidance, auditing standards and other professional requirements, but also to ensure that our audit is aligned with the Committee's service expectations.

This report summarises our assessment of the key risks which drive the development of an effective audit for Essex County Council Pension Fund and outlines our planned audit strategy in response to those risks.

We welcome the opportunity to discuss this report with you on 12 March 2014 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Peter O'Neill
For and behalf of Ernst & Young LLP
Enc

Contents

1. Overview

Context for the audit

This audit plan covers the work that we plan to perform in order to provide you with our audit opinion on whether the financial statements of Essex County Council Pension Fund ('the Pension Fund') give a true and fair view of the financial position as at 31 March 2014 and of the income and expenditure for the year then ended.

When planning the audit we take into account several key inputs:

- Strategic, operational and financial risks relevant to the financial statements.
- Developments in financial reporting and auditing standards.
- The quality of systems and processes.
- Changes in the business and regulatory environment.
- Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter. And by focusing on the areas that matter, our feedback is more likely to be relevant to the Pension Fund.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

In part 2 of this report we provide more detail on the areas which we believe present significant risk to the financial statements audit. We also outline our plans to address these risks.

Details of our audit process and strategy are set out in Section 3.

2. Financial statement risks

We outline below our assessment of the financial statement risks facing Essex County Council Pension Fund, identified through our knowledge of the entity's operations and discussion with members and officers.

At our meeting, we will seek to validate this with you.

Significant risks (including fraud risks)	Our audit approach
Management override	
As identified in ISA (UK & Ireland) 240, management is in a unique position to perpetrate fraud because of their ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	Our approach will focus on: ► Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; ► Reviewing accounting estimates for evidence of management bias; and ► Evaluating the business rationale for significant unusual transactions.

We will provide an update to the Audit Committee on the results of our work in these areas in our report to those charged with governance scheduled for delivery in September 2014.

Respective responsibilities in relation to fraud and error

We would like to take this opportunity to remind you that management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has put in place a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Based on the requirements of auditing standards our approach will focus on:

- Identifying fraud risks during the planning stages.
- Inquiry of management about risks of fraud and the controls put in place to address those risks.
- Understanding the oversight given by those charged with governance of management's processes over fraud.
- Consideration of the effectiveness of management's controls designed to address the risk of fraud.
- Determining an appropriate strategy to address those identified risks of fraud.
- Performing mandatory procedures regardless of specifically identified fraud risks.

3. Our audit process and strategy

3.1 Objective and scope of our audit

Under the Audit Commission's Code of Audit Practice ('the Code'), dated March 2010, our principle objectives are to review and report on, to the extent required by the relevant legislation and the requirements of the Code, the Pension Fund's financial statements.

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK and Ireland).

3.2 Audit process overview

Our approach is to assess the Council's level of internal controls and to place reliance upon those controls where our assessment allows.

In doing so, we will look to rely on the work of Internal Audit as much as possible whilst complying with the requirements of auditing standards. We have discussed our requirements with Internal Audit, establishing which financial systems they are reviewing this year and have built this in to our work plan.

Processes

Our initial assessment of the key processes across the entity has identified the following key processes where we will seek to test and rely on key controls, both manual and IT:

- Contributions
- Pension's payroll.

Investments and cash balances will be tested substantively at year end. We will also undertake work in accordance with our IAS 19 protocol to provide information on which relevant admitted bodies of the Essex County Council Pension Scheme can place reliance when preparing its financial statements. **Analytics**

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular in respect of pension payroll and journal entries. These tools:

- help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- give greater likelihood of identifying errors than random sampling techniques.

Internal audit

As in prior years, we will review internal audit plans and the results of work undertaken. We will reflect the findings from these reports, together with reports from other work completed in the year, in our detailed audit plan, where issues are raised that could impact the year-end financial statements.

We seek to place reliance on the work of internal audit wherever possible in line with auditing standards. We have already liaised with Internal Audit and in March will commence our review and re-performance of their work on the systems detailed above.

Use of experts

In producing the financial statements, management will place reliance on the work undertaken by a small number of experts, We anticipate being able to undertake sufficient procedures such that we will be able to place reliance on the work undertaken by management's experts.

We also anticipate relying on the work of the experts commissioned by the Audit Commission in respect of the work undertaken by the pension scheme actuary appointed by Essex County Council.

We will utilise specialist EY resource, as necessary, to help us to form a view on judgments made in the financial statements. Our plan currently includes the involvement of specialists in pensions and valuations.

Mandatory procedures required by auditing standards

In addition to the financial statement risks outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

- Addressing the risk of fraud and error.
- Significant disclosures included in the financial statements, in particular disclosures relating to financial instruments.
- Entity-wide controls.
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements.
- Auditor independence.

Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements.
- Reviewing, and where appropriate, examining evidence that is relevant to the Pension Fund's corporate performance management and financial management arrangements and reporting on these arrangements.

3.3 Materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition.

We have determined that overall materiality for the financial statements of the Pension Fund is £39.585 million based on 1% of net assets. We will communicate uncorrected audit misstatements greater than £1.979 million to you.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

3.4 Fees

The Audit Commission has published a scale fee for all authorities. The scale fee is defined as the fee required by auditors to meet statutory responsibilities under the Audit Commission

Act in accordance with the Code of Audit Practice 2010. The indicative fee scale for the audit of the Pension Fund is £31,266. Further information is provided in Appendix A.

3.5 Your audit team

The engagement team is led by Peter O'Neill who leads EY's pension's assurance team. Peter is supported by Christine Connolly who is responsible for the day-to-day direction of audit work, and who is the key point of contact for your finance and pension teams. Peter is planning to retire later this year at which point we will update the Audit Committee on the new Pension's engagement partner.

Rob Murray is the director leading our overall engagement with Essex County Council and our relationship with the Audit Committee.

3.6 Timetable of communication, deliverables and insights

We have set out below a timetable showing the key stages of the audit, including the value for money work and the Whole of Government accounts; and the deliverables we have agreed to provide to you through the audit committee cycle in 2014. These dates are determined to ensure our alignment with the Audit Commission's rolling calendar of deadlines.

We will provide a formal report to the Audit Committee in September incorporating the outputs from our year-end procedures. From time to time matters may arise that require immediate communication with the Audit Committee and we will discuss them with the Audit Committee Chair as appropriate.

Following the conclusion of our audit we will prepare an annual audit letter in order to communicate to the Council and external stakeholders, including members of the public, the key issues arising from our work.

Audit phase	Timetable	Audit Committee timetable	Deliverables
High level planning:	**April 13**		Audit Fee letter
Risk assessment and setting of scopes	**January/ February 14**	Audit Committee	Audit Plan
Testing of routine processes and controls	**January to March 14**		
Year-end audit	**July to September 14**		
		Audit Committee	Report to those charged with governance Audit report (including our opinion on the financial statements). Audit completion certificate
	October 14		Annual Audit Letter

In addition to the above formal reporting and deliverables we will seek to provide practical business insights and updates on regulatory matters.

4. Independence

4.1 Introduction

The APB Ethical Standards and ISA (UK and Ireland) 260 “Communication of audit matters with those charged with governance”, requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our independence and objectivity. The Ethical Standards, as revised in December 2010, require that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	Final stage
► The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us; ► The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ► The overall assessment of threats and safeguards; ► Information about the general policies and process within EY to maintain objectivity and independence.	► A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ► Details of non-audit services provided and the fees charged in relation thereto; ► Written confirmation that we are independent; ► Details of any inconsistencies between APB Ethical Standards, the Audit Commission’s Standing Guidance and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and ► An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

4.2 Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. However we have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective.

Self interest threats

A self interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; where we receives significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved and that are in compliance with the Audit Commission's Standing Guidance.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard 4.

We have considered the relevant guidance and confirm there are no other self interest threats at the date of this report.

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

We have considered the relevant guidance and confirm there are no self review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of your entity. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

We have considered the relevant guidance and confirm there are no management threats at the date of this report.

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

We have considered the relevant guidance and confirm there are no other threats at the date of this report.

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Peter O'Neill, your audit engagement partner and the audit engagement team have not been compromised.

4.3 Other required communications

EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 28 June 2013 and can be found here:

http://www.ey.com/UK/en/About-us/EY-UK-Transparency-Report-2013

Appendix A Fees

A breakdown of our agreed fee is shown below.

	Planned Fee [current year]	Actual Fee [prior year]	Explanation of variance
Total Audit Fee – Code work	**31,266**	**31,266**	

The agreed fee presented above is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- We are able to place reliance, as planned, on the work of internal audit;
- The level of risk in relation to the audit of accounts in consistent with that in the prior year;
- Our accounts opinion being unqualified
- Appropriate quality of documentation is provided by the audited body
- Effective control environment and system controls.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with you in advance.

Appendix B UK required communications with those charged with governance.

There are certain communications that we must provide to the audit committee of audited clients. These are detailed here:

Required communication	Reference
Planning and audit approach Communication of the planned scope and timing of the audit including any limitations.	Audit Plan
Significant findings from the audit ► Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ► Significant difficulties, if any, encountered during the audit ► Significant matters, if any, arising from the audit that were discussed with management ► Written representations that we are seeking ► Expected modifications to the audit report ► Other matters if any, significant to the oversight of the financial reporting process	Report to those charged with governance
Misstatements ► Uncorrected misstatements and their effect on our audit opinion ► The effect of uncorrected misstatements related to prior periods ► A request that any uncorrected misstatement be corrected ► In writing, corrected misstatements that are significant	Report to those charged with governance
Fraud ► Enquiries of the audit committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ► Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ► A discussion of any other matters related to fraud	Report to those charged with governance
Related parties Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ► Non-disclosure by management ► Inappropriate authorisation and approval of transactions ► Disagreement over disclosures ► Non-compliance with laws and regulations ► Difficulty in identifying the party that ultimately controls the entity	Report to those charged with governance
External confirmations ► Management's refusal for us to request confirmations ► Inability to obtain relevant and reliable audit evidence from other procedures	Report to those charged with governance
Consideration of laws and regulations ► Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ► Enquiry of the audit committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the audit committee may be aware of	Report to those charged with governance
Independence Communication of all significant facts and matters that bear on EY's objectivity	Audit Plan Report to those charged

Required communication	Reference
and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: ► The principal threats ► Safeguards adopted and their effectiveness ► An overall assessment of threats and safeguards ► Information about the general policies and process within the firm to maintain objectivity and independence	with governance
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ► Whether the events or conditions constitute a material uncertainty ► Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ► The adequacy of related disclosures in the financial statements	Report to those charged with governance
Significant deficiencies in internal controls identified during the audit	Report to those charged with governance
Fee Information ► Breakdown of fee information at the agreement of the initial audit plan ► Breakdown of fee information at the completion of the audit	Audit Plan Report to those charged with governance and Annual Audit Letter if considered necessary

UK required communications with those charged with governance.

EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

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ey.com

Essex Pension Fund Board	EPB/14/14
Date: 9 July 2014	

Internal Audit Annual Report of Pension Fund Reviews

Report by Peter Tanton - Head of Internal Audit

Enquiries to Peter Tanton on 01245 430413

1. Purpose of the Report

1.1 The Essex Pension Fund Board's Terms of Reference include the monitoring of administration of the Essex Pension Fund. It is therefore appropriate for the Board to receive reports from Internal Audit regarding the control environment of the Pension Fund and Administration.

1.2 This report provides a summary of Internal Audit's 2013/14 activity in relation to the pension fund and proposals for 2014/15.

2. Recommendations

2.1 Pension Board Members are requested to note outcomes of the 2013/14 plan.

2.2 Pension Board members are requested to note the outcomes of the main 2012/13 NFI and supplementary NFI exercises.

2.3 Pension Board members are requested to note the planned audits of the Pension Fund for 2014/15.

3. Background

3.1 ECC is the administering authority for the Pension Fund and as such the Pensions Administration and Pension Fund Investment represent major systems in terms of financial control and reporting of the Council's activities.

4. 2013/14 Internal Audit Reviews

4.1 We undertook two reviews in accordance with the agreed Audit Plan:

- Pension Administration (Annex A) – Full Assurance
- Pension Investment (Annex B) – Full Assurance

4.2 Both reviews received a **'Full Assurance'** opinion which means that at the time of our review there was a sound system of internal control. It should be noted that this is our highest level of assurance.

5. National Fraud Initiative (NFI)

5.1 The Audit Commission are currently responsible for the biennial NFI where electronic data is matched between public and private sector bodies to prevent and detect fraud and error. This includes police authorities, local probation boards, fire and rescue authorities as well as local councils and a number of private sector bodies.

5.2 As part of the overall NFI data matching exercise ECC Pension Payroll data is matched against the Department for Work and Pensions deceased person's data. Results for the last mandatory NFI exercise were reported to the board at the meeting on 10th July 2013.

5.4 At the Pension Board meeting on 10th July 2013 it was agreed that data would be provided for a supplementary (non-mandatory) NFI pension payroll exercise. The benefit of this would be earlier identification of deceased pensioners where the fund has not been notified, thereby restricting the value of overpayments (which can often prove problematic to recover the longer the duration). It would also provide an annual assurance to the Board. This supplementary exercise identified 22 cases where we had not previously been made aware of the death. These were all instances of error (not fraud). This has identified **overpayments in respect of deceased pensioners of £7,272.85** (in recovery)**, with an annualised pension value of £55,431.66.**

5.5 Data is due to be submitted for the next planned mandatory NFI exercise in October 2014 with any matches being made available for investigation in January 2015.

5.6 It should be noted that in April 2015 the responsibility for the National Fraud Initiative will move from the Audit Commission to the Cabinet Office.

6. 2014/15 Audit Plan

6.1 On 17 March 2014, the Audit Committee approved the Internal Audit plan for 2014/15. The plan contains the following Pension Audits:

- KFS 9 Pension Investment – 25 days
- KFS10 Pensions Administration – 25 days
- CF1 National Fraud Initiative – 5 - 10 days (see note 1 below)

Note 1: The plan details 60 days (for all NFI datasets) - a proportion will be used for the pension payroll data submission and investigation of matches. Indicatively this is usually between 5 and 10 days but this is dependent on the nature and volume of matches returned and further investigatory work.

We will also undertake testing at key stages of the implementation of the new Pension System during 21014/15.

6.2 The total charge to the Pensions Fund for this activity will be £22,500.

7. Link to Essex Pension Fund Objectives

7.1 Audit work assists the Fund in achieving a number of its objectives, including:

- to ensure that the Fund is properly managed
- understand and monitor risk and compliance
- to deliver a high quality, informative and friendly service to all beneficiaries, potential beneficiaries and employers

8. Risk Implications

8.1 Audit work is a means of both identifying and mitigating risk.

9. Communication Implications

9.1 Other than ongoing reporting to the Board and ECC's Audit Committee, there are no communications implications.

10. Finance and Resources Implications

10.1 As highlighted at 6.2 the charge to the Fund in 2014/15 will be £22,500.

11. Background Papers

11.1 None.

Final Internal Audit Report 2013/14 – Pension Investment (KFS 108)

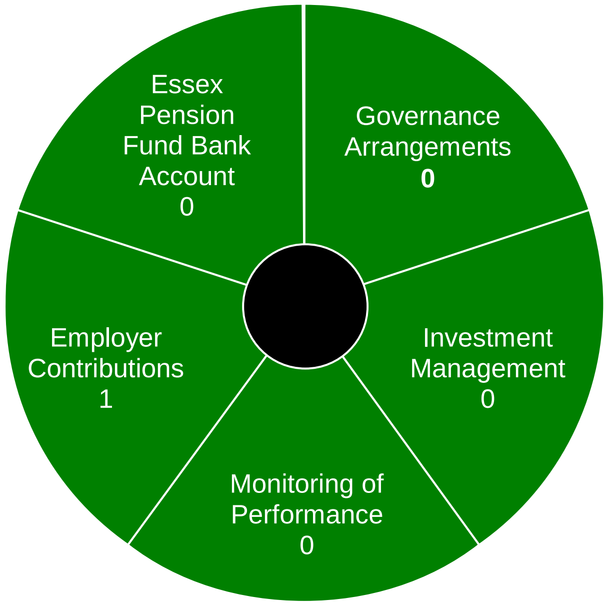
1. Executive Summary

Department: Corporate Services **Audit Sponsor:** **Kevin McDonald,** Director for Essex Pension Fund **Distribution List:** **Margaret Lee,** Executive Director for Corporate Services and Corporate Operations; **Kevin McDonald,** Director for Essex Pension Fund; **Jody Evans** , Head of Essex Pension Fund **Cllr Rodney Bass,** Chairman Essex Pension Fund Board **Christine Connolly** External Audit **Final Report Issued:** 13 March 2014 **Date of last review:** April 2013	**Overall Opinion** **FULL ASSURANCE** **Direction of Travel** Control environment has not changed since our prior audit	**Number of Control Design Issues Identified** 0 Critical 0 Major 0 Moderate 1 Best Practice	**Number of Control Operating in Practice Issues Identified** 0 Critical 0 Major 0 Moderate 0 Best Practice	**Number of Recommendations** 0 Made N/A Rejected N/A Critical Rejected N/A Major Rejected

Scope of the Review and Limitations:	The audit examined the extent to which the risks regarding potential non compliance with governance arrangements, investment management and performance monitoring, and receipt of employer contributions were being addressed, controlled and managed. The Essex Pension Fund's assets were transferred to a new Custodian, Northern Trust, in October 2012. Whilst this occurred in 2012-13, no review of this was undertaken in the audit of 2012-13 therefore, confirmation of the transfer was determined in this review to provide assurance of the completeness and accuracy of transfer. However, all other testing samples were taken from 2014 .

Critical and Major Findings and Recommendations

There are no Major and Critical Recommendations



Each risk area for this review is shown as a segment of the wheel. The key to the colours on the wheel is as follows:

- (red) Critical priority Control Design or Control Operating in Practice issues identified
- (orange) Major priority Control Design or Control Operating in Practice issues identified
- (yellow) Moderate priority Control Design or Control Operating in Practice issues identified
- (green) No / Minor Control Design or Control Operating in Practice Issues identified

Auditor: Nicola Meadows

Fieldwork Completed: 31 January 2014

Draft Report Issued: 25th February 2014

Management Comments Expected: 18 March 2014

Management Comments Received: 10 March 2014

Final Report: 13 March 2014

Issues raised and officers responsible for implementation:

Name	Critical	Major	Moderate	Best Practice	Total	Agreed
Advice and best practice recommendations	**0**	**0**	**0**	**1**	**1**	**N/A**

Releasing Internal Audit Reports: All distributed draft and final reports remain the property of the respective Director and the Executive Director for Finance. Approval for distributing this report should be sought from the relevant Director. Care must be taken to protect the control issues identified in this report.

Risk Management: The management of the following risks has been reviewed in this audit. Where appropriate, the Audit Sponsor is responsible for adding new risks identified to the relevant risk register.

Registered Risks Reviewed

Risk Ref	Risk	Risk Already Identified	Risk Managed
	Governance Arrangements: Lack of knowledge of and failure to apply pension regulations leading to ultra vires acts and a failure to comply with regard to: • preparing, publishing and maintaining the Statement of Investment Principles, Statement of Compliance, Funding Strategy and Annual Report; • obtaining actuarial valuations and certificates; and • providing copies of these documents to stakeholders resulting in potential loss of reputation, qualification of accounts and legal reprimand. Lack of knowledge of and a failure to operate best practice resulting in governance arrangements not matching up to recommended best practice leading to loss of reputation and employer and employee confidence.	Yes	●
	Investment Management: Poor strategic planning and response to incidents, changes in markets, rules and regulations leading to failure of the funding strategy resulting in a forecasted inability to pay benefits and a consequent need to raise employer contributions. Poor security of data leading to potential loss of records resulting in non compliance with regulations and additional staff costs to correct. Lack of reconciliations between Council records and fund manager records allowing discrepancies between the two remaining undetected and potential errors in the accounts, resulting in qualification of accounts, misrepresentation of fund value and loss of reputation. Fund assets are not accurately accounted for resulting in potential errors in the accounts and fund valuation leading to inaccurate actuarial conclusions and potential funding shortfall causing increased employer contributions from Council Tax. Lack of restrictions / guidelines on investments resulting in potential loss of income and capital and providing poor value of money for the Pension Fund.	Yes	●
	Monitoring of Performance: Poor contract drafting and / or management allowing poor performance in the supply of services to the pension fund to occur without redress resulting in loss of reputation, reduced investment income, potential legal proceedings and increased employer contributions and funding from Council Tax. Poor management of administration costs resulting in poor value for money and reduced value of the Pension Fund potentially resulting in increased employer contributions to ensure the fund is forecasted to meet future commitments.	Yes	●
	Employer Contributions: Employer contributions not amended in line with actuarial recommendations resulting in potential forecasted shortfall in the Pension Fund leading to increased reliance on Council Tax and damage to reputation. Employer contributions not accurately accounted for allowing erroneous entries to appear in the accounts resulting in misrepresentation of the fund value, potential qualification of accounts and loss of reputation.	Yes	●

	Essex Pension Fund Bank Account: Lack of reconciliation of the Essex Pension Fund bank account resulting in erroneous entries remaining undetected (e.g. pension income/expenditure posted to ECC, incorrect amounts posted). Failure to subsequently correct miscoded transactions may result in loss for the Pension Fund and / or Essex County Council.	Yes	

Unregistered Risks Identified & Audited

n/a	None	n/a	n/a

2. Basis of our opinion and assurance statement

Risk rating	Assessment rationale
Critical	Major financial loss – Large increase on project budget/cost: (Greater of **£1.0M** of the total Budget or more than **15 to 30%** of the departmental budget). Statutory intervention triggered. Impacts the whole Council. Cessation of core activities. Strategies not consistent with government's agenda, trends show service is degraded. Failure of major projects – elected Members & Corporate Leadership Team are required to intervene. Intense political and media scrutiny i.e. front-page headlines, TV. Possible criminal, or high profile, civil action against the Council, Members or officers. Life threatening or multiple serious injuries or prolonged work place stress. Severe impact on morale & service performance. Mass strike actions etc.
Major	High financial loss – Significant increase on project budget/cost: (Greater of **£0.5M** of the total Budget or more than **6 to 15%** of the departmental budget). Service budgets exceeded. Significant disruption of core activities. Key targets missed, some services compromised. Management action required to overcome medium term difficulties. Scrutiny required by external agencies, Audit Commission etc. Unfavourable external media coverage. Noticeable impact on public opinion. Serious injuries or stressful experience requiring medical treatment, many work days lost. Major impact on morale & performance of more than 100 staff.
Moderate	Medium financial loss – Small increase on project budget/cost: (Greater of **£0.3M** of the total Budget or more than **3 to 6%** of the departmental budget). Handled within the team. Significant short-term disruption of non-core activities. Standing Orders occasionally not complied with, or services do not fully meet needs. Service action will be required. Scrutiny required by internal committees or Internal Audit to prevent escalation. Probable limited unfavourable media coverage. Injuries or stress level requiring some medical treatment, potentially some work days lost. Some impact on morale & performance of up to 100 staff.
Best Practice	Minimal financial loss – Minimal effect on project budget/cost: (**< 3%** Negligible effect on total Budget or **<1%** of departmental budget) Minor errors in systems/operations or processes requiring action or minor delay without impact on overall schedule. Handled within normal day to day routines. Internal review, unlikely to have impact on the corporate image. Minor injuries or stress with no work days lost or minimal medical treatment. No impact on staff morale.
Level of assurance	**Description**
Full	***Full assurance*** – there is a sound system of internal control designed to achieve the objectives of the system/process and manage the risks to achieving those objectives. Recommendations will normally only be Advice and Best Practice.
Substantial	***Substantial assurance*** – whilst there is basically a sound system of control, there are some areas of weakness, which may put the system/process objectives at risk. There are Moderate recommendations indicating weaknesses but these do not undermine the system's overall integrity. Any Critical recommendation will prevent this assessment, and any Major recommendations relating to part of the system would need to be mitigated by significant strengths elsewhere.
Limited	***Limited assurance*** – there are significant weaknesses in key areas in the systems of control, which put the system/process objectives at risk. There are Major recommendations or a number of moderate recommendations indicating significant failings. Any Critical recommendations relating to part of the system would need to be mitigated by significant strengths elsewhere.
No	***No assurance*** – internal controls are generally weak leaving the system/process open to significant error or abuse. There are Critical recommendations indicating major failings.

Auditors' Responsibilities It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal Audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems. We shall endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, Internal Audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected. Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist, unless we are requested to carry out a special investigation for such activities in a particular area.

3. Advice and Best Practice

	Matters Arising	Potential Risk Implications	Recommendations	Priority	Management Responses and Agreed Actions
Control Design - Lack of reconciliation of apportioned deficit amounts					
1.	The Town and Parish Council deficit liability is apportioned across all Councils on a per capita basis. In apportioning the total to individual parish Councils a transposition error was identified for one Parish Council. This apportionment had not been reconciled resulting in the in year notification to that particular council being understated. This error would have been identified as part of the year end reconciliation process.	The amount collected from individual Town and parish Councils may be incorrect, resulting in over/under payment of the deficit amount.	The apportionment of deficit collection rates across Town and Parish Councils should be reconciled to ensure no errors have occurred before collection schedules are prepared and communicated with the individual Councils. **Audit Note** The Director for the Essex Pension Fund has advised that for future years, all data is being updated and checked as a result of the 2013 Actuarial Valuation	● Advice and Best Practice	Response not required for advice and best practice recommendations.

5. Controls Assessment Schedule

Governance Arrangements Risks:

Lack of knowledge of and failure to apply pension regulations leading to ultra vires acts and a failure to comply with regard to:

- preparing, publishing and maintaining the Statement of Investment Principles, Statement of Compliance, Funding Strategy and Annual Report;
- obtaining actuarial valuations and certificates; and
- providing copies of these documents to stakeholders

resulting in potential loss of reputation, qualification of accounts and legal reprimand.

Lack of knowledge of and a failure to operate best practice resulting in governance arrangements not matching up to recommended best practice leading to loss of reputation and employer and employee confidence.

Control	Control In Place?	Action Plan Ref.
Best practice guidelines are available, and are adhered to wherever possible. Key staff members within the Pension Investment team are aware of best practice guidelines available. Those charged with the governance of the Fund and the Scheme are able to fulfil their responsibilities effectively.	**Yes**	
The Fund's Governance Policy is published, and governance arrangements are subject to review. Required documentation (in accordance with the Local Government Pension Scheme (Administration) Regulations 2008) has been prepared, published and issued. Formal reports and documentation is available for all key stakeholders. Actuarial valuations have been completed and received.	**Yes**	

Investment Management Risks:

Poor strategic planning and response to incidents, changes in markets, rules and regulations leading to failure of the funding strategy resulting in a forecasted inability to pay benefits and a consequent need to raise employer contributions.

Poor security of data leading to potential loss of records resulting in non compliance with regulations and additional staff costs to correct.

Lack of reconciliations between Council records and fund manager records allowing discrepancies between the two remaining undetected and potential errors in the accounts, resulting in qualification of accounts, misrepresentation of fund value and loss of reputation.

Fund assets are not accurately accounted for resulting in potential errors in the accounts and fund valuation leading to inaccurate actuarial conclusions and potential funding shortfall causing increased employer contributions from Council Tax.

Lack of restrictions / guidelines on investments resulting in potential loss of income and capital and providing poor value of money for the Pension Fund.

Control	Control In Place?	Action Plan Ref.
Records retained by Essex County Council, appointed Custodians and Fund Managers are reconciled on a periodic basis.	**Yes**	

Control	Control In Place?	Action Plan Ref.
A reconciliation between book cost and cash is undertaken, with supporting information. Calculations of timing differences between Custodian and Fund Manager are undertaken. The journal updating IFS has supporting evidence, is accurate and is fully authorised.		
Appropriate independent external advisors are engaged, to provide formal advice with a view to mitigating risks and optimising the value of the fund. Strategic plans are in place, to reflect the Fund's investment objectives. The strategy considers the Pension Fund's own liabilities and risk profile. Significant changes in the market are identified promptly and effectively communicated.	**Yes**	

Monitoring of Performance Risks:

Poor contract drafting and / or management allowing poor performance in the supply of services to the pension fund to occur without redress resulting in loss of reputation, reduced investment income, potential legal proceedings and increased employer contributions and funding from Council Tax.

Poor management of administration costs resulting in poor value for money and reduced value of the Pension Fund potentially resulting in increased employer contributions to ensure the fund is forecasted to meet future commitments.

Control	Control In Place?	Action Plan Ref.
An effective contract management framework is in place, with monitoring against benchmarks undertaken. Contracts are regularly reviewed in light of changing market conditions and actual performance. Any breach of investment guidance or contract is identified, and addressed.	**Yes**	
Administration / Fund Manager costs are reviewed on a periodic basis to ensure that value for money is achieved.	**Yes**	

Employer Contributions Risks:

Employer contributions not amended in line with actuarial recommendations resulting in potential forecasted shortfall in the Pension Fund leading to increased reliance on Council Tax and damage to reputation.

Employer contributions not accurately accounted for allowing erroneous entries to appear in the accounts resulting in misrepresentation of the fund value, potential qualification of accounts and loss of reputation.

Control	Control In Place?	Action Plan Ref.
Checks are completed to ensure that all employer contributions are received, are complete, accurate, and accounted for correctly. Contributions are amended in line with actuarial recommendations.	**Yes**	
Contribution rates are accurately applied. A process is in place to verify contributions received. Contributions are amended in line with actuarial recommendations. On an annual basis, an M99 reconciliation is completed.	**Yes**	

Essex Pension Fund Bank Account Risks:

Lack of reconciliation of the Essex Pension Fund bank account resulting in erroneous entries remaining undetected (e.g. pension income/expenditure posted to ECC, incorrect amounts posted).

Failure to subsequently correct miscoded transactions may result in loss for the Pension Fund and / or Essex County Council.

Control	Control In Place?	Action Plan Ref.
The Essex Pension Fund Bank account is subject to reconciliation on a regular basis. Miscodings are promptly identified and amended to the correct cost centre.	**Yes**	

Final Internal Audit Report 2013/14 – Pensions Services Administration (KFS11)

1. Executive Summary

Department: **Corporate Services**

Audit Sponsor: **Kevin McDonald**, Director for Essex Pension Fund

Distribution List: **Kevin McDonald**, **Jody Evans,** Head of Essex Pension Fund, **Joel Ellner,** Team Manager; **Daniel Chessell,** Team Manager, Pensions; **Margaret Lee,** Executive Director for Corporate Services and Corporate Operations; **Cllr Rodney Bass,** Chairman of Essex Pension Fund; **Christine Connolly;** External Audit.

Final Report Issued: **13 March 2014**
Date of last review: March 2013

Overall Opinion

FULL ASSURANCE

Direction of Travel

Control environment has not changed since our prior audit

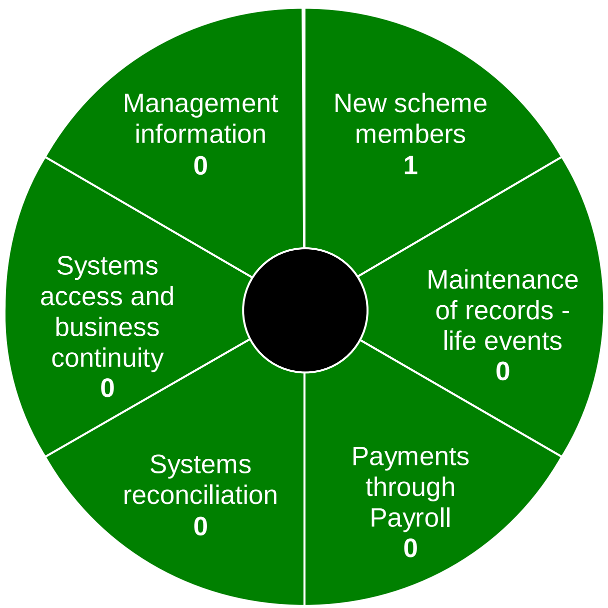
Number of Control Design Issues Identified		Number of Control Operating in Practice Issues Identified		Number of Recommendations	
0	**Critical**	0	**Critical**	**0**	**Made**
0	**Major**	0	**Major**	**tbc**	**Rejected**
0	**Moderate**	0	**Moderate**	**N/A**	**Critical Rejected**
0	**Best Practice**	1	**Best Practice**	**N/A**	**Major Rejected**

Scope of the Review and Limitations:

This audit reviewed the maintenance of pension member scheme records; payroll and lump sum payments; systems access; business continuity; system reconciliations and management information.
The management and controls surrounding the Essex Pension Fund bank reconciliation and coding on the General Ledger were out of scope of this audit, these areas are being reviewed as part of the Pensions Investment audit (KFS10).

Critical and Major Findings and Recommendations

There are no critical or major recommendations.



Each risk area for this review is shown as a segment of the wheel. The key to the colours on the wheel is as follows:

- Red: Critical priority Control Design or Control Operating in Practice issues identified
- Orange: Major priority Control Design or Control Operating in Practice issues identified
- Yellow: Moderate priority Control Design or Control Operating in Practice issues identified
- Green: No / Minor Control Design or Control Operating in Practice Issues identified

Essex County Council

Auditor: Anita Goold

Fieldwork Completed: 7 February 2014

Draft Report Issued: 25 February2014

Management Comments Expected: 18 March 2014

Management Comments Received: 10 March 2014

Final Report: 13 March 2013

Issues raised and officers responsible for implementation:

Name	Critical	Major	Moderate	Best Practice	Total	Agreed
Advice and best practice recommendation	**0**	**0**	**0**	**1**	**1**	N/A

Releasing Internal Audit Reports: All distributed draft and final reports remain the property of the respective Director and the Executive Director for Corporate Services. Approval for distributing this report should be sought from the relevant Director. Care must be taken to protect the control issues identified in this report.

Risk Management: The management of the following risks has been reviewed in this audit. Where appropriate, the Audit Sponsor is responsible for adding new risks identified to the relevant risk register.

Risk Ref	Risk	Risk Already Identified	Risk Managed
Registered Risks Reviewed			
PF0001	**Systems reconciliation:** Loss of connectivity causes an inability to deliver a service for pension's administration and pensioner payroll which may lead to claims being made against the Essex Pension Fund and loss of reputation.	Yes	●
PF0002	**Systems access and business continuity:** System errors will not be identified leading to errors or omissions in the transfer of data between the AXIS modules.	Yes	●
Unregistered Risks Identified & Audited			
N/A	**New scheme members:** New scheme members (including transfers in) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Essex Pension Fund regulations. Supporting documentation for members is not retained resulting in failure to demonstrate members have met the requirements of the scheme.	N/A	●
N/A	**Maintenance of records - life events**: Scheme members' records (including transfers out, retirement, death, deferred membership and changes to working hours, salary and contributions) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Essex Pension Fund regulations and potential for incorrect pension calculations.	N/A	●
N/A	**Payments through Payroll:** New members to the payroll system are not authorised, processed and recorded completely and accurately and in accordance with scheme rules resulting in incorrect and/or illegitimate payments being made to pensioners or dependants and individuals who are no longer eligible. Notifications of deaths are not received and actioned promptly resulting in overpayments of pensions and the potential for fraudulent payments. The recovery of pension overpayments is not managed resulting in financial loss to the Essex Pension Fund. Amendments to payroll data are not authorised, processed and recorded completely and accurately; and checked for accuracy resulting in over/underpayments. Management information and checks on the payroll process are inadequate resulting in errors and fraudulent payments going undetected. Lump sum payments are not authorised and processed correctly resulting in incorrect or potentially fraudulent payments.	N/A	●
N/A	**Systems reconciliation:** Reconciliations between the Essex Pension Fund payroll system and the general ledger are not performed regularly resulting in errors going undetected and inaccurate financial reporting. Reconciliations of payroll, payment file and BACS are not carried out resulting in erroneous and/or fraudulent payments being made. Returned monies are not properly recorded, managed and reconciled resulting in failure to account for such monies and detect any errors.	N/A	●
N/A	**Systems access and business continuity:** Access to AXIS and payroll systems and data is not controlled and restricted to relevant staff, leading to systems and data being amended and/or fraudulently manipulated by unauthorised people. Essex Pension Fund data is not held securely resulting in loss or theft of data.	N/A	●
N/A	**Management information:** Management information is inadequate or incomplete resulting in poor performance management of the pensions and payroll systems.	N/A	●

2. Basis of our opinion and assurance statement

Risk rating	Assessment rationale
Critical	Major financial loss – Large increase on project budget/cost: (Greater of **£1.0M** of the total Budget or more than **15 to 30%** of the departmental budget). Statutory intervention triggered. Impacts the whole Council. Cessation of core activities. Strategies not consistent with government's agenda, trends show service is degraded. Failure of major projects – elected Members and Corporate Leadership Team are required to intervene. Intense political and media scrutiny i.e. front-page headlines, TV. Possible criminal, or high profile, civil action against the Council, Members or officers. Life threatening or multiple serious injuries or prolonged work place stress. Severe impact on morale & service performance. Mass strike actions etc.
Major	High financial loss – Significant increase on project budget/cost: (Greater of **£0.5M** of the total Budget or more than **6 to 15%** of the departmental budget). Service budgets exceeded. Significant disruption of core activities. Key targets missed, some services compromised. Management action required to overcome medium term difficulties. Scrutiny required by external agencies, External Audit etc. Unfavourable external media coverage. Noticeable impact on public opinion. Serious injuries or stressful experience requiring medical treatment, many work days lost. Major impact on morale & performance of more than 100 staff.
Moderate	Medium financial loss – Small increase on project budget/cost: (Greater of **£0.3M** of the total Budget or more than **3 to 6%** of the departmental budget). Handled within the team. Significant short-term disruption of non-core activities. Standing Orders occasionally not complied with, or services do not fully meet needs. Service action will be required. Scrutiny required by internal committees or Internal Audit to prevent escalation. Probable limited unfavourable media coverage. Injuries or stress level requiring some medical treatment, potentially some work days lost. Some impact on morale & performance of up to 100 staff.
Best Practice	Minimal financial loss – Minimal effect on project budget/cost: (**< 3%** Negligible effect on total Budget or **<1%** of departmental budget) Minor errors in systems/operations or processes requiring action or minor delay without impact on overall schedule. Handled within normal day to day routines. Internal review, unlikely to have impact on the corporate image. Minor injuries or stress with no work days lost or minimal medical treatment. No impact on staff morale.

Level of assurance	Description
Full	***Full assurance*** – there is a sound system of internal control designed to achieve the objectives of the system/process and manage the risks to achieving those objectives. Recommendations will normally only be Advice and Best Practice.
Substantial	***Substantial assurance*** – whilst there is basically a sound system of control, there are some areas of weakness, which may put the system/process objectives at risk. There are Moderate recommendations indicating weaknesses but these do not undermine the system's overall integrity. Any Critical recommendation will prevent this assessment, and any Major recommendations relating to part of the system would need to be mitigated by significant strengths elsewhere.
Limited	***Limited assurance*** – there are significant weaknesses in key areas in the systems of control, which put the system/process objectives at risk. There are Major recommendations or a number of moderate recommendations indicating significant failings. Any Critical recommendations relating to part of the system would need to be mitigated by significant strengths elsewhere.
No	***No assurance*** – internal controls are generally weak leaving the system/process open to significant error or abuse. There are Critical recommendations indicating major failings.

Auditors' Responsibilities It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal Audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems. We shall endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, Internal Audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected. Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist, unless we are requested to carry out a special investigation for such activities in a particular area.

3. Advice and Best Practice

	Matters Arising	Potential Risk Implications	Recommendations	Priority	Management Responses and Agreed Actions
Operating Effectiveness - Reconciliation process of new Starters Update Spreadsheet					
1.	Employers provide the Pensions Administration Service with a monthly "Starters Update" spreadsheet which provides details of the new scheme members. The "Starters Update" spreadsheet is formatted to ensure consistency and all spreadsheets are then amalgamated into one spreadsheet which is uploaded onto AXISe. A reconciliation to ensure that the total number of records from each employer had been correctly amalgamated into the spreadsheet is not carried out. Audit testing did not identify any missing records for the sample of months selected. A check of the "Validation" report from AXISe is undertaken to ensure that all records have been completely and accurately transferred from the "Starters Update" spreadsheet. *Audit note:* *The lack of any reconciliation between spreadseets from employers and the 'Starters Update Spreadsheet' was discussed during the audit. This reconciliation has now been introduced.*	**New Scheme Members:** Without a complete reconciliation between source data and the uploaded spreadsheet, there is a potential risk that new starters may be inadvertently missed from the spreadsheet, which remain undetected until the year-end processes are completed leading to an inability to provide assurance that a robust checking process has been completed to ensure that all records have been accurately and appropriately added to AXISe.	As part of the monthly validation process, it is recommended that a reconciliation is carried out between the number of records submitted by each employer, to the number of entries copied into the amalgamated spreadsheet to ensure completeness of data. The process mapping and procedure notes should also be updated accordingly.	● Advice and Best Practice	Discussed at exit meeting, management responses not required.

4. Controls Assessment Schedule

01 New scheme members Risks:

New scheme members (including transfers in) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Essex Pension Fund regulations.

Supporting documentation for members is not retained resulting in failure to demonstrate members have met the requirements of the scheme.

Control	Control In Place?	Action Plan Ref.
Clearly defined processes are in place to authorise and admit new starters and these are complied with. New scheme members are entered onto AXIS accurately and receive a notification of membership in a timely manner.	**Yes**	
The disks received from the admitted bodies are complete and sense checked pre and post input into AXIS to ensure all data has been transferred accurately. All new scheme members entered onto AXIS.	**Yes**	
All documentation relating to manually added scheme members is recorded and notifications sent to scheme members in a timely manner.	**N/A**	
Documentation received and completed for individuals transferring into the Essex Pension Fund is recorded on the system and retained securely. All quotations, calculations, notifications to scheme members and payments are checked by management before payment.	**Yes**	

02 Maintenance of records - life events Risks:

Scheme members' records (including transfers out, retirement, death, deferred membership and changes to working hours, salary and contributions) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Essex Pension Fund regulations and potential for incorrect pension calculations.

Control	Control In Place?	Action Plan Ref.
Deferred membership pensions are independently checked and authorised before they are paid. All documentation is securely retained.	**Yes**	
There is a clearly defined process in place for admitting new retirees onto the Payroll system. This process includes ensuring appropriate authorisation, processing and accurate recording of data in accordance with scheme rules. All documentation in securely retained.	**Yes**	
Documentation is received and retained on notification of death in accordance with regulations. All related documentation is securely retained. Notification of deaths are received and actioned promptly. Pension on death calculations are produced from AXIS and checked for accuracy by an appropriate manager prior to payment.	**Yes**	
Any overpayment which are identified are recovered in accordance with set policy. All documentation is securely retained.	**Yes**	
Procedure notes describing all key processes are complete and adhered to by all Pensions Service Administration staff.	**Yes**	
Transfers out have been calculated in accordance with scheme rules, approved by an authorised manager and all documentation retained securely.	**Yes**	
There is a clearly defined process in place for payment of lump sums. This process includes ensuring appropriate authorisation, processing and accurate recording of data in accordance with scheme rules. All documentation is securely retained.	**Yes**	

03 Payments through Payroll Risks:

Control	Control In Place?	Action Plan Ref.
Amendments to payroll data are in writing and promptly recorded and authorised by management. Amendment reports are produced and checked before the BACS file is sent for payment. Payments are independently checked, correctly authorised, supported by appropriate documentation and calculations have been verified prior to authorisation. Overpayments are identified and recovered in line with set policy. All overpayment calculations have been verified and supporting documentation retained. Lump sum payments are accurate and authorised by appropriate management in accordance with the scheme regulations.	**Yes**	
All new members to the Payroll system are authorised by an appropriate manager in accordance with the scheme rules, ensuring separation of duty is maintained.	**Yes**	
All new members to the Payroll system are authorised by an appropriate manager in accordance with the scheme rules, ensuring separation of duty is maintained.	**Yes**	
Amendment reports are produced and checked before the BACS file is sent for payment. Payments are independently checked, correctly authorised, supported by appropriate documentation and calculations have been verified prior to authorisation.	**Yes**	

04 Systems reconciliation Risks:

Loss of connectivity causes an inability to deliver a service for pension's administration and pensioner payroll which may lead to claims being made against the Essex Pension Fund and loss of reputation.

Reconciliations between the Essex Pension Fund payroll system and the general ledger are not performed regularly resulting in errors going undetected and inaccurate financial reporting.

Reconciliations of payroll, payment file and BACS are not carried out resulting in erroneous and/or fraudulent payments being made.

Returned monies are not properly recorded, managed and reconciled resulting in failure to account for such monies and detect any errors.

Control	Control In Place?	Action Plan Ref.
The Essex Pension Fund Control Accounts are reconciled monthly and appropriate management authorisation is evidenced.	**Yes**	
Procedure notes describing the key processes are followed by staff when performing the various reconciliations.	**Yes**	
Regular reconciliation between the AXIS modules is undertaken to ensure that all data is transferred between modules and is complete and there are no system errors. Appropriate management sign-off is evidenced. Regular reconciliation between IFS and the AXIS modules is completed and approved. Investigation is undertaken if there are any discrepancies.	**Yes**	

05 Systems access and business continuity Risks:

System errors will not be identified leading to errors or omissions in the transfer of data between the AXIS modules.
Access to AXIS and payroll systems and data is not controlled and restricted to relevant staff, leading to systems and data being amended and/or fraudulently manipulated by unauthorised people.
Essex Pension Fund data is not held securely resulting in loss or theft of data.

Control	Control In Place?	Action Plan Ref.
Access permissions and restrictions are in line with Business need and there is appropriate separation of duty. Robust controls exist for the administration of passwords, password changes and account lockout following failed attempts.	**Yes**	
Business continuity / disaster recovery plans are in place if critical systems are unavailable and these are tested regularly.	**Yes**	
Regular back-up of core data is undertaken and tested to ensure adequate recovery processes are in place.	**Yes**	

06 Management information Risks:

Management information is inadequate or incomplete resulting in poor performance management of the pensions and payroll systems.

Control	Control In Place?	Action Plan Ref.
Management information is provided on a regular basis identifying compliments and complaints and also providing information on poor performance. Where complaints or poor performance is identified there is a process in place to address these to a satisfactory outcome.	**Yes**	

AGENDA ITEM 10

Essex Pension Fund Board	EPB/15/14
date: 9 July 2014	

Essex Pension Fund Draft Accounts 2013/14

Report by the Executive Director for Corporate Services & Customer Operations

Enquiries to Samantha Andrews on 01245 436974, Ext: 30974

1. Purpose of the Report

1.1 To provide Members with the draft Pension Fund financial statements for 2013/14; and

1.2 To advise Members of the content and timescale for production of the Pension Fund Annual Report.

2. Recommendation.

2.1 That the Board should note the report.

3. Draft Accounts 2013/14

3.1 The draft County Council Accounts for 2013/14 (incorporating draft Pension Fund financial statements) have been prepared and were submitted to the Audit Committee on 30 June 2014.

3.2 Colleagues from EY are due to commence the external audit on 14 July 2014.

3.3 The final draft accounts will be brought to the next meeting of the Board on 17 September 2014 ahead of the meeting of Essex CC's Audit Committee on 22 September 2014 and the formal conclusion of the audit on 30 September 2014.

3.4 A copy of the Pension Fund's draft financial statements for 2013/14 are attached: **Section Two – Pension Fund Accounts**

4. Pension Fund Annual Report publication

4.1 Under the Local Authority Pension Scheme (Administration) Regulations 2008 a Pension Fund Annual Report is required to be published by 1 December 2014.

4.2 In addition to the financial statements, a number of other documents are required to be included within the Annual Report (e.g. the Funding Strategy Statement, Governance Compliance Statement, Communications Policy Statement, Knowledge and Skill Compliance Statement & Statement of Investment Principles).

4.3 Work is currently underway on compiling the Annual Report and a full list of the contents is attached at Appendix 1. When work has been completed a final draft will be submitted to the Essex Pension Board Chairman for approval. Subsequently a copy of the approved Annual Report will be made available all Board Members.

5. Background papers

5.1 The Local Government Pension Scheme (Administration) Regulations 2008

Pension Fund Annual Report 2013/14 Contents

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.

Pension Fund Accounts

Fund Account for the year ended 31 March 2014

2012/13 £000	Note		2013/14 £000	£000
		Contributions and Benefits		
		Income		
		Contributions receivable		
(47,260)	7	Member contributions	(48,843)	
(177,755)	7	Employers' contributions	(164,798)	
(13,217)	7	Transfers in from other Pension Funds	(10,157)	
(132)		Other income	(66)	
(238,364)		**Total income**		(223,864)
		Expenditure		
		Benefits payable		
154,022	7	Pensions	162,589	
36,138		Commutation of pensions & lump sum retirement benefits	36,518	
4,403		Lump sum death benefits	3,951	
		Payments to and on account of Leavers		
70		Refunds of contributions	29	
6		State scheme premiums	7	
8,851	7	Transfers out to other schemes	9,967	
1,744	9	Administration expenses	2,292	
205,234		**Total expenditure**		215,353
(33,130)		**Net additions from dealings with members**		(8,511)
		Returns on investments		
(71,300)	8	Investment income	(63,564)	
(355,171)	11	Profit and losses on disposal of investments and changes in market value of investments	(330,474)	
3,106	14	Taxes on income	3,010	
17,669	10	Investment management expenses	20,638	
(405,696)		**Net returns on investments**		(370,390)
(438,826)		**Net (increase)/decrease in the assets available for benefits during the year**		(378,901)
(3,519,647)		**Net assets as at 1 April**		(3,958,473)
(3,958,473)		**Net assets as at 31 March**		(4,337,374)

Pension Fund Accounts

Net Assets Statement as at 31 March 2014

31 March 2013 £000	Note		31 March 2014 £000	31 March 2014 £000
	11	**Investments at market value**		
		Investment assets		
179,980		Fixed interest securities	186,598	
2,427,887		Equities	2,644,294	
264,371		Index linked securities	344,996	
195,665		Property	237,300	
222,930		Property unit trusts	231,664	
196,995		Private Equity	212,033	
113,567		Infrastructure	127,236	
30,972		Timber	34,705	
25,332		Active currency	-	
175,598		Other managed funds	185,029	
1,925		Derivative contracts	4,282	
96,481		Cash/deposits	93,508	
10,570		Other investment balances	10,524	
3,942,273				4,312,169
		Investment liabilities		
(18,010)		Derivative contracts	(390)	
(3,191)		Other investment balances	(1,541)	
(21,201)				(1,931)
3,921,072		Total Investments		4,310,238
		Long term assets		
9,414		Contributions due from employers		7,907
	13	**Current assets and liabilities**		
		Current Assets		
17,276		Cash		13,638
17,853		Contributions due from employers and other current assets		18,516
3,965,615				4,350,299
		Current liabilities		
(7,142)		Unpaid benefits and other current liabilities		(12,925)
3,958,473		Net assets of the scheme available to fund benefits		4,337,374

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").

The Essex Pension Fund is part of the Local Government Pension Scheme and is administered by Essex County Council ("the Administering Authority") which is the reporting entity for this pension fund.

Established by the Local Government Superannuation Regulation 1974, the Fund is administered in accordance with the following secondary legislation:

- Local Government Pension Scheme(LGPS) Benefits, Membership and Contribution Regulations 2007 (as amended);
- LGPS (Administration) Regulations 2008 (as amended);
- LGPS (Management and Investment of Funds) Regulations 2009; and
- LGPS (Miscellaneous Amendments) Regulations 2014.

The Fund is a contributory defined benefit pension scheme administered by Essex County Council to provide pensions and other benefits for its employees and those other scheduled Bodies within its area. It 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 **530** 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.

The Council has delegated its pension functions to the Essex Pension Fund Board and Investment Steering Committee. Responsibility for the administration and financial management of the Fund has been delegated to the Executive Director for Corporate Services and Customer Operations along with the Director for Essex Pension Fund.

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 2013/14 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 2013/14 (SORP) and the Financial Reports of Pension Schemes Statement of Recommended Practice (revised May 2007). The accounts are prepared on a going concern basis.

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 2013/14 financial year and its position as at 31 March 2014. 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 2014 using IAS19 methodology is included in the notes to the accounts and can be found at Note 3.3.

3. Actuarial valuation

The contributions payable for 2013/14 were determined by the 2010 Actuarial Valuation.

3.1 Actuarial Valuation 2013

An actuarial valuation of the Essex Pension Fund was carried out as at 31 March 2013 to determine the contribution rates with effect from 1 April 2014 to 31 March 2017. 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 **£3,958m** represented **80%** of the Funding Target liabilities of **£4,878m** at the valuation date. The valuation also showed that a common rate of contribution of **14.3%** 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 **7.2%** of Pensionable Pay for 20 years. This would imply an average employer contribution rate of **21.5%** 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.

The main financial assumptions used were as follows:

	Past and Future liabilities *Rate per annum*
Rate of discount	**5.80%**
Retail Price Index (RPI)	**3.50%**
Consumer Price Index (CPI)	**2.70%**
Rate of increase to pensions in payment (in excess of guaranteed minimum pension)	**3.00%**
Short term pay increase	**In line with CPI assumptions for 2 years to 31 March 2015**
Long term pay increase	**4.50%**

The assets were assessed at market value.

The next triennial actuarial valuation of the Fund is due as at 31 March 2016. Based on the results of this valuation, the contributions payable by the individual employers will be revised with effect from 1 April 2017.

3.2 Actuarial present value of promised retirement benefits

Many of the Fund's employers comply with the accounting disclosure requirements of either IAS 19 or FRS 17. These accounting standards specify the approach taken when calculating liabilities for disclosure in an employer's annual accounts – they do not determine the employer contribution. Employer contributions are determined via the Actuarial Valuation (as described in note 3 above).

3.3 Actuarial present value of promised retirement benefits

Separate to the Actuarial Valuation, IAS 26 requires the present value of the Fund's promised retirement benefits to be disclosed. For this purpose the actuarial assumptions and methodology used are based on IAS 19 rather than the assumptions and methodology used in the Actuarial Valuation 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 a roll forward approach in valuing the Fund's liabilities which were last calculated at the triennial actuarial valuation as at 31 March 2013.

Liabilities are valued using a discount rate based on corporate bond yields. At 31 March 2014 the Actuary has used the point of the Merrill Lynch AA-rated corporate bond curve which is closest to the duration of the Fund's liabilities.

The duration of the Fund's liabilities is the weighted average time to pay each future expected cash flow for each member. This is based on the data from the last actuarial valuation. The Fund's liability duration as at 31 March 2014 is 18 years which in turn means a discount rate of **4.4%** per annum (31 March 2013: 4.3%). The value of the Fund's promised retirement benefits as at 31 March 2014 was **£6,515m** (31 March 2013: £6,585m).

Similar calculations were carried out as per the prior 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 was used. On this basis, the value, for IAS 26 purposes, of the Fund's promised retirement benefits at that date was **£4,720m**.

4. Accounting policies

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 are 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 7 which commences on page 147).

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 7 which commences on page 147).

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**

  This 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 14 (page 162).

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

  This income 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.

- **Income from other investments**

  This income 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**

  This consists primarily of rental income on property leases, and is recognised on a straight line basis over the term of the leases.

- **Change in market value of investments**

  This 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 items

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 that members' leave 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 14).

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.

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 2013/14 this totalled **£1.686m** (2012/13: £1.438m).

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, an element of some managers' fees is performance related, subject to them reaching a trigger point. Performance related fees totalled **£401,000** in 2013/14 (2012/13: £1.466m).

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

4.3 Net Asset Statement

4.3.1 Financial Assets

Financial assets are held at fair value, as at each 31 March, and are recognised 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 in the Fund Account. Acquisition costs are included in the purchase cost of investments.

4.3.2 Valuation of investments

The value of investments is determined as outlined in the following paragraphs.

- **Market Quoted Investments**

  The value of these investments is taken as the bid market price ruling on each 31st March.

- **Unquoted Investments**

  Unquoted equity, and private equity limited partnership, investments are valued based on the latest financial statements published by the respective fund managers. In general these are valued as at each 31 March, in accordance with the guidelines issued by the British Venture Capital Association or an equivalent body. However, in a few cases an estimate of the valuation at 31 March 2014 is made – in such instances, the 31 December valuation is adjusted for payments made to, and received from, the private equity managers in the period 1 January to 31 March.

  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**

  These include investments in limited partnerships, unlisted companies, trust and bonds.

  The valuation of other unquoted securities (typically including pooled investments in property, infrastructure, debt securities and private equity) 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**

  These 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**

  Fixed interest investments 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 11).

- **Direct Property Investments**

  Direct property investments have been valued, at open market value as at 31 March 2014, by Jones Lang LaSalle, Chartered Surveyors. The valuer's opinion of market value and existing use value was primarily derived using comparable recent market transactions on arm's-length terms.

4.3.3 Derivatives

Derivative financial instruments are used to manage exposure to specific risks arising from its investments activities – they are not held 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 (see note 11).

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.

4.3.4 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.

4.3.5 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.

4.3.6 Financial Liabilities

Financial liabilities are recognised on the date the Fund becomes party to the liability at fair value as at each 31 March. From this date, any gains or losses arising from changes in the fair value of the liability are recognised by the Fund.

4.3.7 Contingent liabilities and contingent assets

Contingent liabilities are possible obligations that arise from past events whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the Pension Fund's control.

Contingent assets are possible assets that arise from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the Council's control.

Contingent liabilities are not recognised in the financial statements, but are disclosed as a note to the accounts, unless the possibility of an outflow of resources is remote.
Contingent assets are not recognised in the financial statements but are disclosed as a note to the accounts where an inflow of economic benefits or service potential is probable and can be reliably measured.

4.3.8 Financial Instruments

Financial assets are recognised only when goods or services have been provided or rendered to a third party. Financial liabilities are recognised when the goods or services ordered from a third party have been received by the Fund and the third party has performed its contractual obligations.

The Fund currently only has liabilities carried at amortised cost and the carrying amount for instruments that will mature within the next twelve months from the balance sheet date is assumed to equate to the fair value.

The fair values of loans and receivables at 31st March have been reviewed and were assessed as being the same as the carrying amounts in the Balance Sheet. Assets are carried in the Balance Sheet at fair value. The values are based on the bid price.

When an asset or liability is translated at balance sheet date the gain / loss is taken as unrealised but when the asset or liability is settled (i.e. received / paid) the gain / loss becomes realised.
The Fund has not entered into any financial guarantees that are required to be accounted for as financial instruments.

5. Critical judgements in applying accounting policies

In applying the accounting policies set out within Note 4, the Fund has had to make certain judgements about complex transactions or those involving uncertainty about future events. The critical judgements made in the Fund Accounts are:

- **Use of Financial Instruments**

  The Fund uses derivatives financial instruments to manage its exposure to specific risks arising from its investments. The valuation of these types of investments is highly subjective in nature. They are inherently based on forward-looking estimates and judgements that involve many factors.

- **Unquoted private equity**

  Unquoted private equities are valued by the investment managers using guidelines set out by the British Venture Capital Association. The value of unquoted private equities as at 31 March 2014 was **£212m** (31 March 2013: £197m).

- **Infrastructure**

  Overseas infrastructure values are determined in accordance with generally accepted valuation principles, in compliance with article 5 (3) of the Luxembourg law of 15 June 2004 on investment companies in risk capital. The infrastructure portfolio managed by M&G Investments is valued by the investment manager using guidelines set out by the International Private Equity and Venture Capital (IPEV) Valuation Guidelines. The value of infrastructure as at 31 March 2014 was **£127.2m** (31 March 2013: £113.6m).

- **Timber**

  Timber valuations are determined by independent appraisers that typically estimate fair market values in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) and standards of professional appraisal practice that prevail in the countries where assets are located. The value of timber as at 31 March 2014 was **£34.7m** (31 March 2013: £31m).

- **Pension fund liability**

  The pension fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with International Accounting Standard (IAS) 19. This estimate is subject to significant variances, based on changes to the underlying assumptions.

  As permitted under IAS26, the Fund has opted to disclose the actuarial present value of the promised retirement benefits by way of a note to the Net Asset Statement. This is shown in Note 3.3.

6. Assumptions made about the future and other major sources of estimation uncertainty

The Fund Accounts contains estimated figures that are based on assumptions made about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates. The items in the net assets statement at 31 March 2014 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, a **0.5%** decrease in the discount rate assumption would result in an increase in the pension liability of **£415m**. A **0.5%** increase in the long-term rate of salary increase would increase the value of liabilities by approximately **£46m.** Increasing the long-term rate of improvement used in the mortality projection from **1.5%** to **1.75%** per annual would increase the liability by approximately **£45m**.
Private equity / Infrastructure / Timber	Private equity investments are valued at fair value in accordance with British Venture Capital Association guidelines. These investments are not publicly listed and as such there is a degree of estimation involved in the valuation.	The total private equity investments in the financial statements are **£212m**. There is a risk that this investment may be under or overstated in the accounts.

7. Membership activities

7.1 Membership

31 March 2013		31 March 2014 *Provisional*
45,001	Contributors	**49,516**
42,092	Deferred pensioners	**43,693**
33,873	Pensioners	**35,254**

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

7.2 Pension benefits payable

2012/13 £000		2013/14 £000
57,296	Administering Authority	**60,296**
81,284	Scheduled Bodies	**85,589**
7,327	Admitted Bodies	**7,681**
4,075	Community Admission Bodies	**4,354**
3,580	Transferee Admission Bodies	**4,171**
460	Resolution Bodies	**498**
154,022		**162,589**

7.3 Contributions receivable

7.3.1 By category

Contributions receivable from employers are set out below:

2012/13 £000		2013/14 £000
93,082	Normal	**97,611**
-	Augmentation	**4**
78,669	Deficit	**62,905**
6,004	Other	**4,278**
177,755		**164,798**

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

7.3.2 By type

2012/13			2013/14	
Member £000	Employer £000		Member £000	Employer £000
15,400	50,062	Administering Authority	**15,355**	**49,821**
24,583	87,854	Scheduled Bodies	**26,699**	**92,997**
1,006	20,764	Admitted Bodies	**848**	**4,448**
3,628	10,633	Community Admission Bodies	**3,340**	**9,467**
2,422	7,794	Transferee Admission Bodies	**2,371**	**7,367**
221	648	Resolution Bodies	**230**	**698**
47,260	177,755		**48,843**	**164,798**

During 2013/14 Greenfields paid a total of **£815,000** (2012/13: £689,000) towards the Actuarial deficiency.

The 2013 Actuarial Valuation took place during 2013/14. A number of employers opted to pay in 2013/14 sums based on the emerging results. These were:

- Orchestras Live - **£5,000**;
- Local Valuation Service - **£13,000**;
- Open College Network Eastern Region - **£52,000**;
- Inclusion Trust - **£14,000**; and
- Social Care Institute for Excellence - **£148,000**.

All employers made these payments prior to 31 March 2014.

In 2013/14 Final termination amounts were received from Westminster Drugs Project (**£58,000**), Sodexo Ltd (**£31,000**) and from RM Education (**£60,000**).

In 2012/13 Final termination amounts were received from General Social Care Council (**£13.4m**), Thurrock Thames Gateway Development Corporation **(£2.5m**) and Serco Solutions (**£30,000**).

7.4 Transfers in from, and out to, other pension funds

2012/13			2013/14	
Transfers in £000	Transfers out £000		Transfers in £000	Transfers out £000
336	-	Group transfers	**-**	**-**
12,881	8,851	Individual transfers	**10,157**	**9,967**
13,217	**8,851**	**Total**	**10,157**	**9,967**

8. Investment income

8.1 By Type

2012/13 £000		2013/14 £000
37,863	Dividends from equities	**36,299**
2,558	Income from index linked securities	**2,732**
7,547	Income from pooled property investments	**7,448**
13,131	Net rent from properties	**14,386**
587	Interest from cash deposits	**56**
8,660	Other	**788**
70,346	**Total investment income showing net property rent**	**61,709**
	Add back:	
954	Property operating expenses	**1,855**
71,300	**Total investment income showing gross property rent**	**63,564**

The above table shows rent from properties net of related expenses, but the Fund Account shows rent from properties on a 'gross' basis.

8.2 Investment property net rental

2012/13 £000		2013/14 £000
13,783	Rental Income from investment property	13,825
(661)	Direct operating expenses arising from investment property	(1,251)
13,122	**Total**	**12,574**

8.3 Movement in the fair value of investment properties

	Freehold £000	Leasehold £000	Total £000
Fair value at 1 April 2012	**153,260**	**42,780**	**196,040**
Additions	416	7,541	7,957
Disposals	(100)	(21)	(121)
Net gain/loss on fair value	(7,236)	(975)	(8,211)
Fair value at 31 March 2013	**146,340**	**49,325**	**195,665**
Additions	30,272	9,539	39,811
Disposals	(9,854)	-	(9,854)
Net gain/loss on fair value	7,572	4,106	11,678
Fair value at 31 March 2014	**174,330**	**62,970**	**237,300**

9. Administrative expenses

2012/13 £000		2013/14 £000
1,438	Administration and Processing	1,686
114	Actuarial Fees	194
51	Audit fees	64
134	Legal fees	348
7	Other professional fees	-
1,744		2,292

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

10. Investment management expenses

2012/13 £000		2013/14 £000
15,841	Management fees	17,800
357	Custody fees	527
29	Performance monitoring services	4
459	Advisory fees	407
983	Other	1,900
17,669	**Total**	20,638

11. Investments

11.1 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:

2013			2014	
£m	%		£m	%
465	11.9	Aviva Investors	510	11.8
320	8.2	Baillie Gifford and Co	383	8.9
281	7.2	FIL Pensions Management	-	-
232	5.9	First State Investments (UK) Ltd	217	5.0
180	4.6	Goldman Sachs Asset Management International	186	4.3
3	0.1	Hermes UK Smaller Compancies Focus Fund	4	0.1
1,598	40.7	Legal and General Investment Management	1,531	35.5
(16)	-0.4	Legal and General Investment Management (Currency)	4	0.1
-	-	Longview Partners	290	6.7
301	7.7	Marathon Asset Management Ltd	325	7.6
25	0.6	Mellon Capital Management	-	-
-	-	M&G Investments	277	6.4
156	4.0	M&G Investments Alpha Opportunities	166	3.9
72	1.8	M&G Investments Infracapital	68	1.6
16	0.4	M&G Investments Financing Fund	15	0.3
43	1.1	Partners Group Management II S.à r.l	60	1.4
214	5.4	Private Equity/Other	239	5.6
31	0.8	Stafford Timberland Limited	35	0.8
3,921	100.0		4,310	100.0

11.2 Investments by asset type

The tables below provide an analysis of investment assets by type and show the movements in the market value of the investments, including profits and losses realised on the sales of investments:

2012/13	Value at 1 April 2012	2012/13 Movement					Value at 31 March 2013
		Purchases	Net Transfers	Sale Proceeds	Change in Market Value	Cash Movement	
	£000	£000	£000	£000	£000	£000	£000
Fixed interest securities							
UK quoted	**170,600**	-	-	-	9,380	-	**179,980**
Equities							
UK quoted	**77,437**	54,811	(31,027)	(23,923)	12,065	-	**89,363**
Overseas quoted	**1,114,687**	419,231	(194,123)	(457,019)	123,030	-	**1,005,806**
UK unit trusts	**291,304**	-	30,617	(19,100)	49,086	-	**351,907**
Overseas unit trusts	**702,179**	-	190,020	(56,309)	144,921	-	**980,811**
Global unit trusts	**-**	-	-	-	-	-	**-**
Index linked securities (UK public sector quoted)	**127,446**	81,105	47,789	(17,295)	25,326	-	**264,371**
Property							
UK properties (freehold)	**153,260**	416	-	(100)	(7,236)	-	**146,340**
UK properties (leasehold)	**42,780**	7,541	-	(21)	(975)	-	**49,325**
Property unit trusts	**237,865**	1,702	-	(4,570)	(12,067)	-	**222,930**
Private equity							
UK unquoted	**251**	-	-	(38)	169	-	**382**
Overseas unquoted	**154,173**	52,040	-	(35,402)	25,802	-	**196,613**
Infrastructure							
UK unquoted	**66,762**	2,208	-	(4,157)	6,781	-	**71,594**
overseas unquoted	**36,240**	6,759	-	(2,024)	998	-	**41,973**
Timber (Overseas unquoted)	**28,181**	2,161	-	-	630	-	**30,972**
Active currency (UK unquoted)	**25,676**	-	-	-	(344)	-	**25,332**
Other managed funds							
UK unquoted	**162,687**	6,955	-	(721)	6,677	-	**175,598**
Overseas unquoted	**723**	-	-	(631)	(92)	-	**-**
Derivative future contracts	**21**	-	-	-	(21)	-	**-**
Cash							
Cash deposits held at the custodian/other							
Sterling	**40,951**	-	7,017	-	-	20,471	**68,439**
Foreign currency	**27,588**	-	-	28,630	(28,630)	454	**28,042**
Cash deposits held in the margin account at GSAM							
Sterling	**276**	-	-	-	-	(276)	**-**
Foreign currency	**53**	-	-	329	(329)	(53)	**-**
	3,461,140	634,929	50,293	(592,351)	355,171	20,596	**3,929,778**
Other investment balances							
Assets							
Amounts receivable for sales of investments	**2,591**						**4,156**
Investment income due	**5,494**						**6,414**
Liabilities							
Amounts payable for purchase of investments	**(4,484)**						**(2,990)**
Investment withholding tax payable	**(127)**						**(201)**
Derivative pending foreign currency contracts							
Assets	**21,632**						**1,925**
Liabilities	**(45)**						**(18,010)**
	3,486,201						**3,921,072**

2013/14	Value at 1 April 2013	2013/14 Movement Purchases	Net Transfers	Sale Proceeds	Change in Market Value	Cash Movement	Value at 31 March 2014
	£000	£000	£000	£000	£000	£000	£000
Fixed interest securities							
UK quoted	179,980	-	-	-	6,618	-	186,598
Equities							
UK quoted	89,363	22,180	33,073	(13,678)	(2,305)	-	128,633
Overseas quoted	1,005,806	304,909	(20,700)	(316,123)	79,437	-	1,053,329
UK unit trusts	351,907	48,559	(104,981)	(98,113)	31,395	-	228,767
Overseas unit trusts	980,811	480,613	(479,084)	(372,057)	75,697	-	685,980
Global unit trusts	-	28,972	506,491	-	12,122	-	547,585
Index linked securities (UK public sector quoted)	264,371	60,626	65,114	(27,828)	(17,287)	-	344,996
Properties							
UK properties (freehold)	146,340	30,272	-	(9,854)	7,572	-	174,330
UK properties (leasehold)	49,325	9,539	-	-	4,106	-	62,970
Property unit trusts	222,930	22,304	-	(22,532)	8,962	-	231,664
Private equity							
UK unquoted	382	-	-	-	40	-	422
Overseas unquoted	196,613	34,284	-	(39,912)	20,626	-	211,611
Infrastructure							
UK unquoted	71,594	1,525	-	(7,301)	1,942	-	67,760
overseas unquoted	41,973	22,084	-	(2,829)	(1,752)	-	59,476
Timber (Overseas unquoted)	30,972	5,931	-	(627)	(1,571)	-	34,705
Active currency (UK unquoted)	25,332	-	(23,509)	-	(1,823)	-	-
Other managed funds							
UK unquoted	175,598	4,720	-	(2,383)	7,094	-	185,029
Overseas unquoted	-						-
Derivative future contracts	-	-	-	-	-	-	-
Cash							
Cash deposits held at the custodian/other							
Sterling	68,439	-	-	-	-	(23,727)	44,712
Foreign currency	28,042	-	-	(99,601)	99,601	20,754	48,796
Cash deposits held in the margin account							
Sterling	-	-	-	-	-	-	-
Foreign currency	-	-	-	-	-	-	-
	3,929,778	1,076,518	(23,596)	(1,012,838)	330,474	(2,973)	4,297,363
Other investment balances							
Assets							
Amounts receivable for sales of investments	4,156						3,787
Investment income due	6,414						6,737
Liabilities							
Amounts payable for purchase of investments	(2,990)						(1,428)
Investment withholding tax payable	(201)						(113)
Derivative pending foreign currency contracts							
Assets	1,925						4,282
Liabilities	(18,010)						(390)
	3,921,072						4,310,238

For 2013/14, the total transaction costs were **£1.081m** (2012/13: £1.5m).

31 March 2013 £000		31 March 2014 £000
	Fixed interest securities	
179,980	UK quoted	**186,598**
	Equities	
89,363	UK quoted	**128,633**
1,005,806	Overseas quoted	**1,053,329**
351,907	UK unit trusts	**228,767**
980,811	Overseas unit trusts	**685,980**
-	Global Unit trusts	**547,585**
264,371	**Index linked securities:** UK public sector quoted	**344,996**
	Property	
146,340	UK properties (freehold)	**174,330**
49,325	UK properties (leasehold)	**62,970**
222,930	Property unit trusts	**231,664**
	Private equity	
382	UK unquoted	**422**
196,613	Overseas unquoted	**211,611**
	Infrastructure	
71,594	UK unquoted	**67,760**
41,973	Overseas unquoted	**59,476**
30,972	**Timber**: Overseas unquoted	**34,705**
25,332	**Currency: Overseas unquoted**	**-**
175,598	**Other managed funds**: UK unquoted	**185,029**
	Derivative contracts	
1,925	**Assets**: Derivative pending foreign currency contracts	**4,282**
(18,010)	**Liabilities**: Derivative pending foreign currency contracts	**(390)**
	Cash deposits	
	Cash deposits held at custodian/other	
68,439	Sterling	**44,712**
28,042	Foreign currency	**48,796**
3,913,693		**4,301,255**
	Other investment balances	
	Assets	
4,156	Amounts receivable for sales of investments	**3,787**
6,414	Investment income due	**6,737**
	Liabilities	
(2,990)	Amounts payable for purchase of investments	**(1,428)**
(201)	Investment withholding tax payable	**(113)**
3,921,072	**Value at 31 March**	**4,310,238**

11.3 Pooled investments representing 5% or more of net assets

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

31 March 2013 £000	%		31 March 2014 £000	%
373,996	9.4	Legal & General North America Equity Index	**302,277**	**7.0**
-	-	M&G Global Dividend Fund	**276,855**	**6.4**
-	-	Legal & General FTSE RAFI AW 3000 Index	**270,730**	**6.2**
298,158	7.5	Legal & General Europe (Ex UK) Equity Index	**223,027**	**5.1**
351,907	8.9	Legal & General UK Equity Index	**121,015**	**2.8**
204,579	5.2	Legal & General Japan Equity Index	**100,496**	**2.3**

11.4 Single investments in excess of 5% 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:

31 March 2013 £000	%	Asset type / Asset name	31 March 2014 £000	%
		UK QUOTED EQUITIES		
13,959	*15.6%*	Unilever plc Ord GBP0.031	**14,820**	***11.5%***
1,882	*2.1%*	WPP Plc Ord GBP0.10	**12,355**	***9.6%***
1,069	*1.2%*	Compass Group Ord GBP0.10	**12,007**	***9.3%***
1,035	*1.2%*	Lloyds Banking GP Ord GBP0.1	**10,564**	***8.2%***
9,511	*10.6%*	Sabmiller plc Ord USD0.10	**8,969**	***7.0%***
-	-	Pearson Ord GBP0.25	**8,956**	***7.0%***
2,981	*3.3%*	Arm Holdings Ord GBP0.0005	**7,455**	***5.8%***
5,962	*6.7%*	Aggreko	**2,998**	***2.3%***
		UK INDEX LINKED BONDS		
18,997	*7.2%*	UK (Govt) Treasury IL Stock 2.5% 16 April 2020	**19,684**	***5.7%***
18,709	*7.1%*	UK (Govt) Treasury IL Stock 1.875% 22 Nov 2022	**19,250**	***5.6%***
18,168	*6.9%*	Uk(Govt) Treasury IL Stock 2.5% 17 July 2024	**18,436**	***5.3%***
17,465	*6.6%*	UK (Govt) Treasury IL Stock 1.250% 22 Nov 2027	**17,845**	***5.2%***
15,539	*5.9%*	UK (Govt) Treasury IL Stock 1.250% 22 Nov 2055	**16,960**	***4.9%***
14,951	*5.7%*	UK (Govt) Treasury IL Stock 1.125% 22 Nov 2037	**15,704**	***4.6%***
14,625	*5.5%*	UK (Govt) Treasury IL Stock 2.0% 26 Jan 2035	**15,095**	***4.4%***
14,534	*5.5%*	UK (Govt) Treasury IL Stock 1.250% 22 Nov 2032	**14,950**	***4.3%***
		PROPERTY		
15,575	*8.0%*	48-49 Chancery Lane, London	**17,400**	***7.3%***
13,425	*6.9%*	55-57 Dean Street, London	**13,900**	***5.9%***
11,200	*5.7%*	734-736 Seven Sisters Road, London	**11,500**	***4.8%***
11,060	*5.7%*	971 Great West Road, Brentford	**11,300**	***4.8%***
10,450	*5.3%*	74-82 Western Road, Brighton	**10,400**	***4.4%***

31 March 2013 £000	31 March 2013 %	Asset type / Asset name	31 March 2014 £000	31 March 2014 %
		PROPERTY UNIT TRUSTS		
24,891	*11.2%*	Aviva Investors Property Fund	**27,681**	***11.9%***
15,165	*6.8%*	Blackrock UK Property Fund	**16,156**	***7.0%***
20,959	*9.4%*	Lothbury Property Fund	**12,836**	***5.5%***
6,372	*2.9%*	Industrial Property Investment Fund	**12,802**	***5.5%***
11,244	*5.0%*	Standard Life Property Fund Closed	**12,651**	***5.5%***
11,706	*5.3%*	Standard Life UK Shopping Centre	**12,154**	***5.2%***
		PRIVATE EQUITY		
11,969	*6.1%*	New Mountain Partners	**11,658**	***5.5%***
8,225	*4.2%*	Avenue Europe Special Situations Fund II (Euro)	**10,967**	***5.2%***
11,140	*5.7%*	Providence Debt Opportunity Fund	**10,477**	***4.9%***
11,454	*5.8%*	Apollo Overseas Partners VII	**7,578**	***3.6%***
9,853	*5.0%*	Warburg Pincus Private Equity VIII	**7,491**	***3.5%***
		INFRASTRUCTURE		
71,594	*63.0%*	Infracapital Partners	**67,760**	***53.3%***
37,905	*33.4%*	Partners Group Global Infrastructure 2009 S.C.A., SICAR	**42,875**	***33.7%***
-	-	Partners Group Global Infrastructure 2012 LP	**10,117**	***7.9%***
4,069	*3.6%*	Partners Group Global Infrastructure 2011 S.C.A.,SICAR	**6,484**	***5.1%***
		TIMBER		
30,972	*100.0%*	Stafford Timberland	**34,705**	***100.0%***
		ACTIVE CURRENCY		
25,332	*100.0%*	Mellon Offshore Currency Opp Enhanced UK Equitized Fund	**-**	**-**
		OTHER MANAGED FUNDS		
156,070	*88.9%*	M&G Alpha Opportunities Fund	**166,007**	***89.7%***
16,213	*9.2%*	M&G UK Companies Financing Fund	**14,529**	***7.9%***
		CASH		
41,422	*42.9%*	BNP Paribas Investment Partners GBP	**34,260**	***36.6%***
16,645	*17.3%*	Northern Trust Liquidity Fund US$	**29,635**	***31.7%***
24,007	*24.9%*	Northern Trust Liquidity Fund GBP	**18,876**	***20.2%***
5,695	*5.9%*	BNP Paribas Investment Partners EURO	**2,744**	***2.9%***

11.5 Derivative contracts

11.5.1 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 may be used to gain exposure to an asset more efficiently than holding the underlying asset. The use of derivatives is managed in line with the investment agreement agreed between the Fund and the various investment managers.

11.5.2 Futures

There were no outstanding exchange traded futures contracts as at 31 March 2014 and 31 March 2013.

11.5.3 Forward foreign currency

In order to maintain appropriate diversification and to take advantage of overseas investment returns, **53.1%** of the Fund's portfolio is in overseas stock markets as at 31 March 2014 (31 March 2013: 50.6%).

To reduce the volatility associated with fluctuating currency rates 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.

11.5.4 Open forward currency contracts

Settlement	Currency Bought	Local value 000	Currency sold	Local value 000	Asset value £000	Liability value £000	Net value £000
Up to one month	AUD	(81)	DKK	(6)	-	-	-
Up to one month	AUD	27,451	GBP	15,233	29	-	29
Up to one month	AUD	11	HKD	6	-	-	-
Up to one month	CAD	19,260	GBP	10,439	28	-	28
Up to one month	CHF	28,893	GBP	19,595	24	-	24
Up to one month	EUR	(194)	DKK	-	-	-	-
Up to one month	EUR	78,824	GBP	65,204	-	(40)	(40)
Up to one month	GBP	14,938	AUD	27,451	-	(323)	(323)
Up to one month	GBP	11,020	CAD	19,260	553	-	553
Up to one month	GBP	19,527	CHF	28,893	-	(92)	(92)
Up to one month	GBP	94,352	EUR	113,407	593	-	593
Up to one month	GBP	37	HKD	478	-	-	-
Up to one month	GBP	65,114	JPY	11,158,357	123	-	123
Up to one month	GBP	8,647	SEK	92,351	103	-	103
Up to one month	GBP	83	TRY	297	-	(1)	(1)
Up to one month	GBP	179,472	USD	294,317	2,933	-	2,933
Up to one month	GBP	144	ZAR	2,540	-	(1)	(1)
Up to one month	HKD	498	SGD	-	-	-	-
Up to one month	JPY	11,158,357	GBP	65,525	-	(535)	(535)
Up to one month	SEK	92,351	GBP	8,569	-	(25)	(25)
Up to one month	USD	(1)	AUD	-	-		-
Up to one month	USD	294,317	GBP	176,936	-	(397)	(397)
One to six months	GBP	44,692	AUD	83,132	-	(1,332)	(1,332)
One to six months	GBP	32,535	CAD	60,207	-	(147)	(147)
One to six months	GBP	58,382	CHF	86,349	-	(315)	(315)
One to six months	GBP	206,733	EUR	250,459	-	(411)	(411)
One to six months	GBP	183,764	JPY	31,277,962	1,421	-	1,421
One to six months	GBP	25,618	SEK	276,186	81	-	81
One to six months	GBP	527,543	USD	876,327	1,623	-	1,623
Open forward currency contracts at 31 March 2014					**7,511**	**(3,619)**	**3,892**
Open forward currency contracts at 31 March 2013					***5,696***	***(21,781)***	***(16,085)***

12. 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, Prudential 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, Prudential and Standard Life to the Fund is shown in the table below.

2012/13 £000		2013/14 £000
5,809	Value of AVC fund at beginning of year	**5,840**
364	Employees contributions	**413**
509	Investment income and change in market value	**320**
(842)	Benefits paid and transfers out	**(918)**
5,840		**5,655**

13. Current assets and liabilities

13.1 Analysis of current assets

31 March 2013 £000		31 March 2014 £000	£000
	Cash Balances		
5,742	Cash at bank	**2,659**	
11,534	Cash on short term deposits within 3 months	**10,979**	
17,276			**13,638**
	Debtors and payments in advance		
5,142	Contributions due – employees	**4,027**	
11,787	Contributions due – employers	**11,073**	
924	Sundry debtors	**3,416**	
17,853			**18,516**
35,129	**Total**		**32,154**

13.2 Analysis of debtors

31 March 2013			31 March 2014	
Short term £000	Long term £000		Short term £000	Long term £000
1,381	8,868	Central Government	**1,789**	**7,622**
13,877	483	Other Local Authorities	**11,275**	**235**
-	-	NHS Bodies	**52**	**-**
646	63	Public Funded Bodies	**1,826**	**50**
1,949	-	Other	**3,574**	**-**
17,853	9,414	**Total**	**18,516**	**7,907**

13.3 Analysis of long term debtors

31 March 2013 £000		31 March 2014 £000
625	Financial strain instalments due	**374**
8,789	Other employer contributions due	**7,533**
9,414	**Total**	**7,907**

13.4 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.

13.5 Analysis of current liabilities

31 March 2013 £000		31 March 2014 £000
	Unpaid benefits and other current liabilities	
(485)	Contributions due – employers	**(2,570)**
(3,415)	Investment manager fees payable	**(4,176)**
(3,090)	Benefits payable	**(5,746)**
(152)	Other	**(433)**
(7,142)	**Total**	**(12,925)**

13.6 Analysis of creditors

31 March 2013 £000		31 March 2014 £000
	Creditors and receipts in advance	
(276)	Central Government	**(921)**
(1,276)	Other Local Authorities	**(6,501)**
-	NHS Bodies	**(20)**
(276)	Public Funded Bodies	**(361)**
(5,314)	Other	**(5,122)**
(7,142)	**Total**	**(12,925)**

13.7 Contingent liabilities and contractual commitments

As at 31 March 2014, the Fund had a commitment to contribute a further **£314.8m** to its existing direct and indirect partnership investments, including private equity, infrastructure, timber and financing (31 March 2013: £201m). 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.

14. Taxes on income

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

2012/13 £000		2013/14 £000
472	UK withholding tax	**552**
2,623	Overseas withholding tax	**2,404**
11	Payment to HMRC in respect of returned contributions	**54**
3,106		**3,010**

15. 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.

15.1 Administration of the Fund

The Essex Pension Fund is administered by Essex County Council.

The Council incurred costs of **£1.686m** in 2013/14 (2012/13: £1.438m) 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 **£49.821m** to the Fund in 2013/14 (2012/13: **£50.062m**). No significant amounts were owing to and due to be paid from the Fund in the year.

Surplus cash is invested by the County Council's treasury management team on the sterling money markets, in accordance with the Essex Pension Fund treasury management policy and strategy as agreed by the Essex Pension Fund Board on **6 March 2013**. This service is provided to the Fund at a cost of **£26,000** (2012/13: £25,000).

During the year to 31 March 2014, the Pension Fund had an average investment balance of **£15.119m** (2012/13: £16.990m) earning **£98,000** interest (2012/13: £135,000).

15.2 Governance

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.

15.3 Members of the LGPS

Essex County Council administers the LGPS for its own employees and numerous other bodies. Under legislation introduced in 2003/04, Councillors are also entitled to join the Pension Fund. Those Members of the Essex Pension Board and Investment Steering Committee who, during 2013/14, were also members of the LGPS are listed below.

Representative of scheme members	County Councillors
▪ K. Blackburn	▪ Cllr D. M. Finch
Representative of small admitted bodies	▪ Cllr N. J. Hume
▪ J. Moore	▪ Cllr S. Barker
Representatives for Essex Police and Crime Commissioner	▪ Cllr M. C. Lager
▪ Cllr S. Walsh	
▪ C. Garbett	

As at 31 March 2014 Keith Neale, independent adviser to the Investment Steering Committee (ISC) was in receipt of pension benefits from the Fund during the financial year.

The employees of Essex County Council who hold key positions in the financial management of the Essex Pension Fund during 2013/14 were the Executive Director for Corporate Services and Customer Operations, the Director for Essex Pension Fund and the Head of Essex Pension Fund. During 2013/14 approximately **3%** (2012/13: 3%) of the Executive Director for Corporate Service and Customer Operation’s time was spent on the Pension Fund, with other officers spending 100% of their time in this way. As a consequence, the short term benefits (i.e. pay) associated with the time spent by these staff working on the Fund during 2013/14 was **£141,000** (2012/13: £169,000). The 2013/14 current service cost in respect of these personnel was **£82,000** (2012/13: £81,000). The current service cost is the increase in the value of the Fund’s future liabilities arising out of employees’ on-going membership of the Fund.

16. Financial Instruments

16.1 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.

31 March 2013			Asset type	31 March 2014		
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			
179,980	-	-	Fixed interest securities	186,598	-	-
2,427,887	-	-	Equities	2,644,294	-	-
264,371	-	-	Index linked securities	344,996	-	-
222,930	-	-	Pooled unit trusts	231,664	-	-
196,995	-	-	Private equity	212,033	-	-
109,498	-	-	Infrastructure	120,752	-	-
30,972	-	-	Timber	34,705	-	-
25,332	-	-	Active currency	-	-	-
175,598	-	-	Other managed funds	185,029	-	-
1,925	-	-	Derivative contracts	4,282	-	-
-	113,757	-	Cash deposits	-	107,146	-
10,570	-	-	Other investment balances	10,524	-	-
-	27,267	-	Debtors	-	26,423	-
3,646,058	141,024	-		3,974,877	133,569	-
			Financial liabilities			
(18,010)	-	-	Derivative contracts	(390)	-	-
(3,191)	-	-	Other investments balances	(1,541)	-	-
-	-	(7,142)	Creditors		-	(12,925)
-	-	-	Borrowing		-	-
(21,201)	-	(7,142)		(1,931)	-	(12,925)
3,624,857	141,024	(7,142)	**Balance at the end of the year**	3,972,946	133,569	(12,925)
		3,758,739	**Total**			4,093,590

16.2 Net gains and losses on financial instruments

Asset value as at 31 Mar 2013 £000		Asset value as at 31 Mar 2014 £000
	Financial assets	
392,897	Fair value through profit and loss	**219,266**
(28,959)	Loans and receivables	**99,601**
363,938	**Total**	**318,867**

16.3 Fair value of financial instruments and liabilities

31 March 2013			31 March 2014	
Carry value £000	Fair value £000		Carry value £000	Fair value £000
		Financial assets		
3,646,058	3,646,058	Fair value through profit and loss	**3,974,877**	**3,974,877**
141,024	141,024	Loans and receivables	**133,569**	**133,569**
3,787,082	3,787,082		**4,108,446**	**4,108,446**
		Financial liabilities		
(21,201)	(21,201)	Fair value through profit and loss	**(1,931)**	**(1,931)**
(7,142)	(7,142)	Financial liabilities measured at amortised cost	**(12,925)**	**(12,925)**
(28,343)	(28,343)		**(14,856)**	**(14,856)**
3,758,739	3,758,739	**Total net financial assets**	**4,093,590**	**4,093,590**

16.4 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 where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Assets classified as Level 1 comprise 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 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 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.

  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.

Values as at 31 March 2013				Values as at 31 March 2014		
Level 1 Quoted market prices £000	Level 2 Using observable inputs £000	Level 3 Significant unobservable inputs £000		Level 1 Quoted market prices £000	Level 2 Using observable inputs £000	Level 3 Significant unobservable inputs £000
			Financial assets			
2,884,733	423,860	337,465	Fair value through profit and loss	**3,190,694**	**416,693**	**367,490**
141,024	-	-	Loans and receivables	**133,569**	**-**	**-**
3,025,757	423,860	337,465		**3,324,263**	**416,693**	**367,490**
			Financial liabilities			
(21,201)	-	-	Fair value through profit and loss	**(1,931)**	**-**	**-**
(7,142)	-	-	Financial liabilities measured at amortised cost	**(12,925)**	**-**	**-**
(28,343)	-	-		**(14,856)**	**-**	**-**
2,997,414	423,860	337,465	**Total net assets per level**	**3,309,407**	**416,693**	**367,490**
		3,758,739	**Total Net Assets**			**4,093,590**

17. Nature and Extent of Risks arising

17.1 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 minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole of the Fund's investments. The Fund achieves this through asset diversification to reduce its exposure to a variety of financial risks: market risk; other 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.

17.2 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 the Fund's independent adviser 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).

17.3 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 Fund's overall strategy. The LGPS investment regulations also contain prescribed limits to avoid over-concentration in specific areas.

17.4 Other price risk sensitivity analysis

In consultation with its institutional consultants, Hyman Robertson LLP, 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 2013/14.

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.

31st March 2013 Potential Market movement %	Asset type	31st March 2014 Potential Market movement %
10.0%	UK bonds	**8.7%**
15.5%	UK equities	**16.1%**
19.4%	Overseas equities	**19.4%**
7.9%	UK index linked bonds	**6.5%**
14.5%	Pooled property unit trusts	**14.7%**
27.5%	Private equity	**28.0%**
14.5%	Infrastructure funds	**14.7%**
14.5%	Timber	**14.7%**
14.5%	Property	**14.7%**
0.8%	Cash	**0.6%**
19.4%	Currency active	**19.4%**

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:

31st March 2013 £000	Percentage change %	Value increase £000	Value decrease £000	Asset type	31st March 2014 £000	Percentage change %	Value increase £000	Value decrease £000
96,481	0.8%	97,253	95,709	Cash and equivalents	**93,508**	**0.6%**	**94,069**	**92,947**
				Investment portfolio assets				
179,980	10.0%	197,978	161,982	UK bonds	**186,598**	**8.7%**	**202,832**	**170,364**
89,363	15.5%	103,214	75,512	UK equities	**128,633**	**16.1%**	**149,343**	**107,923**
1,005,806	19.4%	1,200,932	810,680	Overseas equities	**1,053,329**	**19.4%**	**1,257,675**	**848,983**
351,907	15.5%	406,453	297,361	UK equities unit trusts	**228,767**	**16.1%**	**265,598**	**191,936**
980,811	19.4%	1,171,088	790,534	Overseas equities unit trusts	**685,980**	**19.4%**	**819,060**	**552,900**
-	19.4%	-	-	Global unit trusts	**547,585**	**19.4%**	**653,816**	**441,354**
264,371	7.9%	285,256	243,486	UK index linked bonds	**344,996**	**6.5%**	**367,421**	**322,571**
222,930	14.5%	255,255	190,605	Pooled property unit trusts	**231,664**	**14.7%**	**265,719**	**197,609**
196,995	27.5%	251,169	142,821	Private equity	**212,033**	**28.0%**	**271,402**	**152,664**
113,567	14.5%	130,034	97,100	Infrastructure	**127,236**	**14.7%**	**145,940**	**108,532**
30,972	14.5%	35,463	26,481	Timber	**34,705**	**14.7%**	**39,807**	**29,603**
25,332	19.4%	30,246	20,418	Active currency	**-**	**19.4%**	**-**	**-**
175,598	14.5%	201,060	150,136	Other managed funds	**185,029**	**14.7%**	**212,228**	**157,830**
195,665	14.5%	224,036	167,294	Property	**237,300**	**14.7%**	**272,183**	**202,417**
(16,085)	-	(16,085)	(16,085)	Net derivative assets	**3,892**	**-**	**3,892**	**3,892**
6,414	-	6,414	6,414	Investment income due	**6,737**	**-**	**6,737**	**6,737**
(2,990)	-	(2,990)	(2,990)	Amounts payable for purchases	**(1,428)**	**-**	**(1,428)**	**(1,428)**
4,156	-	4,156	4,156	Amounts receivable for sales	**3,787**	**-**	**3,787**	**3,787**
(201)	-	(201)	(201)	WHT payable	**(113)**	**-**	**(113)**	**(113)**
3,921,072		4,580,731	3,261,413	Total assets available to pay benefits	**4,310,238**		**5,029,968**	**3,590,508**

17.5 Sensitivity of funding position

Market conditions and the underlying investment performance of the Fund's assets will have a direct impact on the funding position, albeit that a smoothed rather than spot rate methodology is used by the Fund's Actuary.

Barnett Waddingham's approach adopted at the 2013 Actuarial Valuation includes the following features:

- Financial assumptions such as inflation and the discount rate are based on smoothed market indicators from around the valuation date, specifically over the six month period from 1 January 2013 to 30 June 2013. The discount rate is based on the expected investment return from the Fund's assets.
- The market value of assets at 31 March 2013 is then adjusted to also be smoothed over the same six month period so that a consistent comparison can be made with the liabilities.

17.6 Interest rate risk

The Fund's investments are subject to interest rate risk (i.e. to 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; a passive bond mandate with Legal & General and bond mandates with M&G Investments (M&G) and Goldman Sachs Asset Management (GSAM) in which exposure is actively managed.

The Fund's direct exposure to interest rate movements is shown below. The underlying assets are shown at their fair value.

Asset value as at 31 Mar 2013 £000	Asset type	Asset value as at 31 Mar 2014 £000
96,481	Cash and cash equivalents	**93,508**
17,276	Cash balances	**13,638**
179,980	Fixed interest securities	**186,598**
264,371	Index-linked securities	**344,996**
558,108	**Total assets**	**638,740**

17.7 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.

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 2013 £000	Change in year in the net assets to pay benefits +100 BPS £000	-100 BPS £000	Asset type	Asset value as at 31 Mar 2014 £000	Change in year in the net assets to pay benefits +100 BPS £000	-100 BPS £000
96,481	965	(965)	Cash and cash equivalents	**93,508**	**935**	**(935)**
17,276	173	(173)	Cash balances	**13,638**	**136**	**(136)**
179,980	1,800	(1,800)	Fixed interest securities	**186,598**	**1,866**	**(1,866)**
264,371	2,644	(2,644)	Index-linked securities	**344,996**	**3,450**	**(3,450)**
558,108	5,582	(5,582)	**Total change in assets available**	**638,740**	**6,387**	**(6,387)**

17.8 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 summarises the Fund's currency exposure as at 31 March 2014 and prior year:

31 Mar 2013 £000	Asset type	31 Mar 2014 £000
1,005,806	Overseas equities quoted	**1,053,329**
980,811	Overseas unit trusts	**685,980**
-	Global unit trusts	**547,585**
196,613	Overseas private equity	**211,611**
41,973	Overseas infrastructure	**59,476**
30,972	Overseas timber	**34,705**
2,256,175	**Total oversea assets**	**2,592,686**

17.9 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 **13%** (2012/13: 12%) (approximately one standard deviation) assuming other factors remain constant.

The table below shows the effect of a **13%** (2012/13: 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 2013 £000	Change in year in the net assets to pay benefits +12% £000	-12% £000	Asset type	Asset value as at 31 Mar 2014 £000	Change in year in the net assets to pay benefits +13% £000	-13% £000
1,005,806	1,126,503	885,109	Overseas equities quoted	**1,053,329**	**1,190,262**	**916,396**
980,811	1,098,508	863,114	Overseas unit trusts	**685,980**	**775,157**	**596,803**
-	-	-	Global unit trusts	**547,585**	**618,771**	**476,399**
196,613	220,207	173,019	Overseas private equity	**211,611**	**239,120**	**184,102**
41,973	47,010	36,936	Overseas infrastructure	**59,476**	**67,208**	**51,744**
30,972	34,689	27,255	Overseas timber	**34,705**	**39,217**	**30,193**
2,256,175	**2,526,917**	**1,985,433**	**Total change in assets available**	**2,592,686**	**2,929,735**	**2,255,637**

17.10 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.

17.11 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 Employer team. In addition, member records are undated throughout the year with any new information provided to them. At the end of the financial year employers are required to provide an annual return which is used to reconcile 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 tax backed scheme employer for any new body. An analysis of debtor balances at 31 March 2014 is provided in Note 13.

17.12 Forward currency contracts

Forward currency contracts are undertaken by Legal & General for the passive currency overlay programme and by the Fund's 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 2014 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 11.

Exposure at 31 March 2013 £000	%	Counterparty	Exposure at 31 March 2014 £000	%
148,850	8.7%	Barclays Capital	**210,137**	**11.6%**
225,711	13.3%	BNP Paribas Capital Markets	**66,410**	**3.7%**
-	-	Citigroup	**266,650**	**14.8%**
133,072	7.8%	Australian Commonwealth Bank	**-**	**-**
201,007	11.8%	Credit Suisse AG	**198,546**	**11.0%**
187,096	11.0%	Deutsche Bank AG	**179,669**	**9.9%**
181,720	10.7%	J P Morgan Securities	**234,581**	**13.0%**
82,881	4.9%	Lloyds	**26,148**	**1.4%**
-	-	Merrill Lynch	**59,057**	**3.3%**
140,605	8.3%	RBC Europe	**90,418**	**5.0%**
-	-	RBS	**118,333**	**6.6%**
4,349	0.3%	SEB	**-**	**-**
194,796	11.5%	SG Securities	**100,508**	**5.6%**
184,288	10.8%	UBS	**40,831**	**2.3%**
16,162	0.9%	Westpac Bank Corp	**213,637**	**11.8%**
1,700,537	100.0%	**Total**	**1,804,925**	**100.0%**

17.13 Futures

There were no open future contracts as at 31st March 2013 or 31st March 2014.

17.14 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 2014, the average credit quality of the M&G bond mandate was **BBB+** rated (**A** rated as at 31 March 2013) and the portfolio had suffered four defaults since inception, none have been experienced in the financial year ended 31 March 2014. The average credit rating of the financing fund was **BB+** rated as at 31 March 2014 (BB rated as at 31 March 2013), and the portfolio has not suffered any defaults since inception. The portfolio managed by GSAM as at 31 March 2014 had an average credit quality of **AA+** (AA rated as at 31 March 2013) and has suffered two defaults since inception, both occurring 2011/12.

17.15 Cash held on deposit and current accounts

Cash managed internally – The Fund has operated a separate bank account since 1 April 2010 with Lloyds TSB Bank plc, which is also banker to the Administering Authority. The bank holds an **A-** (A in 2012/13) long term credit rating with Standard and Poor. Cash is invested with Lloyds TSB and 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 2014 **£13.638m** (31 March 2013: £17.276m) 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.

Cash managed externally – The majority of the cash held by the Fund's custodian, the Northern Trust 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 2014, the total balance held in the Sterling, US dollar and Euro AAA money market funds was **£85.515m** with a smaller balance of **£7.748m** held in the custodian current account (31 March 2013: £87.769m and £8.342m 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 2013			31 March 2014	
Rating	**£000**		***Rating***	**£000**
		Cash managed externally		
		Cash held on deposit		
AAA	**47,117**	BNP Paribas Investment Partners	*AAA*	**37,004**
AAA	**40,652**	Northern Trust	*AAA*	**48,511**
		Cash held in Current Account		
AA	**4**	The Bank of New York Mellon	***AA***	**-**
AA-	**8,342**	Northern Trust	***AA-***	**7,748**
A+	**366**	Barclays plc	***A***	**245**
	96,481	**Total cash managed externally**		**93,508**
		Cash managed internally		
		Cash held on deposit		
A+	**3**	Barclays Bank	***A***	**2**
AA-	**6,510**	HSBC	***AA-***	**7,473**
AAA	**-**	IGNIS	***AAA***	**1,502**
A	**5,019**	Royal Bank of Scotland Group	***BBB***	**2,001**
		Cash held in Current Account		
A	**5,744**	Lloyds TSB Bank plc	***A-***	**2,660**
	17,276	**Total cash managed internally**		**13,638**
	113,757	**Total**		**107,146**

The following table summarises the maximum exposure to credit risk of the cash held with Northern Trust and other financial institutions.

31 March 2013 £000		31 March 2014 £000	Maximum limit per Financial Institution £000	Historical risk of default %	Estimated maximum exposure to default and uncollectability £000
	Cash managed externally				
	Deposit with bank and other financial institutions				
87,769	AAA Rated	**85,515**	-	-	-
8,346	AA Rated	**7,748**	-	**0.02%**	**2**
366	A Rated	**245**	-	**0.09%**	-
96,481	**Total cash managed externally**	**93,508**			**2**
	Cash managed internally				
	Deposit with bank and other financial institutions				
-	AAA Rated	**1,502**	**10,000**	-	-
6,510	AA Rated	**7,473**	**10,000**	**0.02%**	**1**
10,766	A Rated	**2,662**	**5,000**	**0.09%**	**2**
-	BBB Rated	**2,001**	**5,000**	**0.20%**	**4**
17,276	**Total cash managed internally**	**13,638**			**7**
113,757	**Total cash**	**107,146**			**9**

17.16 Liquidity Risk

Liquidity risk is the possibility that the Fund might not have adequate cash resources available to meet its financial commitments as they full 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 **26 February 2014**, **24.5%** 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 2014 had immediate access to its pension fund cash holdings held internally and externally of **£107.146m** (31 March 2013: £113.757m). These monies are primarily invested on an overnight 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 Robertson, the Fund is currently preparing a future cash flow forecast modelling tool which will incorporate the effects of the potential regulatory changes to the future of the scheme which is due to take effect in 2014/15.

17.17 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.

17.18 Custody

In 2012 the Fund appointed Northern Trust as a global custodian, replacing the Bank of New York Mellon, with responsibility for safeguarding the assets of the Fund. As at 31 March 2014 Northern Trust had **$5.58 trillion** of assets under custody (31 March 2013: $5.02 trillion) and had a credit rating of **AA-** (31 March 2013: AA-). Monthly reconciliations are performed between the underlying records of the custodian and all investment managers and partnerships of the Fund.

17.19 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 the custodian's performance measurement service to monitor performance. In addition to presenting to the ISC, managers also meet with Fund officers and advisers to review progress.

17.20 Post Balance Sheet Event

As at 31 March 2014 the transfer of probation services from Probations Trusts to Community Rehabilitation Companies and National Probation Services is due to take place on 1 June 2014. As part of the transfer probation services liabilities will transfer to the Greater Manchester Pension Fund for administration by Tameside Metropolitan Borough Council.

All membership will transfer as with effect from the transfer date the liability to pay benefits or a refund of contributions under the Scheme to and in respect of these members will transfer to the Greater Manchester Pension Fund. Early calculations estimate that approximately £55m will be transferred.

As at 31st March 2013, there were no post balance sheet events.

18. 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:

Director of Essex Pension Fund
County Hall
Chelmsford
CM1 1LX

Telephone 01245 431301
E-mail pensions.investments.web@essex.gov.uk

AGENDA ITEM 11

Essex Pension Fund Board	EPB/16/14
Date: 9 July 2014	

Administering Authority Discretions

Report by the Head of the Essex Pension Fund

Enquiries to Jody Evans on 01245 431700

1. Purpose of the Report

1.1 To bring to the attention of the Board the need to review the Fund's Statement of Policy on Discretions in relation to the Local Government Pension Scheme in light of the new scheme regulations now being in place

1.2 To ask the Board to note the ongoing work being undertaken by officers.

2. Recommendations

2.1 That the Board note the ongoing work being undertaken by officers.

2.2 That the Board note a draft revised Statement of Policy will be brought to the Board for approval at its next meeting.

3. Background

3.1 The Pension Fund Board of Essex County Council, as the administering authority of the Essex Pension Fund, is required to make decisions on certain areas of flexibility (referred to as 'discretions') included within the Local Government Pension Scheme Regulations 2013 and related legislation.

3.2 A statement of policy was approved by the Board at its 15 December 2010 meeting and this statement of policy should be reviewed due to the new scheme regulations now being in place.

3.2 Many of the discretions relate to relatively straightforward areas of Administration, such as the frequency of contribution payments to the Fund by employers. However there are some more significant areas such as the process for determining who should receive payment of a death grant.

3.4 There is a statutory requirement to publish a written statement of policy in respect of certain of the discretions and it is best practice to include all relevant discretions in that written statement.

3.5 Any decision relating to the discretionary provisions will be subject to the policy which is current at the time of the relevant event. In the event of a conflict between the discretion as written in the policy and the governing regulations, the governing regulations will prevail.

3.6 The policy decisions apply to all categories of schemes members (e.g. active, deferred, pensioners, pension credit members and dependents) from its effective date until such point as the policy is reviewed.

4. Review of Policy Statement

4.1 The introduction of the new scheme regulations effective from 1 April 2014 means that the policy should now be reviewed to take account of any changes.

4.2 Work by officers is ongoing and a draft revised Statement of Policy will be brought to the Board for approval at its next meeting.

4.2 Individual discretions will be reviewed on a regular basis by officers and any material changes thought necessary will be brought to the Board for approval.

4.3 In any event, it is considered best practice to fully review the policy statement at least every three years.

5. Link to Essex Pension Fund Objectives

5.1 Approval of this Administering Authority Statement of Policy on Discretions is consistent with the following objectives:

- Act with integrity and be accountable to our stakeholders for our decisions, ensuring they are robust and well based
- Deliver a high quality, friendly and informative service to all beneficiaries, potential beneficiaries and employers at the point of need
- Ensure benefits are paid to, and income collected from, the right people at the right time in the right amount

6. Risk Implications

6.1 The approval of this Statement will minimise the risk of inappropriate decisions being made or decisions being made without the relevant approval, which in turn will minimise the risk of any challenge by a stakeholder.

7. Communication Implications

7.1 Once approved, the Statement will be made available on the Essex Pension Fund website and it will be brought to the attention of Fund employers. No further communication will be necessary.

8. Finance and Resources Implications

8.1 There are not expected to be any further finance or resource implications as a result of this Statement being approved.

9. Background Papers

9.1 None

AGENDA ITEM 12

Essex Pension Fund Board	EPB/17/14
date: 9 July 2014	

Investment Steering Committee (ISC) Quarterly Report

Report by the Director for Essex Pension Fund
Enquiries to Kevin McDonald on 01245 431301

1. Purpose of the Report

1.1 To provide a report on ISC activity since the last Board meeting.

2. Recommendations

2.1 That the Board should note the report.

3. Background

3.1 In accordance with its Terms of Reference, the ISC is required to submit quarterly reports on its activities to the Essex Pension Fund Board.

3.2 Since the Board's last meeting the ISC has met twice on 26 March 2014 and 18 June 2014.

4. Report of meeting of ISC on 26 March 2014

4.1 The Committee reviewed the draft Treasury Management Strategy 2014/15, which was brought to the Committee for the first time following the Board's decision of 5 March 2014. It was agreed that an additional annex be included detailing the Essex Pension Fund internally management Counterparty Lending List. The main 2014/15 Treasury Management Strategy is attached at Appendix A.

4.2 A report on the market conditions was discussed followed by the Q4 2013 Investments Tables, which detailed investment manager performance. It was noted that the Fund's value had risen from £4.075bn as at 30 September 2013 to £4.253bn as at 31 December 2013.

4.3 The Committee noted the traffic light report on investment managers and the reports of meetings that officers & advisers had held with First State and Hamilton Lane 19 December 2013 and 3 February 2014 respectively.

4.4 An update was given on the proposal to rebalance the bond portfolio back to its strategic allocation. The Committee agreed to the proposal outlined.

4.5 Presentations were received from Hamilton Lane on private equity and Alpha Opportunities on the bond portfolio.

5. Report of meeting of ISC on 18 June 2014

5.1 The Committee noted its new membership, its revised Terms of Reference, and the appointment of Cllr Bass as Chairman following the May 2014 annual meeting of Essex County Council. Cllr Hume was appointed as Vice Chairman

5.2 The Committee received a report summarising the key areas and providing initial thoughts of the DCLG consultation documentation, published on 1 May 2014 entitled "Opportunities for collaboration, cost saving and efficiencies" along with the analysis undertaken by Hymans Robertson.

5.3 The Committee noted that the Fund had been successful at the annual *Professional Pensions* awards – Essex has been judged to be "Public Sector Scheme of the Year".

5.4 A report on Q1 2014 market conditions was discussed followed by the Investment Tables which detailed Investment Managers performance. It was noted that as at 31 March 2014 the value of the Fund's assets had risen to a provisional value of £4.287bn.

5.5 Consideration was given to reports on Investment Manager monitoring and Investment Structure. The Committee noted the traffic light report on investment managers, the successful implementation of the rebalancing of the bond mandates back to their strategic allocation and the progress of possibly allocating 2% (£80 - £100m) of assets to an illiquid debt opportunity pooled fund. After discussions, it was agreed that a shortlist of preferred managers be interviewed at the Strategy meeting of the 23 July 2014.

5.6 Presentations were received from First State on the emerging market equity portfolio and Aviva on the property portfolio. In respect of the latter it was agreed that the £25m that had yet to be drawn down be released to Aviva as and when required.

6. Link to Essex Pension Fund Objectives

6.1 Investments
To maximise the returns from investments within reasonable risk parameters.
To ensure the Fund is properly managed.

7. Risk Implications

7.1 None other than those already identified as part of the Fund's investment strategy.

8. Communication Implications

8.1 None

9. Finance and Resources Implications

9.1 None other than those already identified as part of the Fund's investment strategy.

10. Background Papers

10.1 ISC meetings of 26 March 2014 and 18 June 2014 – agenda and draft minutes.

Essex Pension Fund

Treasury Management Strategy for 2014/15

Investment Steering Committee 26 March 2014

Introduction

The treasury management activities covered by this document are comprised of two separate areas:

Section A

- The day to day management of the Pension Fund's cash flows and associated short term cash investments known as "In house cash". These activities are undertaken by Essex County Council on behalf of the Pension Fund under a service level agreement.

Section B

- The cash held and managed by the Global Custodian as part of the Fund's investment strategy.

Longer term investments are administered separately by external fund managers and these activities are covered in the Pension Fund Statement of Investment Principles agreed by the Investment Steering Committee each year.

Section A – "In House Cash" Treasury Management Arrangements

In undertaking the treasury management activities for the Essex Pension Fund, in the absence of any specific guidance on treasury management for Local Government Pension Scheme funds, Essex County Council will comply with the Treasury Management in the Public Services: Code of Practice and Cross-Sectorial Guidance Notes (the Treasury Management Code) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

A fundamental aim of treasury management is to effectively control the risks associated with treasury management activities and to pursue value for money, in so far as this is consistent with the effective management of risk.

The Treasury Management Code requires the following:

- A **Policy Statement** which states treasury management policies, objectives and approach to risk management.
- **Treasury Management Practices** (TMPs) which set out the manner in which the organisation will seek to achieve those policies and objectives, and prescribe how these activities will be managed and controlled.
- An annual **Treasury Management Strategy** that outlines the expected treasury activity. The strategy must define the organisation's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Policy Statement and TMP's were updated and approved by the Board in March 2010. As no further changes or updates are considered necessary, neither have been reproduced in this report.

Treasury Management Strategy

The Treasury Management Strategy is set out in the subsequent paragraphs.

Short Term Cash Investment Strategy

- **Key objectives**

  The primary objectives of investment activities are:

  - Firstly, to **safeguard** the principal sums invested;

- Secondly, to ensure adequate **liquidity**; and
- Lastly, to consider investment returns or **yield**.

Surplus cash balances will only be invested on a short term basis (up to a maximum period of 364 days) until the funds are next required. Longer term investments are outside the scope of this document.

- **Investment counterparty selection criteria**

  Funds will be invested according to the Secretary of State's definition of specified investments, these being sterling deposits made for periods of less than one year, offering high security and high liquidity. Specified investments may include deposits with the UK Government, other local authorities, money market funds and bodies of high credit quality.

  A lending list will be compiled to include counterparties satisfying the criteria set out within **Annex 1**. The lending limits that will be applied to counterparties satisfying these criteria are also set out within **Annex 1**. Additional operational market information (e.g. Credit Default Swaps, negative rating watches/outlooks) will also be considered before making any specific investment decisions.

  The criteria for choosing counterparties provide a sound approach to investment in normal market circumstances. However, the Executive Director for Corporate Services will determine the extent to which the criteria set out within **Annex 1** will be applied in practice (i.e. according to prevailing market circumstances).

- **Liquidity**

  Liquidity is defined as having adequate, but not excessive cash resources, borrowing arrangements and overdraft or standby facilities to ensure that funds are available, at all times, for the achievement of the Pension Fund's objectives. In this respect, the Pension Fund will seek to maintain a contingency of at least **£1m** of cash available with a week's notice. This will be in excess of amounts available at short notice for managing expected cash flows.

- **Performance**

  Investment performance will be measured against the Local Authority Seven Day rate; the aim being to achieve investment returns that are equivalent to, or greater than, the average LA7DR for the year (i.e. subject to security and liquidity considerations being fully satisfied).

Interest Rates

An estimate of the movement in interest rates over the forthcoming three years is provided below :-

Expected movement in interest	2013-14	2014-15	2015-16	2016-17

rates	Latest estimate	Estimate	Estimate	Estimate
Bank rate (at each 31 March) Source : Capita (January 2014)	0.5%	0.5%	0.5%	1.25%

The estimated average balance for "In house cash" is around **£15m**. A **1%** movement in interest rates would affect the level of income earned from short term investments by **£150,000**.
Given the short term nature of "In house cash", no limits are proposed on the maximum exposure to fixed or variable rates of interest.

Borrowing

The administering authority does not have the power to borrow on behalf of the Pension Fund, other than temporary borrowing for the following specific purposes detailed in section 5 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 :-

- paying benefits due under the Scheme, or
- to meet investment commitments arising from the implementation of a decision by the Fund to change the balance between different types of investment.

In the context of this Strategy, short term borrowing will only be undertaken in exceptional circumstance to manage unexpected cash flow fluctuations which occur as a result of the above circumstances.

If short term borrowing is necessary, this will be secured via an overdraft facility with the Fund's bankers or by borrowing from the money markets or other local authorities.

Treasury Management Advisors

Essex County Council uses Capita as its treasury management advisor. Capita provides a range of services, including technical advice on treasury matters, economic and interest rate analysis and credit worthiness information. The services received from Capita are kept under regular review.

Whilst Capita provides treasury management advice to the Council, the final decision on treasury matters remains vested with the Essex Pension Fund Board, and for day to day treasury management, with the Executive Director for Corporate Services.

Section B – Custodian Cash Management Arrangements

One of the functions provided by the Fund's custodian, Northern Trust, is a banking service. A separate bank account is set up in each currency required by each mandate. At 28 February 2014, the Fund held £ 102.4m in cash at the custodian. The details are set out in the table below.

28 Feb 2014	£m	%
Sterling	66.8	65.2 %
Dollar	29.9	29.2%
Euro	2.6	2.6%
Other	3.1	3.0%
	102.4	100.0%

If no other action were taken, these monies would remain on deposit with Northern Trust earning interest at the Custodian's rates.

However, in order to maximise the interest earned where possible, a "cash sweep" is in place for amounts held in sterling, US dollar and euro. This ensures that balances in these currencies across the Funds are swept each day into Global Liquidity Funds (GLFs) managed by either BNP Paribas Insticash or Northern Trust Global Funds PLC where they earn a higher rate of interest. The three currencies subject to the sweep typically constitute in excess of 90% of all custodian cash balances.

The GLF vehicles used have obtained, and seek to maintain an Aaa/MR1+ rating from Moody's and an AAA rating from Standard & Poor's. The GLFs operates a soft limit of 10% in any single security, although there are circumstances in which higher holding levels are permitted. A listing of the investment restrictions for both the Northern Trust GLFs and BNP Paribas GLFs are shown are shown in **Annex 3.1** and **3.2.**

The GLFs are open-ended collective investment companies (OEIC). This means that in placing monies in the GLFs via the cash sweep, the Essex Pension Fund becomes a shareholder and has a share in the pool of investments. A GLF must appoint a board of directors, an investment manager, an administrator and custodian. Clients invest, not with the fund manager, but in the fund run by the fund manager. The manager manages the investments of the fund, an administrator runs the back office and the assets are kept in safe-keeping for the fund by the custodian. The GLFs' overall ratings have two components: a credit risk rating (normally AAA) and a market risk rating. To achieve and maintain the rating, the funds must meet rigorous standards on investment quality, diversification and liquidity profile. Both internal management and the rating agencies ensure compliance with regulatory, prudential, investment and credit policy guidelines. The processes are monitored further by administrators, custodians and auditors.

In order to limit the exposure of the Fund to any single financial institution the maximum exposure to each of the Northern Trust and BNP Paribas GLFs has been set at £60m. The total cash holdings with the Custodian will be carefully monitored. If necessary we will negotiate with individual managers in order to arrange for them to make direct investments in other MMF/GLFs, so that the maximum limit of £120m is not breached.

To accommodate the reallocation of £120m between the Bond mandates and the receipt of deficit contributions from employers in April, the Chairman agreed on 17 April 2014 to a temporary variation to the Pension Fund Treasury Management strategy increasing the upper limit on funds placed with the Northern Trust Global Liquidity fund from £60m to £80m. The temporary limit was effective from 17 April to 12 May 2014.

A series of detailed questions on the how the GLFs operate in practice are shown in **Annex 2** of this document.

Counterparty Criteria for Investments – In House Cash Annex 1

Lending List

The Pension Fund will only invest its short term funds with UK banks and building societies, and non UK banks domiciled in a country with a minimum sovereign long term rating of **AA**, that have credit ratings equivalent to or better than the following:

Rating category	**Credit rating agencies**		
	Fitch	**Standard and Poor**	**Moody's**
Short term rating	**F1**	**A-1**	**P-1**
Long term rating	**A**	**A**	**A2**
Viability / financial strength rating	**a**	**-**	**C**
Support rating	**3**	**-**	**-**

The above ratings will be used to determine the pool of counterparties with whom the Pension Fund can transact. Where the counterparty is rated by more than one credit rating agency, the lowest ratings will be used to determine whether or not it is included on the counterparty list. However, financial institutions will only be considered for inclusion if they have a credit rating in each of the four rating categories.

The criteria outlined above will ensure that funds are only invested with high quality counterparties. The short and long term ratings will be used to determine the maximum amount that can be invested with each of these counterparties, and for what period – see lending limits section.

In addition, the Pension Fund may invest its funds with:

- The UK Government.
- Other local authorities.
- Pooled investment vehicles (i.e. Money Market Funds) that have been awarded an **AAA** credit rating.
- Financial institutions fully or part nationalised by the UK Government whose credit ratings do not meet the above criteria.
- Bank subsidiaries and treasury operations which do not have a full set of credit ratings, provided the parent bank has the necessary ratings outlined above. In addition, the subsidiary must itself have a short and long term rating meeting the above criteria or have an unconditional guarantee from the parent bank.

In the event that the Pension Fund's own banker falls below the minimum credit rating criteria outlined above, and is not nationalised or part nationalised, the bank will be used for transactional purposes only, and not as an active outlet for investments.

Notes:

- There are three main credit rating agencies that assign ratings to financial institutions, namely Fitch, Standard and Poor and Moody's. When these agencies assign ratings, they take account of any country specific circumstances. Ratings are therefore applicable worldwide; hence the risk of investing with two different counterparties that have similar ratings is the same, irrespective of their country of origin.
- Definitions of the credit ratings of the three main credit rating agencies are not reproduced within this report, but are available upon request.
- For group organisations, the viability rating of the group will be used if an individual entity does not have a viability rating.
- A minimum viability rating of **a+** will apply to non UK financial institutions.
- Credit ratings are continually monitored, with changes in credit ratings being notified by the Council's treasury management advisors. Counterparties will be removed from the Pension Fund's lending list in the event that they receive a downgrading to their credit rating status below the minimum criteria outlined above.
- Counterparties that are placed on 'negative ratings watch' will remain on the Pension Fund's lending list at the discretion of the Executive Director for Corporate Services, in consultation with the Chairman of the Pension Fund Board (or Deputy Chairman of the Pension Fund Board if the Chairman is unavailable).
- Money Market Funds (MMFs) are short term pooled investments that are placed, by a manager, in a wide range of money market instruments. The size of the investment pool of a MMF enables the manager to not only offer the flexibility of overnight and call money, but also the stability and returns of longer dated deposits. Strict rules and criteria are set down by the official rating agencies, covering the types of investment counterparties used, the maturity distribution of the funds and investment concentrations. The MMFs that the Pension Fund uses will be denominated in sterling and be regulated within the EU.

Lending Limits

For banks and building societies satisfying the 'lending list' criteria, lending limits will be determined with reference to the counterparties' short and long term credit ratings, as follows:

- Investment limit of **£7.5m** for investments of up to **1** year:

Rating category	Credit rating agencies		
	Fitch	**Standard and Poor**	**Moody's**
Short term rating	**F1+**	**A-1+**	**P-1**
Long term rating	**AA-**	**AA-**	**Aa3**

- Investment limit of **£5m** for investments of up to **1** year:

Rating category	Credit rating agencies		
	Fitch	**Standard and Poor**	**Moody's**
Short term rating	**F1**	**A-1**	**P-1**
Long term rating	**A**	**A**	**A2**

Lending limits for other counterparties will be as follows:

- No restrictions will be placed on the amounts that can be invested with the UK Government (i.e. Debt Management Office). It is not possible to set up a separate Pension Fund account with the DMO so funds would be placed via the County Council, although the credit risk would remain with the Pension Fund.
- An investment limit of **£10m** will be applied for investments of up to **one** year with individual Money Market Funds.
- An investment limit of **£7.5m** will be applied for investments of up to **one** year with individual top tier local authorities. Top tier local authorities will include county councils, unitary and metropolitan authorities and London boroughs.
- An investment limit of **£5m** will be applied for investments of up to **one** year with individual lower tier local authorities. Lower tier local authorities will include district / borough councils, and police and fire authorities.
- In addition to the limits outlined above, a further restriction will be applied in respect of investments with non UK financial institutions; that is, a country limit of **£5m** will be applied. The country limit will restrict the total amount that can be invested within any one country outside of the UK at any one time.

Institutional Lending List

Counterparty ESSEX PENSION FUND	Investment limit £m	
UK BANKS		
Barclays Bank		
Group limit	0.00	
Barclays - CALL acct	0.00	
Barclays - fixed term	0.00	
HSBC		
Group limit	7.50	364 days
HSBC - fixed term	7.50	364 days
HSBC - BIBCA (call account)	7.50	call
Lloyds Banking Group		
Group limit	5.00	364 days
Lloyds TSB Bank - fixed term	5.00	364 days
Lloyds TSB current account	5.00	call
Royal Bank of Scotland		
RBS Group Limit	5.00	364 days
RBS - fixed term	5.00	364 days
RBS - CALL account	5.00	call
UK BUILDING SOCIETIES		
Nationwide	5.00	3 mnths
FOREIGN BANKS (Country limit £5m)		
Australia		
* Commonwealth Bank of Australia	5.00	364 days
Canada		
* Total country limit	5.00	
Bank of Montreal	5.00	364 days
Bank of Novia Scotia	5.00	364 days
Netherlands		
* Rabobank	5.00	364 days
Singapore		
* Total country limit	5.00	
Development Bank of Singapore	5.00	364 days
Overseas Chinese Banking Corporation	0.00	364 days
Sweden		
Total Svenska Handlesbanken limit	5.00	364 days
Svenska Handelsbanken - call a/c	5.00	call
OTHER		
Money Market Funds		
Black Rock - Govmnt Sterling fund	10.00	364 days
Standard MMFs (limit £20m)	20.00	364 days
Black Rock - Inst. Sterling Liquidity	10.00	364 days
Ignis - Sterling Liquidity Fund	10.00	364 days
JP Morgan	0.00	
LOCAL AUTHORITIES		
Top Tier Local Authorities	7.50	364 days
- Essex County Council	7.50	364 days
- [Name of Authority]	7.50	364 days
Lower Tier Local Authorities	5.00	364 days
- [Name of Authority]	5.00	364 days
- [Name of Authority]	5.00	364 days

AGENDA ITEM 13

Essex Pension Fund Board	EPB/18/14
Date: 9 July 2014	

Employer Forum 2014

Joint Report by the Director for the Essex Pension Fund & the Head of the Essex Pension Fund

Enquiries to Kevin McDonald on 01245 431301 & Jody Evans on 01245 431700

1. Purpose of the Report

1.1 To provide feedback to the Board from the Essex Pension Fund Forum held on 9th May 2014.

2. Recommendations

2.1 The feedback is noted.

3. Annual Employer Forum - Background

3.1 At the 5th March Pension Board, Members agreed to the date of 9th May for the 2014 Employer Forum

4. Annual Employer Forum - Feedback

4.1 The event covered the following topics:

- Investment performance
- The new Career Average benefit arrangements; and
- Government consultations

4.2 The attendees at the event were both financial and administration professionals.

4.3 Over 60 people attended the Forum representing 25 different Employers. The feedback forms were issued in hard copy at the event and electronically.

4.4 22 Feedback forms have been received.

- We asked attendees “Overall how did you rate the Employer Forum?”
  100% of responses said it was **“good” or “very good”.**

Details of feedback can be found in Annex A

5 Link to the Essex Pension Fund Objective

5.1 Holding an Employers Forum facilitates effective communication between the Fund and its employers.

- Communicate in a friendly, expert and direct way to our stakeholders, treating all our stakeholders equally.
- Ensure our communications are simple, relevant and have impact.
- Deliver information in a way that suits all types of stakeholder.
- Aim for full appreciation of the pension scheme benefits and changes to the scheme by all scheme members, prospective scheme members and employers.

6 Risk Implications

6.1 None

7 Communication Implications

7.1 Holding an Employer Forum facilitates communication between the Fund and its employers

8 Finance and Resource Implications

8.1 The cost of this event was met by the Pension Fund

9 Background Papers

9.1 Annex A

ANNEX A

Employer Forum 9th May 2014

				venue rating					Overall Forum rating				
Feedback form ref	**most like about forum**	**least like about forum**	**any other comments**	very poor	poor	satisfactory	good	very good	very poor	poor	satisfactory	good	very good
1	Explanation of investment strategy		useful for employers at a senior level.. Would like to see essex doing training sessions for staff actually completing the forms and returns					✓					✓
2		more focus needed on deficit of fund. Fund return done without deficit is misleading	Government consultaion necessary but dull				✓					✓	
3	Seminars on reforms						✓					✓	
4	All of it						✓						✓
5	Matt Mott's presentation							✓					✓
6	Range of topics covered		really useful, informative session					✓					✓
7	Investment Section	Seeing Matt Mott's presetation for 2nd time.				✓							✓
8	Varied Streams of pension information		Great information and feedback of requirements/ responsibilities					✓					✓
9	employer responsibilities answered some questions and reassured me we are following correct procedure. LGPS on hand to ank personal questions after							✓					✓
10	Matt Mott's presentation and employer responsibilities		very informative					✓					✓

				venue rating					Overall Forum rating				
Feedback form ref	most like about forum	least like about forum	any other comments	very poor	poor	satisfactory	good	very good	very poor	poor	satisfactory	good	very good
11	The professionalism of delivery and knowledge imparted							✓					✓
12	Matt Mott's presentation - Very Useful		This is the first time I have attended and it was really interesting and worthwhile					✓					✓
13	LGPS 2014 - although whole session was very informative						✓						✓
14	Matt Mott's presentation		Very good overview					✓					✓
15	Information on benefits and investments							✓				✓	
16	Useful overview. Matt Mott's presentation. Need to hear this a few times as so much to take in.		Small organisations like parish councils have no specialists and little software. All support welcome.					✓				✓	
17	LGPS 2014 Scheme overview						✓					✓	
18	LGPS Scheme Overview presented by Matt Mott		Very informative insight into LGPS scheme				✓					✓	
19	Matt Motts session is most relevant to my role		Interesting background information				✓					✓	
20							✓					✓	
21	Diverse / Easy to Understand						✓					✓	
22	LGPS 2014 presentation. There were numerous additional points		Very Professional and focused presentations					✓					✓
			COUNT OF REPSONSES	0	0	1	9	12	0	0	0	9	13
			%	0%	0%	5%	41%	55%	0%	0%	0%	41%	59%

Essex Pension Fund Board	EPB/19/14
date: 9 July 2014	

Essex Pension Fund Board Annual Report

Report by Secretary to the Board

Enquiries to Ian Myers, 01245 430481, ext 20481

1. Purpose of the Report

1.1 To note the Board's 2013/14 Annual Report (attached as Appendix A) which was considered by the Council on 8 July 2014.

2. Recommendation

2.1 That the Board's Annual Report for 2013/14 be noted.

Essex Pension Fund Board

Annual Report 2013/14

July 2014

1. Introduction

1.1 This is the fifth Annual Report of the Essex Pension Fund Board, covering the period from 1 April 2013 until 31 March 2014.

2. Roles and Functions

2.1 The Essex Pension Fund Board was established by the County Council in May 2008 to ensure that the Pension Scheme complied with the best practice principles for governance as required by the amended Local Government Pension Scheme Regulations 1997.

2.2 The Board's terms of reference, as approved by the County Council, are as follows:

To exercise on behalf of the Council all of the powers and duties of the Council in relation to its functions as Administering Authority of the Essex Pension Fund except where they have been specifically delegated by the Council to another Committee or to an officer; this will include the following specific functions:

(i) to monitor and oversee the work of the Essex Pension Fund Investment Steering Committee through its quarterly reports;

(ii) to monitor the administration of the Pension Scheme, including the benefit regulations and payment of pensions and their day-to-day administration including the Internal Disputes Resolution Procedures, and ensure that it delivers best value and complies with best practice guidance where considered appropriate;

(iii) to exercise Pension Fund discretions on behalf of the Administering Authority;

(iv) to determine Pension Fund policy in regard to employer admission arrangements;

(v) to determine the Pension Fund's Funding Strategy and approve its Funding Strategy Statement;

(vi) to receive periodic actuarial valuation reports from the Actuary;

(vii) To co-ordinate Administering Authority responses to consultations by Central Government, professional and other bodies; and

(viii) to consider any views expressed by employing organisations and staff representatives.

2.3 The Board met four times during the period covered by this report; on 10 July, 18 September and 9 December 2013 and 15 March 2014.

3. Membership

3.1 The Board has 14 members. These represent Essex County Council, the other local authorities in Essex (including Unitary Councils), the Essex Police and Crime Commissioner, Essex Fire Authority, Scheme members and Smaller Employing Bodies (i.e. those which are not already specifically represented on the Board).

3.2 The membership of the Board as at 31 March 2014 was as follows:

Essex County Council (6)

County Councillor Susan Barker	
County Councillor Rodney Bass	Chairman
County Councillor Karen Clempner	
County Councillor Norman Hume	Vice-Chairman
County Councillor Nigel Le Gresley	
County Councillor Jon Whitehouse	

District/Borough Councils in Essex (2)

District Councillor John Archer	Maldon
Borough Councillor Mrs Pamela Challis	Castle Point

Unitary Councils in Essex (2)

Borough Councillor Gerard Rice	Thurrock
Borough Councillor Andrew Moring	Southend-on-Sea

Essex Police and Crime Commissioner(1)
Mr Charles Garbett

Essex Fire Authority (1)
County Councillor Mike Danvers

Scheme Members (nominated by UNISON) (1)
Mr Keith Blackburn

Smaller Employing Bodies (1)
Mrs Jenny Moore

4. Dimensions of the Fund

4.1 Based on the draft accounts, as at 31 March 2014 the value of the Fund's assets was £4.337 billion.

4.2 The total value of pensions paid during 2013/14 was £162.5m, together with other benefits totalling £41.5m. The average value of pension paid was £4,612.

4.3 The total number of beneficiaries are as follows:

	2013	2014
Contributors	45,001	49,516
Pensioners/dependents	33,873	35,254
Deferred Members	42,092	43,693
Total	120,966	128,463

*Provisional numbers

(Deferred Members are former employees who had chosen not to transfer their pension rights.)

4.4 The Board exercises on behalf of the Council the management of the Pension Fund whose membership comes from around 530 separate Employing Bodies, including:

- Essex County Council, Unitary, Borough, City and District Employers
- Incorporated Colleges
- Schools and Academies
- Town and Parish Councils
- Other Scheduled Bodies
- Small Admitted Bodies
- Admitted Bodies
- Community Admission Bodies.

5. Work of the Board

5.1 The following major issues were considered by the Board between 1 April 2013 and 31 March 2014:

Reform of the Local Government Pension Scheme

The Board has kept up-to-date with the latest developments regarding the Government's proposals for the reform of the Local Government Pension Scheme. The Board has responded to consultations on the draft Regulations and the continued membership of councillors in the Scheme. The Board has also given evidence to the Department of Communities and Local Government on the future structure of the Scheme.

The Chairman of the Board wrote to the Parliamentary Under-Secretary of State in the Department for Communities and Local Government expressing serious concerns about the co-ordination, clarity and timeliness of the development of new Regulations that would apply to the Scheme. The continued delay in the publication of the Regulations could adversely impact on the timely implementation of required updates to Fund systems and processes and an entry was added to the Risk Register to reflect this.

Reviewing the Funding Strategy Statement

The Funding Strategy Statement establishes a clear and transparent fund-specific strategy which identifies how employer pension liabilities are to be met going forward. The Statement has been reviewed in the light of the Actuarial Valuation as at 31 March 2013 and the consultation exercise with the Fund's

Employer bodies. The feedback received from the consultation had not required any significant changes to be made to the draft FSS.

All Employer Bodies have been notified of their revised contribution results (a further review for Academies will take place later this year in the light of potential pooling proposals). The Funding level valuation was 80% compared to 71% at the time of the last valuation. The improved funding level reflected better investment returns and the use of an economic model for discount rate calculations rather than a gilts plus model. However, the ongoing cost of the future service increased to 14.3% of pensionable pay compared to 12.2% at the time of the last valuation - due partly to more cautious actuarial assumptions on future investment returns and the anticipated increasing cost of implementing transitional arrangements arising from the new Career Average scheme.

The key points of the proposed FSS were:

- There would normally be no net reduction in payments where a deficit existed;
- The aim would be to provide payment options based on stability of contributions (generally within 1% of payroll rate);
- The starting point for consideration of the length of time over which deficit would be payable was the 2010 deficit duration less three years;
- Annual up-front payment of deficit allowable;
- Triennial up-front payment of deficit allowable;
- Stepped introduction of new rates would be permissible if required.

Recovery periods for each Employer body were variable reflecting each unique employer profile and different joining dates. The majority of major tax raising Employer bodies had opted for an annual up- front payment to be made in April each year.

There would be the opportunity for interim reviews of the FSS prior to the next Triennial valuation.

Other Issues
Amongst the other issues considered by the Board have been:

- approval of proposals to appoint a new pensions administration software provider from a collaborative procurement framework;

- reports to each meeting providing an update on Pension Fund activity with regard to the Business Plan, risk management and measurement of progress against objectives (scorecard);

- reviewed of the Fund’s Governance Policy and Compliance Statement;

- approval of a response to the Department for Communities and Local Government’s consultation on pooling arrangements for Academies with the Local Government Pension Scheme;

- agreement to the extension of the contract with Hymans Robertson as Independent Governance and Administration Adviser to the Board and agreement to the process for proceeding with the procurement of the contract;

- reports from Internal Audit (Essex County Council) reviewing their previous year's work with regard to the Pension Fund and Pensions Administration and outlining their planned work for the coming year. The Board was pleased to note the positive outcome from the two audits undertaken during 2012/13 with the award of Full Assurance in respect of Pension Services Administration and Pension Investment; and

- the receipt of quarterly reports on the work of the Essex Pension Fund Investment Steering Committee (ISC).

Award

Essex won the award for "Pension Fund of the Year" at a ceremony in London organised by *Local Government Chronicle*. In a two stage process, 10 finalist Funds from throughout the Local Government Pension Scheme were initially selected, followed by a shortlist which saw Essex joined by the larger Greater Manchester Fund and Strathclyde (the biggest Fund in the country). It was particularly pleasing that the judges recognised Essex's achievements against other Funds across the following criteria:

1. the Fund's annual report and other communications with its members and employing authorities;

2. the degree to which the Fund had met all its objectives, including performance objectives; and

3. innovations introduced during the year which improved the service provided to pensioners and/or contributors.

Member Training

The Board has continued to demonstrate its commitment to training and development, with a view to ensuring that Members are able to fulfil their roles effectively. An updated training strategy and plan has been approved based on targeted training that is timely and directly relevant to the Board's activities as set out in the Fund's 3-year business plan. New members of the Board have received induction training and all members have been strongly encouraged to participate in a range of training courses and events, both internal and external. In addition, the calendar of meetings included a separate training session and ISC Members attended a training seminar in October arranged by Baillie Gifford.

Details of Members' attendance at Essex Pension Fund Board and Investment Steering Committee meetings and training events (internal and external) are recorded throughout the year and will be presented to the Board at its July 2014 meeting. They are also reported on an ongoing basis as part of the Board’s assessment of its performance against objectives identified in the Business Plan.

During 2013/14, internal training sessions have covered the following issues:
- induction training for new Members
- Actuarial Valuations
- Funding Strategies
- governance
- financial services procurement

6. Future Work Programme

6.1 The Board maintains a forward plan of its forthcoming work (the Forward Look) which identifies items to be brought before Members over time and programmes tasks for future years. The document is reported to each Board meeting.

6.2 In addition to the regular standing items, the reform of the Local Government Pension Scheme remains an issue for consideration in 2014/15.

AGENDA ITEM 15

Essex Pension Fund Board	EPB/20/14
date: 9 July 2014	

Annual Review of Member Attendance

Report by the Secretary to the Board

Enquiries to Ian Myers on 01245 430481 (ext 20481)

1. Purpose of the Report

1.1 To detail members' attendance at Board and Investment Steering Committee (ISC) meetings and training events for the period 1 March 2013 to 28 February 2014.

2. Recommendation.

2.1 That the attendance of members at Essex Pension Fund Board and ISC meetings and training events, as shown in Annexes A and B to this report, be noted.

Essex Pension Fund Board Attendance												
	Board meetings and internal training - 1 March 2013 to 28 February 2014									Attendance		
Event	06-Mar Training	06-Mar Board	10-Jul Training	10-Jul Board	18-Sep Training	18-Sep Board	09-Dec Training	09-Dec Board	22-Jan Training	Possible and/or Required	Actual	%
Training Event theme			Induction		Funding Strategy		Standards & Practices		Governance			
ECC												
R Bass	✓	✓		✓		✓		✓	✓	**8**	**6**	**75%**
J Aldridge										**2**	**0**	**0%**
D Finch	✓	✓								**2**	**2**	**100%**
N Hume		✓		✓	✓	✓		✓		**8**	**5**	**63%**
M Lager	✓	✓								**2**	**2**	**100%**
S Barker	✓	✓		✓	✓	✓	✓	✓	✓	**8**	**8**	**100%**
K Clempner			✓	✓	✓	✓	✓	✓	✓	**7**	**7**	**100%**
N LeGresley			✓	✓			✓	✓	✓	**7**	**5**	**71%**
J Whitehouse			✓	✓	✓	✓	✓	✓	✓	**7**	**7**	**100%**
M Mackrory (sub)					✓		✓		✓	**3**	**3**	**100%**
J Spence (sub)			✓							**4**	**1**	**25%**
K Bobbin (sub)			✓		✓		✓		✓	**4**	**4**	**100%**
District/Borough Councils												
J Archer				✓			✓	✓	✓	**8**	**4**	**50%**
P Challis	✓	✓		✓		✓	✓	✓	✓	**8**	**7**	**88%**
Unitary Councils												
M Healy										**2**	**0**	**0%**
B Kelly										**2**	**0**	**0%**
G Rice										**7**	**0**	**0%**
A Moring			✓	✓	✓	✓				**7**	**4**	**57%**
Essex Police Authority												
C Garbett	✓	✓		✓		✓			✓	**8**	**5**	**63%**
Essex Fire Authority												
E Johnson	✓	✓								**2**	**2**	**100%**
M Danvers				✓		✓				**7**	**2**	**29%**
Smaller Employing Bodies												
J Moore	✓	✓		✓	✓	✓				**8**	**5**	**63%**
Scheme Members												
K Blackburn		✓		✓	✓	✓	✓	✓	✓	**8**	**7**	**88%**

*Substitutes are not required to attend all meetings

Attendance at Meetings of the Investment Steering Committee

									12 months Attendance		
	27-Mar-13	20-Jun-13	24-Jul-13	1-3 Oct-13	27-Nov-13	24-Feb-14	26-Mar-14	18-Jun-14	Possible	Actual	%
Meeting type	Quarterly	Quarterly	Strategy	Baillie Gifford	Quarterly	Quarterly	Quarterly	Quarterly			
Recommended Attendance	All	All	All	All	All	All	All	All			
Current ISC Members											
R Bass	✓	✓	✓	✓	✓	✓	✓	✓	8	8	100%
N Hume	✓	✓	✓	✓			✓	✓	8	6	75%
S Barker		✓	✓	✓	✓	✓	✓	✓	7	7	100%
K Clempner		✓	✓	✓	✓	✓	✓	✓	7	7	100%
J Whitehouse		✓	✓	✓	✓	✓	✓	✓	7	7	100%
N LeGresley		✓		✓	✓	✓	✓	✓	7	6	86%
Current ISC Substitutes											
J Spence									6	0	0%
K Bobbin		✓	✓		✓			✓	6	4	67%
M Mackrory									6	0	0%
J Huntman									3	0	0%
W. Archibald									1	0	0%
Former ISC Members											
D Finch											
M Lager	✓										
J Aldridge											
M Mackrory	✓										
Former ISC Substitutes											
S Barker	✓										
Observers											
J Archer (LGPS employers)	✓	✓	✓	✓	✓	✓	✓		8	7	88%
K Blackburn (LGPS employees)	✓	✓	✓	✓	✓	✓	✓	✓	8	8	100%
Included in apologies											

AGENDA ITEM 16

Essex Pension Fund Board	EPB/21/14
date: 9 July 2014	

Forward Look

Report by the Secretary to the Board

Enquiries: Ian Myers, Corporate Law & Assurance, 01245 430481, Ext 20481

1. Purpose of the Report

1.1 To present a Forward Look detailing the Board's future business.

2. Recommendations

2.1 That the Forward Look attached as Appendix A be noted and approved.

Appendix A

Essex Pension Fund Board
Forward Look

Notes:

There will also be a strategy day held in November 2014 and half day training sessions in May 2014 and January and May 2015.

Meeting	Agenda Item	Type
17 September 2014	Pre-Board Training Board meeting: LGPS Reform update Update on Pension Fund Activity: Business Plans, Risks and Measurement against Fund Objectives Essex Pension Fund 2013/14 Accounts External Auditors Report Investment Steering Committee	Every meeting Every meeting during 2014 Every meeting Annual item Annual item Every meeting
10 December 2014	Pre-Board Training Board meeting: LGPS Reform update Update on Pension Fund Activity: Business Plans, Risks and Measurement against Fund Objectives Governance Policy and Compliance Statement Investment Steering Committee Calendar of Meetings for 2015/16 municipal year	Every meeting Every meeting during 2014 Every meeting Annual item Every meeting Annual item