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Brent

Brent Pension Fund Sub-Committee

Tuesday 25 February 2014 at 6.30 pm
Boardrooms 3, 4 and 5 - Brent Civic Centre, Engineers Way, Wembley, HA9 0FJ

Membership:

Members Councillors:	**first alternates** Councillors:	**second alternates** Councillors:
S Choudhary (Chair)	Hirani	Hossain
Crane (Vice-Chair)	Harrison	Hector
Arnold	Mitchell Murray	Gladbaum
Mrs Bacchus	Oladapo	Daly
Brown	Lorber	
Hashmi	CJ Patel	
BM Patel	HB Patel	Baker

Non Voting Co-opted Members

George Fraser	Employees
Ashok Patel	College of North West London

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democracy.brent.gov.uk

The press and public are welcome to attend this meeting

recycle for Brent

Agenda

Introductions, if appropriate.

Apologies for absence and clarification of alternate members

Item		Page
1	**Declarations of personal and prejudicial interests** Members are invited to declare at this stage of the meeting, any relevant financial or other interest in the items on this agenda.	
2	**Deputations (if any)**	
3	**Minutes of the previous meeting held on 19 November 2013** The minutes are attached.	1 - 6
4	**Matters arising**	
5	**Presentation by Henderson - Total Return Bond Fund** Members will receive a presentation by Henderson representatives on the Total Return Bond Fund.	
6	**Quarterly monitoring report on fund activity** This report provides a summary of the Fund's activity during the quarter ended 31 December 2013. It examines the actions taken, the economic and market background, and investment performance, as well as commenting on events in the quarter.	7 - 28

7 Funding Strategy Statement - triennial update 29 - 70

To comply with regulation 58 of the Local Government Pension Scheme Regulations 2013, the Brent Pension Fund must prepare, maintain and publish a written statement setting out its funding strategy. A formally approved Funding Strategy Statement is published in the Brent Pension Fund Annual Report. The Fund's proposed FSS is attached at Appendix 1.

8 Update on joining a collective investment vehicle for London pension funds and commitments for capital 71 - 100

The report is attached.

9 Date of next meeting

The next meeting of the Brent Pension Fund Sub-Committee will be confirmed at the Annual Council meeting on 4 June 2014.

10 Any other urgent business

Notice of items to be raised under this heading must be given in writing to the Democratic Services Manager or his representative before the meeting in accordance with Standing Order 64.

11 Review of Asset Allocation

This report is not for publication as it contains exempt information as specified in Schedule 12A of the Local Government Act 1972, namely information relating to the financial or business affairs of particular persons (including the authority holding that information).

12 Actuarial Contract - Annual Review

This report is not for publication as it contains exempt information as specified in Schedule 12A of the Local Government Act 1972, namely information relating to the financial or business affairs of particular persons (including the authority holding that information).

- Please remember to ***SWITCH OFF*** your mobile phone during the meeting.
- The meeting room is accessible by lift and seats will be provided for members of the public.

LONDON BOROUGH OF BRENT

MINUTES OF THE BRENT PENSION FUND SUB-COMMITTEE
Tuesday 19 November 2013 at 6.30 pm

PRESENT: Councillor S Choudhary (Chair) and Councillors Arnold, Brown, Hashmi, Hector (alternate for Crane), Oladapo (alternate for Mrs Bacchus), BM Patel and George Fraser

Apologies for absence were received from: Councillors Crane, Mrs Bacchus and Ashok Patel

1. **Declarations of personal and prejudicial interests**

   None declared.

2. **Minutes of the previous meeting**

   RESOLVED:-

   that the minutes of the previous meeting held on 7 October 2013 be approved as an accurate record of the meeting.

3. **Matters arising**

   None.

4. **Deputations**

   None.

5. **Monitoring report on fund activity for the quarter ended September 2013**

   Members considered a report that provided a summary of the Fund's activity during the quarter ended 30 September 2013. In highlighting the Fund's main activity in the quarter, Anthony Dodridge, Head of Exchequer and Investment informed members that the Fund had increased in value by £7.6m from £540.8m to £548.4m during the quarter ended 30 September 2013 and the Fund's return of 1.5% underperformed its quarterly benchmark of 2.5%. Following the quarter ended 30 September 2013, the Fund had continued to increase in value by an estimated £12.9m to £561.3m during the month of October 2013

   Members heard that the main negative relative performers compared to benchmark were private equity and infrastructure. He continued that the 12-month return as at 30 September 2013 continued to remain in double-digit territory at 11.0%, albeit lagging behind its 12.1% benchmark. The Head of Exchequer and Investment informed members that the Fund return for the 3 years ended 30 September 2013 was an annualised 6.5% p.a., which was identical to its long term investment return target of 6.5% p.a.

Peter Davies, Independent Adviser to the Fund presented his quarterly report to the Sub-Committee. Members heard that the UK economy grew by 0.7% in the second quarter with all areas of the economy contributing. Together with positive industry surveys, this caused a sharp increase in forecasts for growth in 2013 and 2014 to 1.4%. The second-quarter growth in the Eurozone turned positive for the first time in six quarters. The Japanese and Chinese economies also maintained their growth levels, although there had been slight reductions in the outlook for the United States and the Emerging Markets.

The Independent Adviser continued that equities had risen by some 5% in July, but most of this gain had been lost by the end of August, partly on fears that the chemical attacks in Syria would provoke military intervention by the Western powers. Within the UK Equity market, the medium- and small-cap sectors continued to outpace the FTSE 100 stocks by a wide margin. Provided the US situation is resolved soon, the improving economic outlook in the UK and Europe should underpin equity markets there, while the eventual start of tapering by the Federal Reserve was likely to cause US bond yields to move higher.

In response to Members' questions, the Independent Adviser stated that it was unlikely that interest rates would be raised within the foreseeable future for fear that a rise in rates could depress spending and growth. Members also heard that there had been very little changes in the bond and currency markets.

RESOLVED:

That the quarterly investment report for the period ended 30 September 2013 be noted.

6. **London pension fund collaboration**

The Sub-Committee received a report that sought their support to investigate and establish collective investment vehicle (CIV). Anthony Dodridge, Head of Exchequer and Investment explained that the establishment of CIV which was being led by Wandsworth Council was a voluntary structure which would harness the joint purchasing power of participating boroughs. He stressed that participating boroughs in the CIV would retain their autonomy in asset allocation and funding strategy whilst providing them with a wide choice of funds within each asset class, selection of fund managers, negotiation and monitoring of fee and service level. As each participating authority was expected to commit up to £25,000 towards meeting the cost of creating such a London-wide vehicle he suggested that authority be delegated to the Chief Finance Officer to approve such expenditure up to a limit of £25,000.

In the discussion that followed, Members enquired as to whether the financial commitment would be borne by the Council or the Fund and whether officers had given any thoughts to the prospect of less than thirty three London boroughs committing to join the scheme. Officers were also asked to clarify the implications of CIV on member control and autonomy.

Conrad Hall, Chief Finance Officer confirmed that the expense of up to £25,000 towards the investigation and establishment of a CIV would be borne by the Fund. Members heard that all London boroughs were working towards committing to the CIV and that if that was not the case, the decision to proceed would be reviewed. He continued that CIV would provide an expedient way of enhancing investment objectives of the Fund without undermining member control and autonomy.

RESOLVED:

that the investigation and establishment of a collective investment vehicle (CIV) be supported and that delegated authority be granted to the Chief Finance Officer to approve expenditure relating to the investigation and set up costs of the CIV up to a limit of £25,000.

7. **Use of alternative indices**

At its meeting of 25 June 2013, members of the Sub-Committee received a a presentation on alternative indices by Legal & General. Following the presentation, members decided that the Head of Exchequer and Investment would produce a follow-on report to the Sub-Committee on the use of alternative indices and any recommendations in relation to the Fund.

Anthony Dodridge, Head of Exchequer and Investment informed the Sub-Committee that the growing interest in alternatively weighted index funds, most notably the Research Affiliates Fundamental Index 3000 (RAFI) Index was the prompt for the presentation by Legal and General to the Pension Fund Sub-Committee meeting. Members heard that in each of the last three calendar years of 2011, 2012 and 2013 the RAFI 3000 Index did not outperform the standard FTSE All World Index and indeed, the RAFI 3000 Index performance was marginally worse than its mainstream counterpart. In addition, the licence fee for RAFI Index would be a substantial addition to the existing management fees.

The Head of Exchequer and Investment advised that the case for Brent Pension Fund using an alternatively weighted index seemed unconvincing based on the information available and would only serve to further complicate an already relatively small but complex Fund.

RESOLVED:

That the report on the use of alternative indices be noted.

8. **Date of next meeting**

It was noted that the next meeting would take place on Tuesday, 25 February 2014 at 6:30pm

9. **Any other urgent business**

None.

10. **Exclusion of press and public**

RESOLVED:

That the press and public be excluded from the remainder of the meeting as the reports to be considered contained the following category of exempt as specified in Schedule 12A of the Local Government Access to Information Act 1972, namely;

"3. Information relating to the financial or business affairs of particular persons (including the Authority holding that information."

11. **2013 Actuarial Valuation of the Brent Pension Fund**

The Committee received a report which introduced and summarised the contribution strategy which would underpin the triennial valuation of the Fund's assets and liabilities due to be signed off in March 2014. Douglas Green and Julie Morrison, representatives of Hymans Robertson, the Fund's actuary gave a detailed presentation on the methods and assumptions of the contribution strategy and their provisional findings of the triennial valuation. This was a requirement under regulation 36 of The Local Government Pension Scheme (Administration) Regulations 2008.

RESOLVED:

that the method and assumptions of the contribution strategy for the Brent Pension Fund triennial valuation be approved.

12. **Annual review of fund managers' fees**

The Sub-Committee considered a report from the Chief Finance Officer that provided an update on investment management fees incurred by the Brent Pension Fund. Members heard that on-going savings were being achieved as a result of the successfully negotiated reduction in fund managers' fees and changes to the Fund's investment portfolio. Anthony Dodridge, Head of Exchequer and Investment advised the Sub-Committee that from December 2013, Brent's average fee rate would be lower than those paid by a representative sample much larger Local Government Pension Scheme (LGPS) funds with similar mandates. It was also comparable to a peer group of 20 large international pension funds from the US, Canada and Europe. This provided members with reasonable assurance that fees were as low as can be expected.

RESOLVED:

that the report on annual review of fund managers' fees be noted.

13. **Review of Additional Voluntary Contributions paid by Fund members**

The Sub-Committee received a report which outlined the findings and recommendations arising from of a recent independent review of the Additional Voluntary Contribution (AVC) arrangements undertaken by Hymans Robertson, the Fund's actuary. Anthony Dodridge, Head of Exchequer and Investment informed members that following a review by the Fund's actuary, a number of shortcomings as set out in the report were identified with the present provider.

The Head of Exchequer and Investment therefore proposed the appointment of Prudential as the Brent Pension Fund's AVC provider in respect of new fund members who wished to make AVCs, with existing fund members being allowed to either continue with Clerical Medical or transfer their AVC investment arrangements to Prudential. These views were echoed by Andrew Gray, Pensions Manager and Mildred Phillips Head of Transactional Services. For the avoidance of doubt and in order to ensure clarity, the Sub-Committee emphasised the need for the Council's Pensions' Team to communicate the changes to the Fund's members.

RESOLVED:

(i) that Prudential be appointed as the Fund's AVC provider;

(ii) that the Council's pensions team should communicate the changes to the Fund's members.

The meeting closed at 8.25 pm

S CHOUDHARY
Chair

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Brent	**Pension Fund Sub-Committee** 25 February 2014 **Report from the Chief Finance Officer**
For Information	Wards Affected: ALL
Quarterly monitoring report on fund activity	

1. SUMMARY

1.1 This report provides a summary of the Fund's activity during the quarter ended 31 December 2013. It examines the actions taken, the economic and market background, and investment performance, as well as commenting on events in the quarter. The main points arising are:

a) The Fund has increased in value by £14.1m from £548.4m to £562.5m during the quarter ended 31 December 2013, and the Fund's return of 2.9% under-performed its quarterly benchmark of 3.2%. The biggest contributors to this positive return during the quarter were publicly quoted UK and overseas developed market equities and UK Property. Infrastructure, European Property and Emerging Market equities had a negative impact.

b) The main negative performers compared to benchmark were Infrastructure and Private Equity (mainly denominated in US$) attributable to sterling's strengthening against the US dollar in the quarter from $1.619 per £ at 30 September 2013 to $1.656 per £ at 31 December 2013, an increase of 2.3%.

c) The 12-month return as at 31 December 2013 continues to remain in double-digit territory at 11.6%, albeit lagging behind its 13.0% benchmark.

d) The Fund return for the 3 years ended 31 December 2013 is an annualised 5.6% p.a., which lags behind its long term investment return target of 6.5% p.a.

e) Following the quarter ended 31 December 2013, the Fund has since fallen back in value by an estimated £8.5m to £554.0m during the month of January 2014.

f) It should be noted that the Fund's quarterly return of 2.9% was worse than the WM Local Authority average of 3.7% due to Brent's asset allocation with its relatively low exposure to publicly-quoted Equities which had an overall positive quarter and high exposure to Alternatives which suffered from a generally negative performance, placing the Brent Pension Fund at the 90th percentile for the quarter ended 31 December 2013.

2. RECOMMENDATIONS

2.1 Members are asked to note the investment report.

3. DETAIL

Economic and market background – quarter ended 31 December 2013

3.1 During the quarter ended 31 December 2013, the robust performance of the UK economy drove sterling's strength against other currencies (most notably the US$ and Euro) and this has had the effect of dampening down the investment performance of the Fund's investment holdings denominated in overseas currencies, such as Private Equity, Infrastructure, Emerging Market Equities and European property.

3.2 There is further evidence that the US economic recovery is gaining momentum. The US Federal Reserve announced plans to reduce the pace of its quantitative easing (QE) programme, reflecting an improvement in the job and housing markets. Initial reductions to the amount of money being pumped into the economy will start in January 2014.

3.3 The UK economy showed signs of on-going strength during the quarter. With the services, construction and production sectors all improving, a faster than expected fall in unemployment prompted speculation that the Bank of England may raise the Bank Rate from 0.5% earlier than had been expected.

3.4 Doubts emerged over the resilience of the Eurozone recovery, as the French and Italian economies contracted.

3.5 Global growth remains below trend, with few signs of inflationary pressures.

3.6 A market review for the quarter ended 31 December 2013, written by the Independent Financial Adviser, is attached.

Investment performance of the Fund

3.7 The investment performance of the Brent Pension Fund in comparison to the WM Local Authority percentile average for all Local Government Pension Schemes (LGPS) funds nationally is shown below:

	Period ended 31 Dec 2012	Period ended 31 Dec 2013
1 year	69th	96th
3 years	98th	96th
5 years	100th	97th
10 years	100th	100th

3.8 The comparative statistics show that the Fund has been one of the lower performing LGPS funds which has been consistently underperforming for a number of years.

3.9 This apparent stalling of improvement to investment returns can be clearly attributed to recent negative returns of the Fund's private equity and infrastructure holdings which are denominated in US dollars and Euro which have weakened against sterling. It must be remembered that almost 20% of Brent Pension Fund's assets are held in unquoted Private Equity and Infrastructure investments which continue to remain relatively immature and in their investment periods. The values of these investments do not change continuously in the way quoted investments do, so that their recent investment performance may not reflect their true underlying worth. Their real performance can only be assessed when distributions are made to investors in future years as the funds realise their assets.

3.10 It should be noted that the Fund's wider investments are beginning to deliver some solid performances over 1 Year relative to other LGPS schemes, e.g., Fixed Income 10th nationally, UK Equities 36th nationally, and UK Property 48th nationally. However, the Fund's strongly positive publicly quoted equity return for the year ended 31 December 2013 of 20.1% has been dragged down significantly by the return on its Alternative Investments which have delivered an average annual return of only 3.2%.

3.11 This cautions against reading too much into the 1 Year performance statistics, which is expected to show considerable improvement as at 31 March 2014 when updated audited figures in respect of Private Equity and Infrastructure become available.

3.12 Table 1 shows the changes in asset allocation, how asset allocation compares with the benchmark and with the average fund (WM Local Authority average), and how the change in the market value during the quarter is allocated across asset classes. Items marked (*) in columns 4 and 8 cannot be separately analysed, but are included within the relevant asset class.

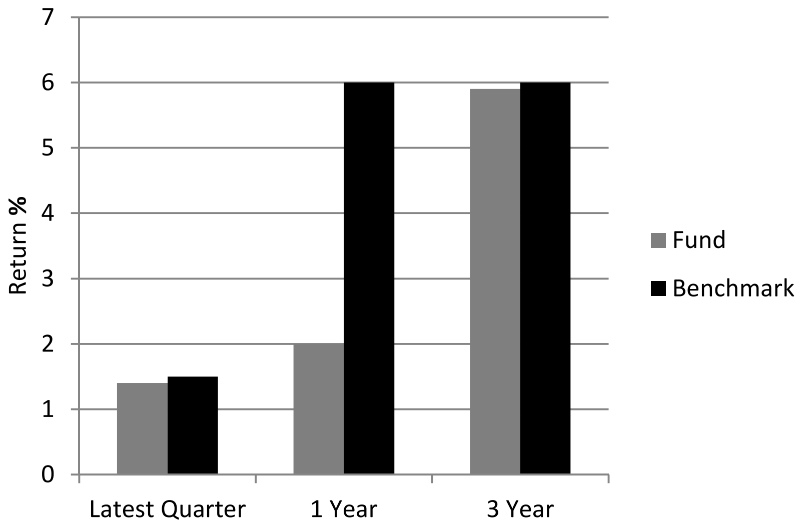
Table 1: Asset allocation as at 31 December 2013 compared to the benchmark

Market (1)	Market Value 31/12/13 £M (2)	Market Value 31/12/13 % (3)	WM LA Average 31/12/13 % (4)	Fund Benchmark 31/12/13 % (5)	Market Value 30/9/13 £M (6)	Market Value 30/9/13 % (7)	WM LA Average 30/9/13 % (8)
Fixed Income							
Henderson – Total Return Bond Fund	83.2	14.8	15.2	15.0	82.1	15.0	16.9
Equities							
UK – Legal & General	85.7	15.2	28.1	13.0	81.3	14.8	24.4
UK - Smaller Companies Fund Henderson	25.8	4.6	*	4.0	24.1	4.4	*
O/seas – developed Legal & General	134.8	24.0	33.6	22.0	127.7	23.3	32.6
O/seas – emerging Dimensional	33.1	5.9	4.8	8.0	33.4	6.1	5.6
Property							
Aviva	34.6	6.2	6.9	8.0	33.8	6.2	7.1
Private Equity							
Capital Dynamics	70.0	12.4	3.7	10.0	70.0	12.7	4.2
Yorkshire Fund	1.1	0.2	*		1.1	0.2	*
Hedge Funds							
Fauchier	29.4	5.2	1.8	5.0	28.7	5.2	2.3
Infrastructure							
Alinda	15.5	2.8	0.9	6.0	15.9	2.9	1.2
Capital Dynamics	16.1	2.8	*		16.6	3.0	*
Henderson PFI Fund II	1.1	0.2	*		1.1	0.2	*
Pooled Multi Asset							
Baillie Gifford DGF	44.5	7.9	1.9	8.0	33.4	6.1	2.4
Cash	-12.4	-2.2	3.1	1.0	-0.8	-0.1	3.3
Total	**562.5**	**100.0**	**100.0**	**100.0**	**548.4**	**100.0**	**100.0**

Manager performance relative to benchmark

3.13 The following bar charts show the active fund manager performances in comparison to their respective benchmarks for periods to the end of December 2013.

Henderson – Total Return Bond Fund

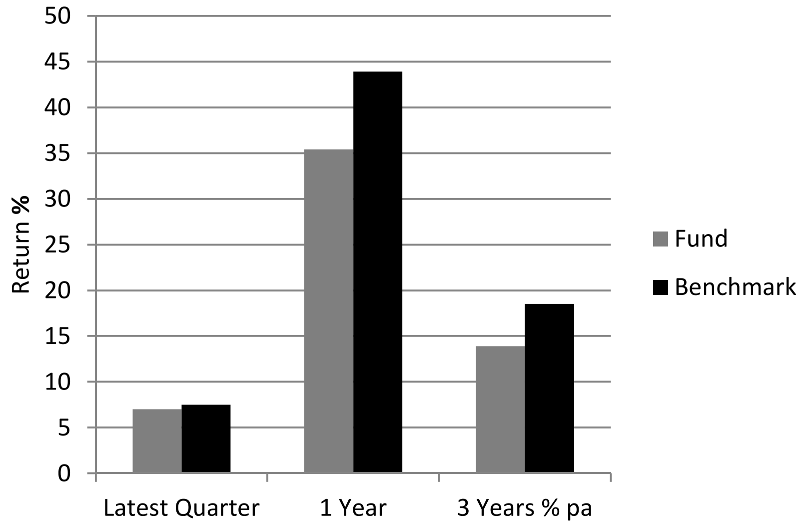


Whilst steady positive returns are being delivered, Henderson’s Total Return Bond Fund performance is lagging behind its 6% p.a. absolute return benchmark in respect of the latest quarter and 1 Year periods. However, over the 3-year period the Total Return Bond Fund is broadly achieving its performance target.

The performance over the latest quarter was positive, with high yield corporate bonds contributing to this positive performance. In developed market government bonds, overall exposure to fixed rate securities remained very low and consequently the poor performance of this sector did not impact returns. Emerging Market (EM) bond holdings were concentrated in countries with strong economic fundamentals (such as Mexico). Consequently, the fund was largely insulated from the ongoing weakness in EM debt markets.

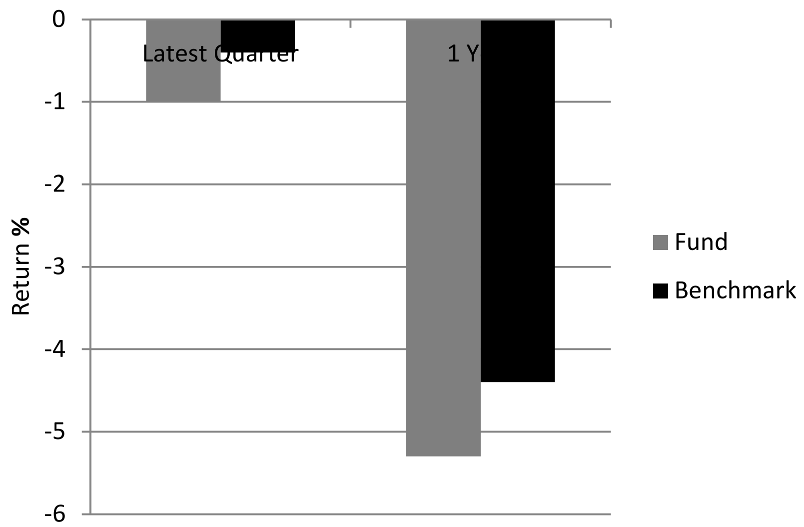
In terms of the outlook for the coming period, corporate bonds are expected to continue to out-perform government debt against a backdrop of strong demand for yield, low default rates, and good corporate liquidity, although valuations in most sectors are less compelling than a year ago.

Henderson – UK & Irish Smaller Companies Fund



Henderson's UK & Irish Smaller Companies Fund has delivered strongly positive returns over recent periods – up 7.0% over the latest quarter, 35.4% over the last 12 months and an annualised 13.9% p.a. over the past 3 years. The Fund aims to achieve a long-term return in excess of the long-term return that is typically achieved from UK & Irish Smaller Companies equity markets. This is measured by comparing its investment performance to the FTSE SmallCap Index, against which it has under-performed over recent periods.

Dimensional – Emerging Markets Value Fund



Over the longer term, Emerging Market equities have higher expected returns than risk free assets, but given the greater volatility of this particular asset class the experience in shorter periods including periods of one year can sometimes be negative.

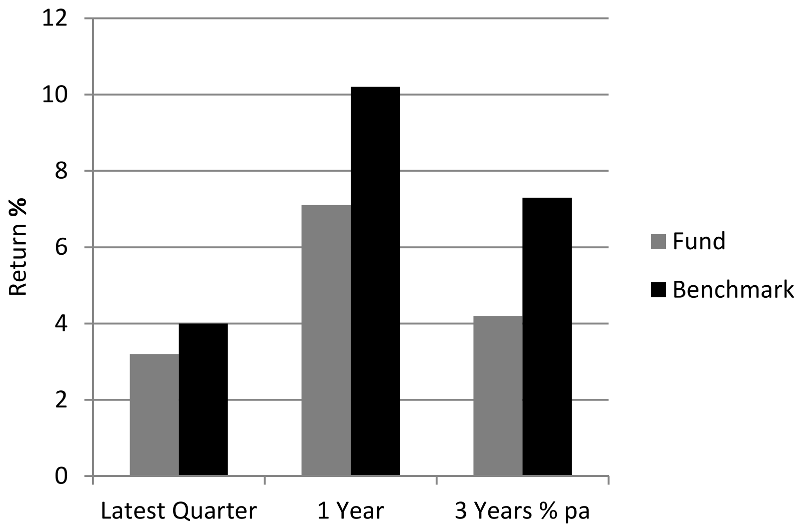
Emerging markets as a whole lagged developed markets for the fifth consecutive quarter as investors considered the implications of changing economic growth and inflation prospects.

In 2013, energy and resource laden emerging markets struggled in an uncertain global macroeconomic environment with concerns over a slowing Chinese economy, an outlook of reduced stimulus from the US Federal Reserve and stalling European economies. These sources of demand were not providing a positive outlook for many export oriented emerging market economies that were experiencing challenging economic conditions domestically, for example, high domestic inflation and currency account deficits.

During 2013, the British pound strengthened against most emerging market currencies which have impacted on returns by an estimated -7.2% over the year. It should be noted that decades of academic research has shown that currency movements are essentially random in the short term and un-hedged and hedged equity portfolios have similar volatilities. Given that there is a direct cost of currency hedging which directly reduces the expected return of currency hedged equity portfolios over the longer term, Dimensional does not hedge its Emerging Markets Value Fund.

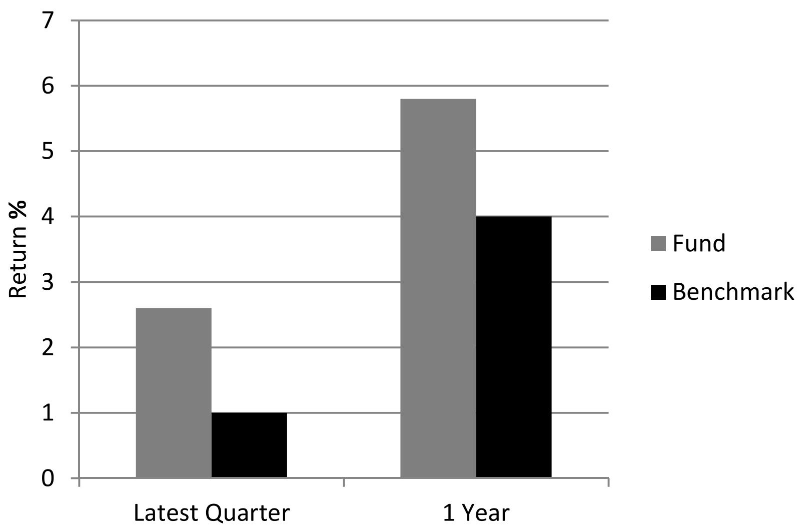
The absolute performance of the Dimensional Emerging Markets Value Fund of -5.3% net of fees was below the benchmark MSCI Emerging Markets Index of -4.4%.

Aviva – Property



The Aviva property portfolio aims to maximise total return through a combination of capital growth and income return. Whilst steady positive returns are being delivered, Aviva's property portfolio performance continues to lag behind its IPD All Properties Index based benchmark in respect of the latest quarter, 1 Year and 3 Year periods. The pooled funds that Aviva invests in are relatively illiquid; the costs of liquidating and investing with a new property manager would be significant. Whilst the UK Real Estate Fund of Funds (market value £29.4m) is an open-ended investment, the European Real Estate Fund of Funds (market value £5.2m) is closed to new investors and will be fully liquidated by 2018.

Baillie Gifford – Diversified Growth Pension Fund



Baillie Gifford's Diversified Growth Fund (DGF) significantly out-performed its Base Rate plus 3.5% p.a. benchmark in respect of the latest quarter and over 1 Year. The Baillie Gifford DGF was the Fund's newest investment acquisition in June 2012.

3.14 The independent WM Company measures the returns on the Brent Pension Fund. Table 2 sets out returns for the periods to 31 December 2013.

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 31/12/13			Year Ended 31/12/13			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
Fixed Income							
Total Return Bond Fund Henderson	1.4	1.5	-0.4	2.0	6.0	-0.2	Absolute return 6% p.a.
Equities							
UK – Legal & General	5.5	5.5	6.0	21.0	20.8	24.0	FTSE All Share
UK - Small Companies Henderson	7.0	7.5	*	35.4	43.9	*	FTSE Small Cap
O/seas – developed Legal & General	5.6	5.6	4.0	24.9	25.0	20.1	FTSE Dev World ex UK
O/seas – emerging Dimensional	-1.0	-0.4	0.0	-5.3	-4.4	1.5	MSCI Emerging Markets
Property							
Aviva	3.2	4.0	4.2	7.1	10.2	9.5	IPD All Properties Index
Private Equity							
Capital Dynamics	-5.6	2.0	1.6	4.3	8.0	9.3	Absolute return 8% p.a.
Yorkshire Fund Managers	0.0	2.0	*	0.0	8.0	*	Absolute return 8% p.a.
Hedge Funds							
Fauchier	2.7	1.3	1.7	13.0	5.5	6.7	LIBOR + 5% p.a.
Infrastructure							
Alinda	-2.2	2.0	0.4	-0.6	8.0	3.0	Absolute return 8% p.a.
Capital Dynamics	-8.5	2.0	*	-6.3	8.0	*	Absolute return 8% p.a.
Henderson PFI Fund II	0.1	2.0	*	-2.7	8.0	*	Absolute return 8% p.a.
Pooled Multi Asset							
Baillie Gifford DGF	2.6	1.0	2.1	5.8	4.0	8.5	Base Rate + 3.5% p.a.
Cash	0.1	0.1	0.2	0.5	0.5	1.6	Base Rate
Total	**2.9**	**3.2**	**3.7**	**11.6**	**13.0**	**15.0**	

3.15 The Fund's overall return of 2.9% under-performed its quarterly benchmark of 3.2%. Whilst Diversified Growth and Hedge Funds out-performed their respective benchmarks, UK Smaller Companies, Emerging Market Equities, Property, Private Equity and Infrastructure under-performed against their benchmarks.

3.16 The Fund's quarterly return of 2.9% was lower than the WM Local Authority average of 3.7% due to Brent's asset allocation with its relatively low exposure to Equities which had an overall positive quarter and high exposure to Alternatives which suffered from a generally negative performance. The Fund out-performed the WM Local Authority average in the asset classes of Fixed Income, Overseas Equities, Hedge Funds and Diversified Growth. The Fund under-performed the WM Local Authority average in the asset classes of Emerging Market Equities, Property, Private Equity and Infrastructure.

3.17 Over one year, the Fund return of 11.6% was below its benchmark of 13.0%. Whilst Hedge Funds and Diversified Growth out-performed their respective benchmarks, Fixed Income, UK Smaller Companies, Property, Emerging Market Equities, Private Equity and Infrastructure under-performed against their benchmarks.

3.18 The Fund's annual return of 11.6% was lower than the WM Local Authority average of 15.0% due to Brent's asset allocation with its relatively low exposure to Equities which had a strongly positive year and high exposure to Alternatives which benefited from a moderate performance.The Fund out-performed the WM Local Authority average in the asset classes of Fixed Income, Overseas Equities and Hedge Funds. The Fund under-performed the WM Local Authority average in the asset classes of Emerging Market Equities, Property, Private Equity, Infrastructure and Diversified Growth.

Compliance with statutory investment limits

3.19 LGPS investment regulations state that the Administering Authority shall have regard both to the diversification and the suitability of investments. The following table demonstrates full compliance when comparing the Fund's actual investment exposure with the statutory limits under regulation:

Investment	**Statutory limit under regulation**	**Actual exposure at 31 Dec 2013**	**Compliant Yes / No**
Any single holding	10%	3%	Yes
Unit trusts managed by any one body	35%	24%	Yes
Lending to any one borrower	10%	Nil	Yes
Unlisted securities of companies	15%	Nil	Yes
Any single partnership	5%	3%	Yes
Total investment in partnerships	30%	18%	Yes

Outstanding contractual commitments

3.20 The Brent Pension Fund has not entered into any new investments in private equity/infrastructure since November 2011 and whilst significant capital call payments have been made over the past two years, the outstanding contractual commitments on existing investments continue to remain significant as follows:

	31 March 2012 £'000	31 March 2013 £'000	31 Dec 2013 £'000
Capital Dynamics	77,545	54,077	39,594
Alinda	10,435	10,636	6,779
Yorkshire Fund Managers	1,113	266	60
Total	**89,093**	**64,979**	**46,433**

3.21 These outstanding investment commitments mean that the Fund needs to retain a sizeable cash balance to meet capital call payments as they arise. It also prevents the Fund from moving to its strategic allocations in Property and limits the extent to which any new investments can be considered at the present time.

Indicative performance of the Fund since December 2013

3.22 Following the quarter ended 31 December 2013, the Fund has decreased in value by an estimated £8.5m as at 31 January 2014 following a sharp downturn in stock market values (although there has been some degree of recovery during February 2014):

	As at 31 January 2014 £M	As at 31 December 2013 £M	Movement
Fixed Income			
Henderson	83.1	83.2	↓
Equities			
UK Legal & General	83.1	85.7	↓
UK - Small Companies Henderson	26.2	25.8	↑
O/seas – Developed Legal & General	130.9	134.8	↓
O/seas – Emerging Markets Dimensional	31.0	33.1	↓
Property			
Aviva	34.6	34.6	=
Private Equity			
Capital Dynamics	70.0	70.0	=
Yorkshire Fund Managers	1.1	1.1	=
Hedge Funds			
Fauchier	-	29.4	↓
Infrastructure			
Alinda	15.5	15.5	=
Capital Dynamics	16.1	16.1	=
Henderson PFI Fund II	1.1	1.1	=
Pooled Multi Asset			
Baillie Gifford DGF	44.1	44.5	↓
Cash	17.2	-12.4	↑
Total	**554.0**	**562.5**	↓

3.23 All monies have been returned from the Fauchier Fund of Hedge Funds investment, and Cash has been returned to a positive balance. Over the longer term, this Cash will be required to meet the on-going capital drawdown commitments to Private Equity and Infrastructure which stood at an estimated £46.4m as at 31 December 2013 – see paragraph 3.20.

4. FINANCIAL IMPLICATIONS

4.1 These are included within the report.

5. DIVERSITY IMPLICATIONS

5.1 None.

6. STAFFING IMPLICATIONS

6.1 None.

7. LEGAL IMPLICATIONS

7.1 None.

8. BACKGROUND INFORMATION

8.1 Henderson Investors – December 2013 quarter report
Legal & General – December 2013 quarter report
Dimensional Asset Management – December 2013 quarter report
Baillie Gifford – December 2013 quarter report

9. CONTACT OFFICERS

9.1 Persons wishing to discuss the above should contact the Treasury and Pension Investment Section, Governance and Corporate Services, on 020 8937 1472 at Brent Civic Centre.

CONRAD HALL
Chief Finance Officer

ANTHONY DODRIDGE
Head of Exchequer and Investment

AllenbridgeEpic
investment advisers

QUARTERLY REVIEW PREPARED FOR

Brent Council Pension Fund

Q4 2013

17 January 2014

Peter Davies
AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)

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BRENT COUNCIL PENSION FUND
Quarterly Review, October – December 2013

The Economy

1. Growth forecasts for 2013 in UK and US have been revised further upwards, while the UK is expected to grow by 2.7% in 2014 – far in advance of earlier estimates. In the UK, rising personal consumption has been the major factor behind this pick-up in growth, but in the absence of any rise in real wages, it is questionable how long consumers will be able to continue on this path. Inflation has been reducing in all regions except Japan (where the target is 2% inflation); in the Eurozone, however, the very low inflation figure of 0.7% prompted the European Central Bank to lower interest rates from 0.5% to 0.25% in November, to avert the threat of deflation.
   [In the table, bracketed figures show the estimates at the time of my previous report]

Consensus real growth (%)					**Consumer prices latest (%)**
	2011	**2012**	**2013E**	**2014E**	
UK	+0.9	-0.1	**+1.5 (+1.4)**	**+2.7 (+2.3)**	+2.0 (CPI)
USA	+1.7	+2.2	+1.8 (+1.6)	+2.7 (+2.7)	+1.2
Eurozone	+1.5	-0.5	-0.4 (-0.3)	+1.0 (+1.0)	+0.8
Japan	-0.7	+1.9	+1.7 (+1.8)	+1.5 (+1.6)	+1.6
China	+9.2	+7.8	+7.7 (+7.5)	+7.3 (+7.3)	+2.5

[Source: The Economist Jan 11th, 2014]

2. In his Autumn Statement on December 5th, George Osborne was able to forecast a budget deficit of £111bn this fiscal year (from £120bn previously expected) as a result of the improvement in economic growth. The deficit is forecast to reduce to £96bn in 2014/15 and to £79bn in 2015/16, and even to turn into a small surplus in 2018/19. Other measures included an earlier raising of the state pension age to 68 (in the mid-2030's), the freezing of fuel duty for the remainder of this Parliament, and increasing the personal allowance to £10,000 from April 2014.

3. At the end of November the UK government announced that under the 'Funding for Lending' programme banks must only lend to companies, and no longer lend on property. UK unemployment data for November showed a fall of 100,000 to 2.4m, and a reduction of the unemployment rate to 7.4%. Since the Governor of the Bank of England has mentioned a rate of 7% as a possible trigger for interest rate rises, it now appears that his 'forward guidance' may be due for a reassessment. The UK inflation rate, as measured by the CPI, fell to 2% in December, hitting its target rate after four years of above-target rises. This suggests that there is no imminent danger of 'over-heating' in the present economic recovery.

4. In December, strong US industrial production data, and a reduction in the rate of unemployment to 7.0%, prompted the Federal Reserve to announce that it would be ‘tapering’ its $85bn per month bond-buying programme by $10bn in January, and by a further $10bn each subsequent month, so that the QE programme would end in 2014.

Markets

5. **Equity** markets in the US and Europe ended the year strongly, while Pacific Basin and Emerging Markets were flat or slightly down. For the full year there has been a wide divergence between the performance of Emerging Markets and Asia Pacific ex-Japan (affected by relatively weak currencies as well as slowing economies) when compared with the gains of 20% and more in Japan, Europe and North America. In the UK, mid- and small-cap shares rose slightly more during the 4th quarter than the large-cap FTSE 100 stocks.

	Capital return (in £, %) to 31.12.13		
Weight %	**Region**	**3 months**	**12 months**
100.0	**FTSE All-World Index**	**+ 4.5**	**+ 17.9**
51.4	FTSE All-World North America	+ 6.9	+25.6
8.4	FTSE All-World Japan	- 0.1	+22.6
11.5	FTSE All-World Asia Pacific ex Japan	-0.4	- 1.7
17.5	FTSE All-World Europe (ex-UK)	+ 4.9	+19.8
8.1	FTSE All-World UK	+ 4.4	+14.6
8.9	FTSE All-World Emerging Markets	-1.0	- 8.1

[Source: FTSE All-World Review, December 2013]

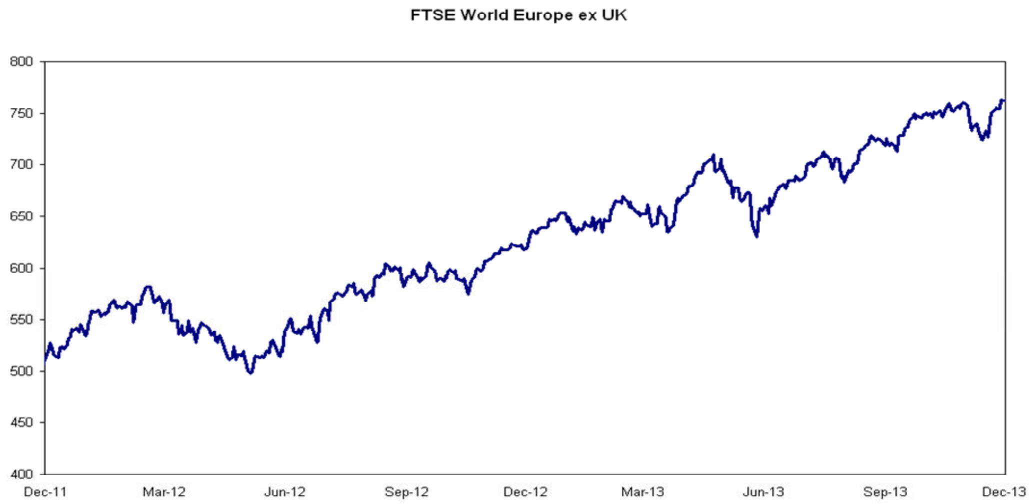
6. All industry groups except Utilities registered gains in the quarter, but for the full year it was noticeable that Oil & Gas, Utilities and Basic Materials performed considerably worse than the other sectors.

Capital return (in £, %) to 31.12.13		
Industry Group	**3 months**	**12 months**
Health Care	+5.6	+29.9
Consumer Services	+5.9	+28.8
Industrials	+6.2	+24.5
Technology	+9.0	+23.0
FTSE All-World	**+4.5**	**+17.9**
Financials	+4.2	+17.8

Telecommunications	+4.4	+17.1
Consumer Goods	+2.2	+16.3
Oil & Gas	+2.7	+8.7
Utilities	-0.9	+4.7
Basic Materials	+2.0	- 4.9

[Source: FTSE All-World Review, December 2013]

Despite the uncertainties surrounding the euro, shares in Continental Europe have risen strongly over the past two years (see graph below).

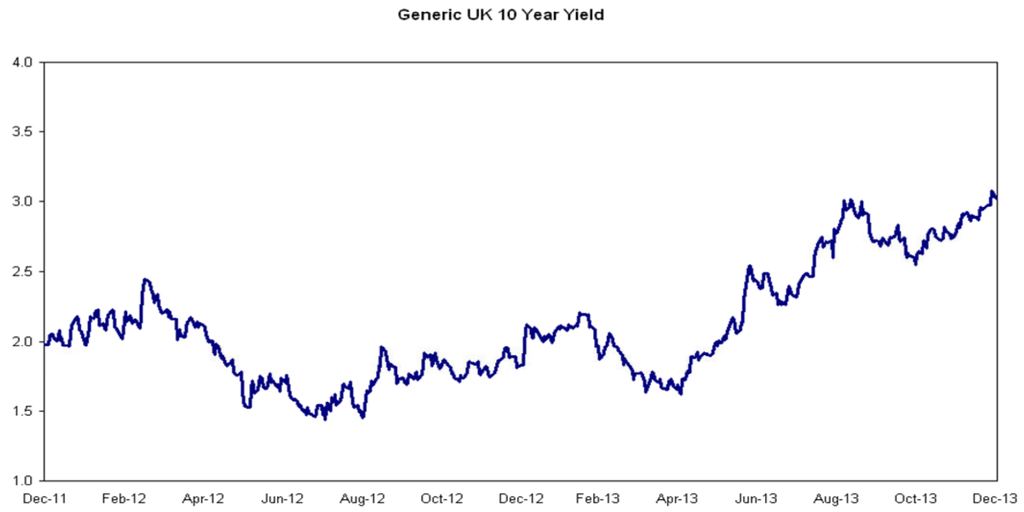


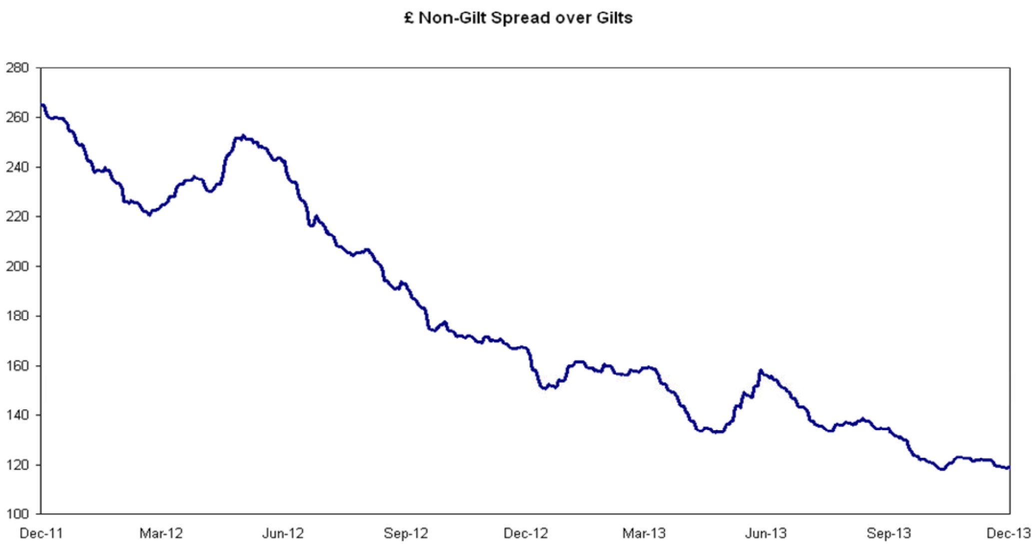
7. **Government Bond** yields rose again in the 4th quarter, as economic recovery became more established in the US and UK, while the confirmation that tapering would begin in January 2014 gave a further upward push to yields in December.

10-year government bond yields (%)					
	Dec 11	**Dec 12**	**June 2013**	**Sept 2013**	**Dec 2013**
US	1.88	1.76	2.49	2.62	3.03
UK	1.98	1.85	2.45	2.73	3.04
Germany	1.83	1.32	1.73	1.78	1.94
Japan	0.98	0.79	0.86	0.69	0.74

[Source: Financial Times]

Meanwhile, the UK corporate bond market has been rising strongly relative to gilts during the past two years. The graphs below show that the non-gilt spread has narrowed by more than the rise in gilt yields over the past two years – so that the average corporate bond yield has actually fallen during this period.





Currencies

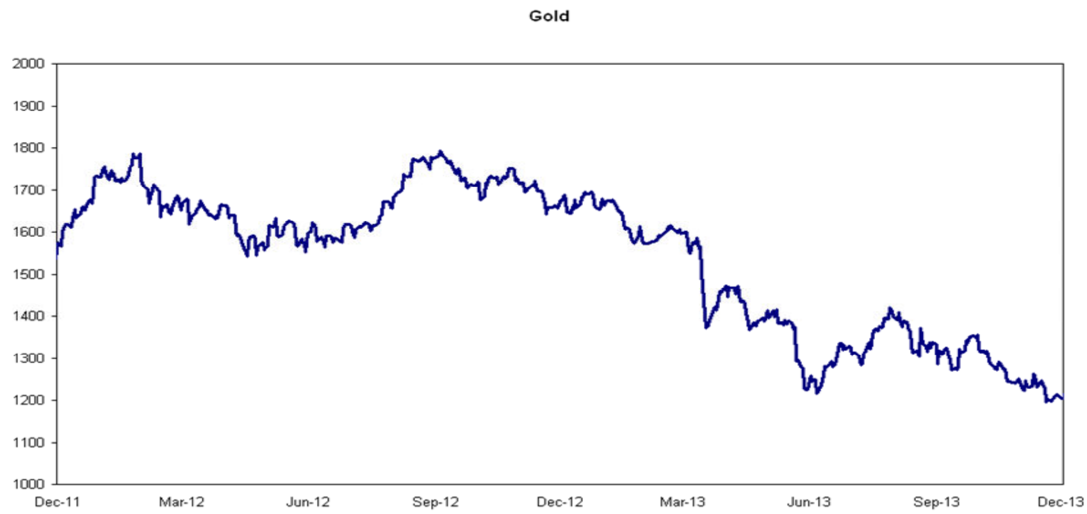
8. The pound rose to its highest level for the year against the dollar, although there was little change in the parity compared with its end-2012 level. The yen continued to weaken against all the other major currencies.

	31.12.12	30.09.13	31.12.13	£ move 3-month	12-month
$ per £	1.625	1.619	1.656	+ 2.3%	+ 1.9%
€ per £	1.233	1.196	1.202	+ 0.5%	- 2.5%
Y per £	140.5	158.9	174.1	+ 9.6%	+23.9%

The pound has gained 45% against the yen in the past two years, as shown in the graph below.

Commodities

9. Gold lost a further 10% during the quarter, to complete a year when it fell by almost 30% in dollar terms. The prices of copper and oil were little changed in the quarter.



Property

10. The UK market has continued to strengthen, with an overall total return of 4.7% for the 3 months to end-December, according to the IPD UK Monthly Property Index. This means that the total return for the full year was +10.9% - the best figure for several years. The bulk of this gain was achieved in the second half of the year, pointing to an accelerating market. By sector the annual returns were:

Retail	**+ 7.6%**
Office	**+14.4%**
Industrial	**+14.2%**

Outlook

11. The early signs of economic recovery in US and Europe have been well received by equity markets, while bonds have eased slightly without falling as rapidly as some had feared. The major influence on equity and bond markets in the next few months is likely to be the pace of tapering by the Federal Reserve; an increase in the planned rate of reduction of $10bn per month would probably push bond yields higher, and may cause capital to flow out of Emerging Markets, as was seen in May and June of last year. Rises in short-term interest rates in US or UK still look unlikely for the duration of 2014, until economic growth is firmly established.

12. I do not expect to see much near-term appreciation in developed market equities after their recent run, as it would only take an escalation of political unrest in the Middle East, or renewed strains in the Eurozone currency, to shake equity markets out of their current state of calm optimism

Peter Davies

Senior Adviser – AllenbridgeEpic Investment Advisers

January 17th, 2014

[All graphs supplied by Legal & General Investment Management]

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Brent	**Pension Fund Sub-Committee** 25 February 2014 **Report from the Chief Finance Officer**
For action	Wards Affected: ALL

Funding Strategy Statement – triennial update

1. SUMMARY

1.1 To comply with regulation 58 of the Local Government Pension Scheme Regulations 2013, the Brent Pension Fund must prepare, maintain and publish a written statement setting out its funding strategy.

1.2 A formally approved Funding Strategy Statement (FSS) is published in the Brent Pension Fund Annual Report.

1.3 The Fund's proposed FSS is attached at Appendix 1.

2. RECOMMENDATION

2.1 That the updated Funding Strategy Statement be approved.

3. DETAIL

3.1 The FSS has been prepared by Brent Council (the Administering Authority of the Fund) in collaboration with the Fund's actuary, Hymans Robertson, and after consultation with the Fund's employers and independent financial adviser, Peter Davies. It would be effective from 1 April 2014.

3.2 In publishing its Funding Strategy Statement (FSS), the Fund must have regard to the guidance set out in the document published in October 2012 by CIPFA called 'Preparing and maintaining a Funding Strategy Statement in the Local Government Pension Scheme 2012' and to its Statement of Investment Principles.

4. FINANCIAL AND LEGAL IMPLICATIONS

4.1 None.

5. DIVERSITY IMPLICATIONS

5.1 None.

6. STAFFING IMPLICATIONS

6.1 None.

7. BACKGROUND

7.1 CIPFA guidance – 'Preparing and maintaining a Funding Strategy Statement in the Local Government Pension Scheme 2012'.
Statutory Instrument 2013 No.2356 – Local Government Pension Scheme Regulations 2013.
Brent Pension Fund's 'Statement of Investment Principles'.

8. CONTACT OFFICERS

8.1 Persons wishing to discuss the above should contact the Treasury and Pension Investment Section, Governance and Corporate Services, on 020 8937 1472 at Brent Civic Centre.

CONRAD HALL
Chief Finance Officer

ANTHONY DODRIDGE
Head of Exchequer and Investment

Appendix 1

BRENT PENSION FUND

FUNDING STRATEGY STATEMENT

1 Introduction

1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the Brent Pension Fund ("the Fund"), which is administered by Brent Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson, and after consultation with the Fund's employers and investment adviser. It is effective from 1 April 2014.

1.2 What is the Brent Pension Fund?

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the Brent Pension Fund, in effect the LGPS for the Brent area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth;
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

1.3 Why does the Fund need a Funding Strategy Statement?

Employees' benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees' contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions;
- transparency of processes;
- stability of employers' contributions; and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in Appendix A.

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework of which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- the Fund's policies on admissions, cessations and bulk transfers;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Statement of Investment Principles (see Section 4).

1.4 How does the Fund and this FSS affect me?

This depends who you are:

- a member of the Fund, i.e., a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;

- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, and in what circumstances you might need to pay more. Note that the FSS applies to all employers participating in the Fund;
- an elected member whose Council participates in the Fund: you will want to be sure that the Council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for Council money;
- a Council Tax payer: your Council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- to adequately fund benefits to secure the Fund's solvency;
- to help ensure that sufficient resources are available to meet all liabilities (i.e., members'/dependants' benefits) as they fall due for payment. One particular way this is approached is by using a prudent long term view in managing solvency;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (N.B. this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

1.6 How do I find my way around this document?

In Section 2 there is a brief introduction to some of the main principles behind funding, i.e., deciding how much an employer should contribute to the Fund from time to time.

In Section 3 we outline how the Fund calculates the contributions payable by different employers in different situations.

In Section 4 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail if you are interested:

A. the regulatory background, including how and when the FSS is reviewed;
B. who is responsible for what;

C. what issues the Fund needs to monitor, and how it manages its risks;

D. some more details about the actuarial calculations required;

E. the assumptions which the Fund actuary currently makes about the future;

F. a glossary explaining the technical terms occasionally used here.

If you have any other queries please contact Anthony Dodridge, Head of Exchequer and Investment, in the first instance at e-mail address anthony.dodridge@brent.gov.uk or on telephone number 020 8937 1472.

2 Basic funding issues

(More detailed and extensive descriptions are given in Appendix D).

2.1 How does the actuary calculate a contribution rate?

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being built up from year to year, referred to as the "*future service rate*"; plus

b) an adjustment for the difference between the assets built up to date and the value of past service benefits, referred to as the "*past service adjustment*". If there is a deficit the past service adjustment will be an increase in the employer's total contribution; if there is a surplus there may be a reduction in the employer's total contribution. Any past service adjustment will aim to return the employer to full funding over an appropriate period (the "deficit recovery period").

2.2 How is a deficit (or surplus) calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets, to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

A larger deficit will give rise to higher employer contributions. If a deficit is spread over a longer period then the annual employer cost is lower than if it is spread over a shorter period.

2.3 How are contribution rates calculated for different employers?

The Fund's actuary is required by the Regulations to report the *Common Contribution Rate*, for all employers collectively at each triennial valuation, combining items (a) and (b) above. This is based on actuarial assumptions about the likelihood, size and timing of benefit payments to be made from the Fund in the future, as outlined in Appendix E.

The Fund's actuary is also required to adjust the *Common Contribution Rate* for circumstances specific to each individual employer. The sorts of specific circumstances which are considered are discussed in Section 3. It is this adjusted contribution rate which the employer is actually required to pay, and the rates for all employers are shown in the Fund's Rates and Adjustments Certificate.

In effect, the *Common Contribution Rate* is a notional quantity, as it is unlikely that any employer will pay that exact rate. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific circumstances.

Details of the outcome of the Actuarial Valuation as at 31 March 2013 can be found in the formal valuation report, including an analysis at Fund Level of the *Common Contribution Rate*. Further details of individual employer contribution rates can also be found in the formal report.

2.4 What else might affect the employer's contribution?

Employer covenant, and likely term of membership, are also considered when setting contributions: more details are given in Section 3.

For some employers it may be agreed to pool contributions, see 3.4.

Any costs of non ill-health early retirements must be paid by the employer, see 3.6.

If an employer is approaching the end of its participation in the Fund then its contributions may be amended appropriately, so that the assets meet (as closely as possible) the value of its liabilities in the Fund when its participation ends.

Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of the higher rate will be taken by the Fund actuary at subsequent valuations.

2.5 What different types of employer participate in the Fund?

Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate. There are currently more employers in the Fund than ever before, a significant part of this being due to new academies.

In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: academy schools, contractors, housing associations, charities, etc.

The LGPS Regulations define various types of employer as follows:

Scheduled bodies - councils, and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such academies, as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as “Scheduled Bodies”, the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the DCLG regarding the terms of academies’ membership in LGPS Funds.

Designating employers - employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

Other employers are able to participate in the Fund via an admission agreement, and are referred to as ‘admission bodies’. These employers are generally those with a “community of interest” with another scheme employer – **community admission bodies** (“CAB”) or those providing a service on behalf of a scheme employer – **transferee admission bodies** (“TAB”). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund’s admissions policy are not met.

2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher pension Fund contributions may result in reduced Council spending, which in turn could affect the resources available for Council services, and/or greater pressure on Council Tax levels;
- Contributions which academies pay to the Fund will therefore not be available to pay for providing education;
- Other employers will provide various services to the local community, perhaps through housing associations, charitable work, or contracting Council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer’s ultimate obligation to the Fund in respect of its current and former employees;

- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;
- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result;
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of Council Tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the Council will wish to minimise the extent to which Council Tax payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see 3.1).

For instance, where an employer is considered relatively low risk then the Fund will permit greater smoothing (such as stabilisation or a longer deficit recovery period relative to other employers) which will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, an employer whose risk assessment indicates a less strong covenant will generally be required to pay higher contributions (for instance, with a more prudent funding basis or a shorter deficit recovery period relative to other employers). This is because of the higher probability that at some point it will fail or be unable to meet its pension contributions, with its deficit in the Fund then falling to other Fund employers.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see Appendix A.

3 Calculating contributions for individual employers

3.1 General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of methods which the Administering Authority may permit, in order to improve the stability of employer contributions. These include, where circumstances permit:-

- capping of employer contribution rate changes within a pre-determined range ("stabilisation")
- the use of extended deficit recovery periods
- the phasing in of contribution rises or reductions
- the pooling of contributions amongst employers with similar characteristics
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

These and associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

3.2 The effect of paying contributions below the theoretical level

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than the theoretical contribution rate. Such employers should appreciate that:

- their true long term liability (i.e., the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the choice of method;
- lower contributions in the short term will be assumed to incur a greater loss of investment returns on the deficit. Thus, deferring a certain amount of contribution will lead to higher contributions in the long-term; and
- it will take longer to reach full funding, all other things being equal.

Overleaf (3.3) is a summary of how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

Section 3.4 onwards deals with various other funding issues which apply to all employers.

3.3 The different approaches used for different employers

Type of employer	**Scheduled Bodies**			**Community Admission Bodies and Designating Employers**		**Transferee Admission Bodies**
Sub-type	**Council**	**Academies**	**Other**	**Open to new entrants**	**Closed to new entrants**	**(all)**
Basis used	Ongoing, assumes long-term Fund participation (see Appendix E)			Ongoing, but may move to "gilts basis" - see Note (a)		Ongoing, assumes fixed contract term in the Fund (see Appendix E)
Future service rate	Projected Unit Credit approach (see Appendix D – D.2)				Attained Age approach (see Appendix D – D.2)	Projected Unit Credit approach (see Appendix D – D.2)
Stabilised rate?	Yes - see Note (b)	No	No	No	No	No
Maximum deficit recovery period – Note (c)	22 years	22 years	22 years	15 years	Future working lifetime of active members	Outstanding contract term
Deficit recovery payments – Note (d)	Monetary amount	Monetary amount	Monetary amount	Monetary amount	Monetary amount	Monetary amount
Treatment of surplus	Covered by stabilisation arrangement	Preferred approach: contributions kept at future service rate. However, reductions may be permitted by the Administering Authority				Reduce contributions by spreading the surplus over the remaining contract term
Phasing of contribution changes	Covered by stabilisation arrangement	3 years - Note (e)	3 years - Note (e)	3 years - Note (e)	3 years - Note (e)	None
Review of rates – Note (f)	Administering Authority reserves the right to review contribution levels, and the level of any specific security provided by the employer to the Fund, at regular intervals between valuations					Particularly reviewed in last 3 years of contract
New employer	n/a	Note (g)	n/a	Note (h)		Notes (h) & (i)
Cessation of participation: cessation debt payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt principles applied would be as per Note (j).			Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (j).		Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising.

Note (a) (Basis for CABs and Designating Employers closed to new entrants)

In the circumstances where:

- the employer is a Designating Employer, or an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may vary the discount rate used to set employer contribution rate. In particular contributions may be set for an employer to achieve full funding on a more prudent basis (e.g., using a discount rate set equal to gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Designating Employers and Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease or the Designating Employer alters its designation.

Note (b) (Stabilisation)

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, an employer whose contribution rates have been "stabilised" (and which may therefore be currently paying less than its theoretical contribution rate) should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority (see below) and;
- there are no material events which cause the employer to become ineligible, e.g., significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring).

The eligibility criteria for stabilisation are that the employer is large, stable, and open to new entrants.

On the basis of extensive modelling carried out for the 2013 valuation exercise (see Section 4), the stabilised details for the Council Pool are as follows:

- Notional contribution rate increased at 1% of payroll each year, from the 2013-14 rate of 27.4%, up to a maximum of 30% of payroll;

- Actual contribution rate split between % of pay element and £ lump sum element each year;

- % of pay element = future service rate for the Council Pool as calculated at 2013 valuation;

- £ lump sum element = amount calculated as balance of notional contribution rate that year, when applied to payroll increased from 2013 in line with valuation assumption (as opposed to actual payroll that year).

The stabilisation criteria and limits will be reviewed at the 31 March 2016 valuation, to take effect from 1 April 2017. This will take into account the Council's membership profile, whether stabilisation should continue to apply (and if so, whether this should be extended to other employers), and other relevant factors.

Note (c) (Deficit Recovery Periods)

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2014 for the 2013 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example where there were no new entrants.

The period lengths have changed since the 2010 valuation as follows:

- Scheduled Bodies: reduced from 25 years to 22 years, with a view to further reducing this to 20 years at the next valuation;

- Community Admission Bodies: typically increased from 3 years to 15 years (if open to new entrants) or future working lifetime (if closed).

Where stabilisation applies, the resulting employer contribution rate would be amended to comply with the stabilisation mechanism.

For employers with no (or very few) active members at this valuation, the deficit should be recovered by a fixed monetary amount over a period to be agreed with the body or its successor, not to exceed 3 years.

Note (d) (Deficit Recovery Payments)

The deficit recovery payments for each employer are typically expressed in monetary terms (as opposed to percentage of payroll). This is to avoid the situation where a stagnating or falling payroll results in insufficient deficit recovery payments being made over the three year period.

For certain employers, at the Administering Authority's discretion, these payments may instead be set as a percentage of salaries. However, the Administering Authority reserves the right to amend these rates between valuations and/or to require these payments in monetary terms instead, for instance where:

- the employer is relatively mature, i.e., has a large deficit recovery contribution rate (e.g., above 15% of payroll), in other words its payroll is a smaller proportion of its deficit than is the case for most other employers, or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed the Fund to new entrants.

Note (e) (Phasing in of contribution changes)

Phasing is the gradual stepping from the current contribution rate in 2013-14 to the full calculated rate resulting from the 2013 valuation. It is often used to help keep employer contribution rates as nearly stable as possible from one year to the next.

In any given case the Administering Authority will discuss with the actuary whether phasing is appropriate given the risks involved (see 3.2 above), including the Administering Authority's view of the strength of the employer's covenant.

Where phasing is applied this will normally result in three equal annual steps.

Note (f) (Regular Reviews)

Such reviews may be triggered by significant events including but not limited to:

- significant reductions in payroll;
- altered employer circumstances;
- Government restructuring affecting the employer's business; or
- failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

Note (g) (New Academy employers)

At the time of writing, the Fund's policies on academies' funding issues are as follows:

a) The new academy will be regarded as a separate employer in its own right and will not be pooled with other employers in the Fund. The only exception is where the academy is part of a Multi Academy Trust (MAT) in which case the academy's figures will be calculated as below but can be combined with those of the other academies in the MAT;

b) The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status;

c) The new academy will be allocated an initial asset share from the Council's assets in the Fund. This asset share will be calculated using the Council's estimated funding position at the date of academy conversion. The academy asset share will be based on the active members' funding level, having first allocated assets in the Council's share to fully fund deferred and pensioner members. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion;

d) The new academy's initial contribution rate will be calculated using market conditions, Council funding position, and membership data, all as at the day prior to conversion.

The Fund's policies on academies are subject to change in the light of any amendments to DCLG guidance. Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS. In particular, in line with the Fund's funding strategy generally, these policies will be reconsidered at each valuation.

Note (h) (New Admission Bodies)

With effect from 1 October 2012, the LGPS 2012 Miscellaneous Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date. Under these Regulations, all new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset under-performance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund;
- the current deficit.

For all new Transferee Admission Bodies, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis.

The above approaches reduce the risk to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

Note (i) (New Transferee Admission Bodies)

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as the Council or an academy) to another organisation (a “contractor”). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees’ Fund benefits. The *quid pro quo* is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see Note (j).

Employers which “outsource” have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i. *Pooling*
The contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which is may be under the stabilisation approach.

ii. *Letting employer retains pre-contract risks*
The letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor’s contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii. *Fixed contribution rate agreed*
The contractor pays a fixed contribution rate throughout the term of the contract, and doesn’t pay any cessation deficit.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example, the contractor should typically be responsible for pension costs that arise from;

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above;
- redundancy and early retirement decisions.

Note (j) (Admission Bodies Ceasing)

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund;
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

a) Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in Appendix E;

b) Alternatively, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee;

c) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

Under (a) and (c), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund would look to any bond, indemnity or guarantee in place for the employer.

In the event that the Fund is not able to recover the required payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a “gilts cessation basis” and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

3.4 Pooled contributions

From time to time the Administering Authority may set up pools for employers with similar characteristics, with the consent of the employers concerned. This will always be in line with its broader funding strategy. In particular:

- With the advice of the actuary, the Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service;
- Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not usually permitted to participate in a pool;
- Transferee Admission Bodies are usually also ineligible for pooling;
- Smaller admitted bodies may be pooled with the letting employer, provided all parties (particularly the letting employer) agree;
- Schools are generally pooled with the Council. However this does not apply to academies, specialist schools or independent schools.

Employers who are permitted to enter (or remain in) a pool at the 2013 valuation will not normally be advised of their individual contribution rate unless agreed by the Administering Authority.

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

3.5 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer’s contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended deficit recovery period, or permission to join a pool with another body (e.g., the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan;
- whether the admission agreement is likely to be open or closed to new entrants.

3.6 Non ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). (N.B. the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014). Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

Employers must make these additional contributions as a one off payment to the Fund in the financial year following the award of an early retirement. In exceptional circumstances, the Administering Authority may at its absolute discretion agree to spread the payment over a period not exceeding three years. If this is agreed, interest will be charged using factors provided by the actuary.

3.7 Ill health early retirement costs

Ill health early retirements can give rise to very large "strains" on the Fund, as the cost of immediate (and possibly enhanced) benefit payments will be greater than the reserve previously being targeted. This strain will normally fall on the employer concerned. (The strain cost may be mitigated by insurance: see 3.8 below).

The cumulative cost of ill health retirements between actuarial valuations will in effect be reflected in the employer's results at the next valuation.

Where a different approach is adopted (e.g., regularly monitoring ill health experience and requesting contributions between valuations), details will be included in that employer's Admission Agreement.

3.8 Ill health insurance

An employer may arrange an insurance policy covering ill health early retirement strains, in which case it should provide satisfactory evidence to the Administering Authority of this. In such cases, the employer's required minimum contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total minimum employer contribution is unchanged.

The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

3.9 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis (see 3.3, Note (j)) and consequently have no further obligation to the Fund. Thereafter, it is expected that one of two situations will eventually arise:

a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;

b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation, the remaining assets would be apportioned pro-rata by the Fund's actuary to the other Fund;

c) In exceptional circumstances the Fund may permit an employer with no remaining active members to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written on-going commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases, as the employer would have no contributing members.

3.10 Policies on bulk transfers

The Fund has a separate written policy which covers bulk transfer payments into, out of and within the Fund. Each case will be treated on its own merits, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities.

  However, the Fund may permit shortfalls to arise on bulk transfers if the Administering Authority is satisfied that the employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.
- Active members switching employment from one Fund employer to another will result in assets equal to the past service liabilities being re-allocated between the employers, i.e., a "fully funded transfer". This means that the deficit at the point of transfer is retained by the ceding employer.

  However, in the case of schools converting to academy status (i.e., the members switch from Council employment to the new Academy), the process is instead as per Note (g) to section 3.3 above. This is because the guidance from the Department for Education and the Department for Communities and Local Government anticipates that the past service deficit will be inherited by the new Academy.

4 Funding strategy and links to investment strategy

4.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (SIP), which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out after each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

4.2 What is the link between funding strategy and investment strategy?

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa.

Therefore, the funding and investment strategies are inextricably linked.

4.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The asset out-performance assumption contained in the discount rate (see E3) is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government (see A1).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.4 How does this differ for a large stable employer?

The actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

- Prudence - the Fund should have a reasonable expectation of being fully funded in the long term;
- Affordability – how much can employers afford;

- Stewardship – the assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position;
- Stability – employers should not see significant moves in their contribution rates from one year to the next, and this will help to provide a more stable budgeting environment.

The key problem is that the key objectives often conflict. For example, minimising the long term cost of the scheme (i.e., keeping employer rates affordable) is best achieved by investing in higher returning assets, e.g., equities. However, equities are also very volatile (i.e., go up and down fairly frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

Therefore a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling: this is a set of calculation techniques applied by the Fund's actuary, to model the range of potential future solvency levels and contribution rates.

The actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach (see 3.3 Note (b)). The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes as described in 3.3 Note (b), struck an appropriate balance between the above objectives. In particular the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Fund.

Whilst the current stabilisation mechanism is to remain in place until 2017, it should be noted that this will need to be reviewed following the 2016 valuation.

4.5 Does the Fund monitor its overall funding position?

The Administering Authority monitors the relative funding position, i.e., changes in the relationship between asset values and the liabilities value, annually. It reports this in its published Brent Pension Fund Annual Report and Accounts.

Appendix A – Regulatory framework

A1 Why does the Fund need an FSS?

The Department for Communities and Local Government (DCLG) has stated that the purpose of the FSS is:

- *"to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;*
- *to support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and*
- *to take a prudent longer-term view of funding those liabilities."*

These objectives are desirable individually, but may be mutually conflicting.

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2012) and to its Statement of Investment Principles.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to "consultation with such persons as the authority considers appropriate", and should include "a meaningful dialogue at officer and elected member level with Council Tax raising authorities and with corresponding representatives of other participating employers".

In practice, for the Fund, the consultation process for this FSS was as follows:

a) A draft version of the FSS was issued to all participating employers in early February 2014 for comment;

b) Comments were requested within 10 days;

c) Following the end of the consultation period the FSS was updated where required and then published, in late February 2014.

A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website, at www.brent.gov.uk;
- A copy sent by e-mail to each participating employer in the Fund;
- A full copy included in the annual report and accounts of the Fund;
- Copies made available on request.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2016.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications;
- amendments affecting only one class of employer would be consulted with those employers;
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Pension Fund Sub-Committee and would be included in the relevant Pension Fund Sub-Committee meeting minutes.

A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Statement of Investment Principles, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at www.brent.gov.uk.

Appendix B – Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to each play their part.

B1 The Administering Authority should:-

- operate the Fund as per the LGPS Regulations;
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
- collect employer and employee contributions, and investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles (SIP) and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the Fund's actuary;
- prepare and maintain a FSS and a SIP, after consultation;
- notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the fund's performance and funding and amend the FSS/SIP as necessary and appropriate.

B2 The individual employer should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

B3 The Fund actuary should:-

- prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;

- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
- advise on the termination of Admission Bodies' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties:-

- investment advisers (either internal or external) should ensure the Fund's SIP remains appropriate, and consistent with this FSS;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the SIP;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures.

Appendix C – Key risks and controls

C1 Types of risk

The Administering Authority has an active risk management programme in place. The measures that it has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.	Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing. Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc. Analyse progress at three yearly valuations for all employers. Inter-valuation roll-forward of liabilities between valuations at whole Fund level.
Inappropriate long-term investment strategy.	Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes. Chosen option considered to provide the best balance.
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	Stabilisation modelling at whole Fund level allows for the probability of this within a longer term context. Inter-valuation monitoring, as above. Some investment in bonds helps to mitigate this risk.
Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.

Pay and price inflation significantly more than anticipated.	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Inter-valuation monitoring, as above, gives early warning. Some investment in bonds also helps to mitigate this risk. Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies.	An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions.
Orphaned employers give rise to added costs for the Fund.	The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future. If it occurs, the actuary calculates the added cost spread pro-rata among all employers – (see 3.9).

C3 Demographic risks

Risk	**Summary of Control Mechanisms**
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.
Maturing Fund – i.e., proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.

Deteriorating patterns of early retirements.	Employers are charged the extra cost of non ill-health retirements following each individual decision. Employer ill health retirement experience is monitored, and insurance is an option.
Reductions in payroll causing insufficient deficit recovery payments.	In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows: Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (b) to 3.3). For other employers, review of contributions is permitted in general between valuations (see Note (f) to 3.3) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.

C4 Regulatory risks

Risk	**Summary of Control Mechanisms**
Changes to national pension requirements and/or HMRC rules, e.g., changes arising from public sector pension reform.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. The results of the most recent reforms have been built into the 2013 valuation. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.

C5 Governance risks

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g., large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data. The actuary may revise the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations. Deficit contributions may be expressed as monetary amounts.
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way.	The Administering Authority maintains close contact with its specialist advisers. Advice is delivered via formal meetings involving elected members, and recorded appropriately. Actuarial advice is subject to professional requirements such as peer review.
Administering Authority failing to commission the Fund actuary to carry out a termination valuation for a departing Admission Body.	The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes. Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.

An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: Seeking a funding guarantee from another scheme employer, or external body, wherever possible (see Notes (h) and (j) to 3.3). Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. Vetting prospective employers before admission. Where permitted under the regulations requiring a bond to protect the Fund from various risks. Requiring new Community Admission Bodies to have a guarantor. Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to 3.3). Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to 3.3).

Appendix D – The calculation of employer contributions

In Section 2 there was a broad description of the way in which contribution rates are calculated. This Appendix considers these calculations in much more detail.

The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the "future service rate"; plus

b) an adjustment for the funding position of accrued benefits relative to the Fund's solvency target, "*past service adjustment*". If there is a surplus there may be a reduction in the employer's contribution rate. If there is a deficit there will be an increase in the employer's contribution rate, with the surplus or deficit spread over an appropriate period. The aim is to return the employer to full funding over that period. See Section 3 for deficit recovery periods.

The Fund's actuary is required by the regulations to report the *Common Contribution Rate*, for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay; it is in effect an average rate across all employers in the Fund.

The Fund's actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to an individual employer. It is the adjusted contribution rate which employers are actually required to pay. The sorts of "peculiar" factors which are considered are discussed below.

In effect, the *Common Contribution Rate* is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific past service deficit spreading and increased employer contribution phasing periods.

D2 How is the Future Service Rate calculated?

The future service element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members' future service in the Fund. This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

The future service rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The calculation is on the "ongoing" valuation basis (see Appendix E), but where it is considered appropriate to do so the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a more prudent basis (see Section 3).

The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies and Designating Employers that may have the power not to automatically admit all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

a) Employers which admit new entrants

These rates will be derived using the "Projected Unit Method" of valuation with a one year period, i.e., only considering the cost of the next year's benefit accrual and contribution income. If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g., because of lower recruitment) the rate would rise over time.

b) Employers which do not admit new entrants

To give more long term stability to such employers' contributions, the "Attained Age" funding method is normally adopted. This measures benefit accrual and contribution income over the whole future anticipated working lifetimes of current active employee members.

Both approaches include expenses of administration to the extent that they are borne by the Fund, and include allowances for benefits payable on death in service and ill health retirement.

D3 How is the Solvency / Funding Level calculated?

The Fund's actuary is required to report on the "solvency" of the whole Fund in a valuation which should be carried out at least once every three years. As part of this valuation, the actuary will calculate the solvency position of each employer.

'Solvency" is defined to be the ratio of the market value of the employer's asset share to the value placed on accrued benefits on the Fund actuary's chosen assumptions. This quantity is known as a funding level.

For the value of the employer's asset share, see D5 below.

For the value of benefits, the Fund actuary agrees the assumptions to be used with the Administering Authority – see Appendix E. These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer's current and former employees, based on pensionable service to the valuation date only (i.e., ignoring further benefits to be built up in the future).

The Fund operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see Section 3).

D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (e.g., mix of members by age, gender, service vs. salary);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;

- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made;

over the period between each triennial valuation.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers, to the extent that employers in effect share the same investment strategy. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus".

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification but not to audit standard. The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

Appendix E – Actuarial assumptions

E1 What are the actuarial assumptions?

These are expectations of future experience used to place a value on future benefit payments ("the liabilities"). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

Changes in assumptions will affect the measured value of future service accrual and past service liabilities, and hence the measured value of the past service deficit. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower liability values and lower employer costs. A more prudent basis will give higher liability values and higher employer costs.

E2 What basis is used by the Fund?

The Fund's standard funding basis is described as the "on-going basis", which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term, a more prudent basis applies: see Note (a) to 3.3.

E3 What assumptions are made in the on-going basis?

a) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund's investments. This "discount rate" assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds ("gilts"). There is, however, no guarantee that Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2013 and setting contribution rates effective from 1 April 2014, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.6% per annum greater than gilt yields at the time of the valuation, for all employers, and for all periods pre- and post-retirement. (At the 2010 valuation a more optimistic assumption was made, and different assumptions applied to different employers and periods).

In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this new 1.6% p.a. asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

b) Salary growth

Pay for public sector employees is currently subject to restriction by the UK Government until 2016. Although this “pay freeze” does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards.

Based on long term historical analysis of the membership in LGPS funds, the salary increase assumption at the 2013 valuation has been set at 0.8% per annum above the retail prices index (RPI). This is a change from the previous valuation, which assumed pay growth of RPI plus 1.5% per annum.

There is an added allowance for promotional increases.

c) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. This change was allowed for in the valuation calculations as at 31 March 2010. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the “formula effect” of the difference between RPI and CPI. At this valuation, we propose a reduction of 0.8% per annum. This is a larger reduction than at 2010 (which was 0.5% p.a.).

d) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund at this valuation and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of “VitaCurves”, produced by the Club Vita’s detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation. This is a change from the 2010, when standard actuarial tables were adopted.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the on-going valuation basis for future improvements in line with “medium cohort” and a 1.25% per annum minimum underpin to future reductions in mortality rates.

The combined effect of the above changes from the 2010 valuation approach, is an average life expectancy around 1½ - 2 years lower than at 2010. The approach taken is considered reasonable in light of the Fund-specific analysis, the data available from Club Vita more broadly, the long term nature of the Fund and the assumed level of security underpinning members' benefits.

e) General

The same financial assumptions are adopted for all employers, in deriving the past service deficit and the future service rate: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

Appendix F – Glossary

Actuarial assumptions / basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of liabilities. The main assumptions will relate to the discount rate, salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value.
Administering Authority	The Council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
Admission Bodies	Employers which voluntarily participate in the Fund, so that their employees and ex-employees are members. There will be an Admission Agreement setting out the employer's obligations. For more details (see 2.5).
Common contribution rate	The Fund-wide future service rate plus past service adjustment. It should be noted that this will differ from the actual contributions payable by individual employers.
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Deficit	The shortfall between the assets value and the liabilities value. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions).
Deficit repair/recovery period	The target length of time over which the current deficit is intended to be paid off. A shorter period will give rise to a higher annual past service adjustment (deficit repair contribution), and vice versa.
Designating Employer	Employers such as town and parish councils which are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund.
Discount rate	The annual rate at which future assumed cash flows (in and out of the Fund) are discounted to the present day. This is necessary to provide a liabilities value which is consistent with the present day value of the assets, to calculate the deficit. A lower discount rate gives a higher liabilities value, and vice versa. It is similarly used in the calculation of the future service rate and the common contribution rate.
Employer	An individual participating body in the Fund, which employs (or used to employ) members of the Fund. Normally the assets and liabilities values for each employer are individually tracked, together with its future service rate at each valuation.

Funding level	The ratio of assets value to liabilities value: for further details (see 2.2).
Future service rate	The actuarially calculated cost of each year's build-up of pension by the current active members, excluding members' contributions but including Fund administrative expenses. This is calculated using a chosen set of actuarial assumptions.
Gilt	A UK Government bond, i.e., a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's covenant to be as strong as its guarantor's.
Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority, but can sometimes be another type of employer such as an Academy.
Liabilities	The actuarially calculated present value of all pension entitlements of all members of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the deficit. It is calculated on a chosen set of actuarial assumptions.
LGPS	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 101 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g., regarding investment strategy, employer contributions and choice of advisers.
Maturity	A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.

Members	The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).
Past service adjustment	The part of the employer's annual contribution which relates to past service deficit repair.
Pooling	Employers may be grouped together for the purpose of calculating contribution rates, so that their combined membership and asset shares are used to calculate a single contribution rate applicable to all employers in the pool. A pool may still require each individual employer to ultimately pay for its own share of deficit, or (if formally agreed) it may allow deficits to be passed from one employer to another. For further details of the Fund's current pooling policy (see 3.4).
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's members, i.e., current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its maturity also.
Rates and Adjustments Certificate	A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal valuation. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, police and fire authorities, etc., other than employees who have entitlement to a different public sector pension scheme (e.g., teachers, police and fire officers, university lecturers).
Solvency	In a funding context, this usually refers to a 100% funding level, i.e., where the assets value equals the liabilities value.
Stabilisation	Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these.

Theoretical contribution rate	The employer's contribution rate, including both future service rate and past service adjustment, which would be calculated on the standard actuarial basis, before any allowance for stabilisation or other agreed adjustment.
Valuation	An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is normally carried out in full every three years (last done as at 31 March 2013), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date also.

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Brent	**Pension Fund Sub-Committee** 25 February 2014 **Report from the Chief Finance Officer**
For Action	Wards Affected: ALL

Update on joining a collective investment vehicle for London pension funds and commitments for capital

1. SUMMARY

1.1 The Pension Fund Sub-Committee has been supportive of a collective investment vehicle for London and at its meeting of 19 November 2013 showed its commitment to collaborating with other London pension funds by agreeing to make a contribution of £25,000 (borne by the Brent Pension Fund), in order to engage expert legal and financial services advisers to perform the necessary financial and regulatory work which in the first instance has included developing a robust business case relating to the investigation and set up of a London-wide collective investment vehicle (CIV). In the longer term, costs incurred in operating the CIV would be recoverable from participating boroughs which would be more than paid for from reduced fees.

1.2 To date, a total of £625,000 has already been contributed by the boroughs (25 boroughs x £25,000 each). The objective of the CIV is to harness the joint purchasing power of the participating boroughs to drive down fund managers' fees and improve investment performance. The CIV would provide an expedient way of enhancing investment objectives of the Brent Pension Fund without undermining Member control and autonomy.

1.3 The Government's review of the future structure of Local Government Pension Schemes is on-going, and could involve reducing the number of locally administered LGPS schemes through merger. It is important that the boroughs can demonstrate progress in working collaboratively in setting up the CIV as a viable alternative to merger to inform the Government's deliberations.

1.4 The London Councils prepared a report for the Leaders' Committee (see attached) which provided an update on progress towards instating a London LGPS CIV and asked the Leaders' Committee to recommend to the boroughs that they proceed and establish an Authorised Contractual Scheme (ACS) and an ACS Operator (which is the company that would manage the ACS), together with establishing a representative body in the form of a Pensions CIV Joint Committee which will comprise elected Councillors nominated by participating boroughs.

1.5 The London Councils Leaders' Committee approved the formation of the CIV on 11 February 2014, so it is necessary for the Council to apply that framework and formally consider whether to join the CIV company and participate in a new Joint Committee.

1.6 Chief finance officers would provide advice to both the borough Pension Committees (as they do now) and to their Authority's representative on the Pensions CIV Joint Committee.

1.7 It should be noted that the proposals are based on voluntary participation by boroughs, and the decision as to whether to invest in the ACS would be made by individual boroughs later in the year. There is nothing in the report that locks any borough into any level of commitment to invest.

1.8 All London boroughs are expected to respond in writing to the London Councils Chief Executive by 14 April 2014 to advise their decision on whether to endorse the proposed recommendations included in the report.

1.9 At its meeting of 3 March 2014, the Council is recommended to resolve to:

a) become a shareholder in a private company limited by shares which will be incorporated to be the Authorised Contractual Scheme Operator (the ACS Operator") of the Collective Investment Vehicle;
b) contribute £1 to the ACS Operator as initial capital;
c) delegate to the Chair of the Pension Fund Sub-Committee authority to act for the Council in exercising its rights as a shareholder of the ACS Operator, and to authorise the Vice Chair of the Pension Fund Sub-Committee to act in their absence; and
d) agree to join the London boroughs' "Pensions CIV Joint Committee", to be formed under section 102 of the Local Government Act 1972 and to delegate to such Joint Committee those functions necessary for the proper functioning of the ACS Operator, including the effective oversight of the ACS Operator and the appointment of Directors.

2. RECOMMENDATION

2.1 Members of the Pension Fund Sub-Committee are asked to give their comments on the recommendations to be resolved by Council at its meeting of 3 March 2014 as outlined in paragraph 1.9 above.

3. DETAIL

3.1 London Councils Leaders' Committee has considered the issue of collective investments for London Pension Funds throughout 2012, and 2013. They have concluded that more collaboration between boroughs that wished to collectively invest some or all of their pension funds would be likely to produce significant savings. The London Councils Leaders' Committee has approved the detailed business case and a proposed governance structure. They have also approved that a London Local Government Pension Scheme (LGPS) Collective Investment Vehicle (CIV), in the form of a UK based, Financial Conduct Authority (FCA) approved, Authorised Contractual Scheme (ACS) be set up. This report details the action that the Council needs to take to enable participation.

3.2 At their meeting on 11 February 2014, London Councils Leaders' Committee approved that they should recommend to the London boroughs that they proceed to establish an Authorised Contractual Scheme (ACS) and the ACS Operator (which is the company that would manage the ACS). For this to occur London boroughs would need to agree to become shareholders in the ACS Operator and delegate oversight of the company to a JointCommittee hosted by London Councils. A copy of the paper submitted to London Councils Leaders Committee is appended.

3.3 It should be noted that, participation is voluntary by boroughs, and even if a borough decides to participate each borough will make separate decisions to invest, disinvest or not invest at all for each asset mandate in the same way that Pensions Committees do currently. It is expected that the decision as to whether to invest in the ACS would be made by individual boroughs later in the year.

3.4 The business case considered by London Councils analysed the savings, benefits and costs for a variety of different levels of collective assets under management: £24bn, £10bn and £5bn, producing estimated annual net savings of £112.2Million, £44.9 Million and £20.9Million respectively. It is considered that a reasonable minimum target size of assets under management for the ACS is in the range of £5bn. This is based on analysis of existing investments held by London borough funds and also takes into account that initially the majority of investment mandates are likely to be passive mandates. Over time, it is expected that actively managed mandates and investments into alternatives such as property and infrastructure assets may be added to the range of investments offered by the ACS.

3.5 The London Councils Leaders Report sets out the likely Governance structures and key principles. The principles include: investment in the ACS should be voluntary; ability to choose how much to invest in individual asset classes; boroughs should have sufficient control over the ACS Operator; the ACS Operator would provide regular information to participating boroughs; and Authorities seeking to invest in the ACS will also take a shareholding interest in the Operator (and have membership of the Pensions CIV Joint Committee). This Joint Committee will be established under the existing London Councils arrangements to assist in the appointment of directors to the ACS Operator. The Pensions CIV Joint Committee will comprise elected Councillors nominated by participating boroughs as provided for under the existing London Councils Governing Agreement. Information will be provided regularly by the ACS and the ACS Operator to local authorities investing, and their Pension Committees and officers, and the Pensions CIV Joint Committee. Directors of Finance will provide advice to both the borough Pension Committees (as they do now) and to their authority's representative on the Pensions CIV Joint Committee. The London Council's report proposes that the Chairman of the Pensions Committee represents the Council or in the event that all 33 boroughs decide to join then the Leader fulfils this role, as in that event the existing London Councils Leaders Committee can undertake the role.

3.6 In order that the Council can participate in the CIV the Council will need to agree to join the Joint Committee, this requires a resolution of the full Council. In addition the Council will need to formally delegate powers to the Joint Committee in respect of pension investments. This will be done by giving the Pensions Committee the ability to place funds with the CIV and to invest in one or more of the funds or fund managers selected by the CIV to manage various asset classes.

3.7 In broad terms, the proposed structure is that the boroughs will own all the share capital of the ACS Operator. Initially this will require minimal share capital (£1 per borough) but this capital requirement will increase once the operator is authorised and investments are made in the ACS.

4. FINANCIAL IMPLICATIONS

4.1 These are included within the report.

5. DIVERSITY IMPLICATIONS

5.1 None.

6. STAFFING IMPLICATIONS

6.1 None.

7. LEGAL IMPLICATIONS

7.1 These are included within the report.

8. BACKGROUND

8.1 Pension Fund Sub-Committee 19 November 2013– London pension fund collaboration.

9. CONTACT OFFICERS

9.1 Persons wishing to discuss the above should contact the Treasury and Pension Investment Section, Governance and Corporate Services, on 020 8937 1472 at Brent Town Hall.

CONRAD HALL	**ANTHONY DODRIDGE**
Chief Finance Officer	**Head of Exchequer and Investment**

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Leaders' Committee

Pensions Working Group: Progress report, business case, and proposed next steps towards a London LGPS CIV

Item no: X

Report by:	Hugh Grover	**Job title:**	Director, Fair Funding, Performance and Procurement
Date:	11 February 2014		
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Summary

This report follows on from previous discussions, in particular at Leaders' Committee throughout 2012, and in May and December of 2013, and discussions at the Executive in September and November 2013. Those discussions have focussed on the potential for more collaboration between boroughs that wished to do so, on the management and investment of pension funds.

In response to the report presented to Leaders' Committee in December 2013, London Councils has engaged expert legal and financial services advisors to develop a robust business case and formal proposal to inform decisions for implementation of a London LGPS Collective Investment Vehicle (CIV), in the form of a UK based, Financial Conduct Authority (FCA) Authorised Contractual Scheme (ACS).

This report which reflects the views and advice of the advisers, in consultation with London Councils' legal advisors from the City of London Corporation, fulfils that request. It sets out the current thinking of the Pensions Working Group (PWG) and asks Leaders' Committee to recommend to the boroughs that they proceed to establish an Authorised Contractual Scheme (ACS) and the ACS Operator (which is the company that would manage the ACS)

It should be noted that, all the proposals outlined in this report are based on voluntary participation by boroughs, and the decision as to whether to invest in the ACS would be made by individual boroughs later in the year. There is nothing proposed in the report that locks any borough into any level of commitment to invest.

Dialogue with HM Government relating to the Government's review of Local Government Pension Schemes is ongoing, and it is apprised of the progress made to date by London Councils and the PWG. At the time of writing the report, we still await the Government announcement on their proposed direction of travel.

This report provides an overview of the proposals and recommendations, Annex A provides Elected members with the underlying detail.

Recommendations Leaders' Committee is asked to:

1. Consider the report and the underlying business case supporting the establishment of a collective investment vehicle, in the form of an authorised contractual scheme (the "ACS"), for local authority pensions in London ("the Arrangements"); AND
2. Endorse and recommend to each local authority which decides to participate that, they resolve that:
   (a) a private company limited by shares be incorporated to be the Authorised Contractual Scheme Operator (the "ACS Operator"), structured and governed as outlined in this report, and that the local authority agrees –
      (i) to become a shareholder in the ACS Operator, and
      (ii) to contribute £1 to the ACS Operator as initial capital, and
      (iii) to appoint an elected Councillor who will have power to act for the local authority in exercising its rights as a shareholder of the ACS Operator, and
      (iv) that Mayor Pipe, Councillors O'Neill and Dombey, Mr Chris Bilsland (Chamberlain, City of London), Mr Chris Buss (Finance Director, LB Wandsworth), Mr Ian Williams (Finance Director, LB Hackney), and Mr John O'Brien (Chief Executive, London Councils) be appointed as the interim Directors of the ACS Operator, subject to the consent of their relevant authorities to the appointments. These directors may be replaced once FCA authorisation is formally applied for; and
   (b) a representative body, in the form of a new sectoral joint committee (the "Pensions CIV Joint Committee"), is established (pursuant to the existing London Councils Governing Agreement, dated 13 December 2001 (as amended)) to act as a representative body for those local authorities that resolve, in accordance with 2(a) above, to participate in the Arrangement (or in the alternative, should all 33 London authorities resolve to participate, that Leaders' Committee exercise these functions and the Governing Agreement be varied accordingly); and
   (c) All London local authorities respond in writing to the London Councils Chief Executive, by 14 April 2014, or before the day of the local government elections (22 May 2014), to advise of their decisions regarding the matters set out at paragraphs 2(a) and 2(b) above.

Pensions Working Group: Progress report and proposed next steps towards a London LGPS CIV

Introduction

1. At its December 2013 meeting, Leaders' Committee received a progress update from the Pensions Working Group (PWG), which outlined the views and recommendations of the PWG in respect of the potential London LGPS Collective Investment Vehicle (CIV). Leaders' Committee agreed the recommendations of the PWG that a business case and formal proposal should be prepared to inform decisions for implementation of a CIV which should be structured as a UK based, Financial Conduct Authority (FCA) Authorised Contractual Scheme (ACS). This report sets out the proposed business case, and formal proposal as to how to proceed. Leaders' Committee is asked to endorse the formal proposal for the formation of the ACS and its Operator, and to recommend the proposal to their own Council.

2. This paper recaps the financial benefits which may arise from operating an ACS, and sets out further details of the expected costs. It also sets out further details of the proposed structure of the ACS and potential governance arrangements (including the ACS Operator), together with the steps that are required to progress the project and establish the ACS and its Operator. This is set out in detail in Annex A, which should be read in conjunction with this report. The decision as to whether to invest in the ACS, once established, will remain with each Borough Pensions Committee and is distinct from the decision which is now being recommended to establish a new Pensions CIV Joint Committee and the Operator of the ACS. Any decisions regarding investment in the ACS will not begin until later in the year and are likely to be on an asset class by asset class basis.

Background

3. In 2012, a report from PwC set out options for reconfiguring the London LGPS funds, and indicated the possible financial benefits of a CIV. Since then, the matter has been discussed several times, and it was agreed that further consideration should be given to creating a CIV, and that the most appropriate structure for the CIV would be an ACS. A number of the local authorities agreed to contribute £25-£50k towards exploring the proposal which are held in a designated fund by London Councils. These contributions will fund the professional costs associated with development of the proposed ACS and its Operator.

4. The Government issued a call for evidence on the future structure of the LGPS last year, and sought professional advice to consider either Collective Investment Vehicles or merger of funds as potential routes forward. This advice, being provided by Hymans Robertson, and the Government consultation are expected to be published shortly. However, it is unlikely that this will be ahead of Leaders' Committee meeting. Nonetheless, informal indications are that, while undoubtedly Leaders' Committee position will need to be considered in the light of whatever is published, it seems unlikely that the benefit of CIVs will be fundamentally challenged.

5. At its December 2013 meeting, Leaders' Committee resolved to engage expert legal and financial services advisors to assist in the development of the ACS and its Operator. These advisors, along with a Custodian advisor, have been appointed and over recent weeks further analysis has been undertaken on the legal, regulatory, and financial aspects of implementing the CIV, in consultation with City of London lawyers who are London Councils' general legal advisors. The Leaders' Committee asked the PWG, having regard to that specialist advice, to develop a robust business case and formal proposal to proceed with implementation of the ACS to inform Boroughs' decisions, and this is set out in the sections which follow.

Proposed structure

6. It was previously agreed that the most appropriate structure for the CIV is an ACS fund and nothing has emerged to suggest that that recommendation should change. The ACS will require an FCA regulated ACS Operator to be established. The board of directors and employees of this company will have overall responsibility for the operation of the ACS.

7. In considering the proposed structure of the ACS and its Operator, the PWG has sought to adhere to the following overarching principles, in order that the arrangement can best meet the requirements of the boroughs:

   a) Investment in the ACS should be voluntary. A borough should be able to decide it does not wish to participate, or to the extent it initially decided to participate, to choose to withdraw its investment.

   b) If a borough chose to invest, it will be able to choose which asset classes to invest into, and how much it might invest into each asset class.

   c) The boroughs should have sufficient control over the ACS Operator, in order to be assured that it will be acting in their best interests.

   d) The ACS Operator would provide regular information to participating boroughs regarding the performance of managers, investment options, and other areas, so that information continues to be available to the same extent it is currently in order for boroughs to make investment decisions.

   e) Authorities seeking to invest in the ACS will also take a shareholding interest in the Operator (and have membership of the Pensions CIV Joint Committee).

   f) The ACS will not increase the overall investment risk faced by boroughs.

8. The ownership structure and process for governance and decision making of the ACS Operator has been considered in some detail and is set out in the diagram below. The analysis contained in this paper including the Annex is a summary of the key issues associated with the establishment of the structure. Additional detail including in particular legal and regulatory analysis will be required in due course as the project progresses.

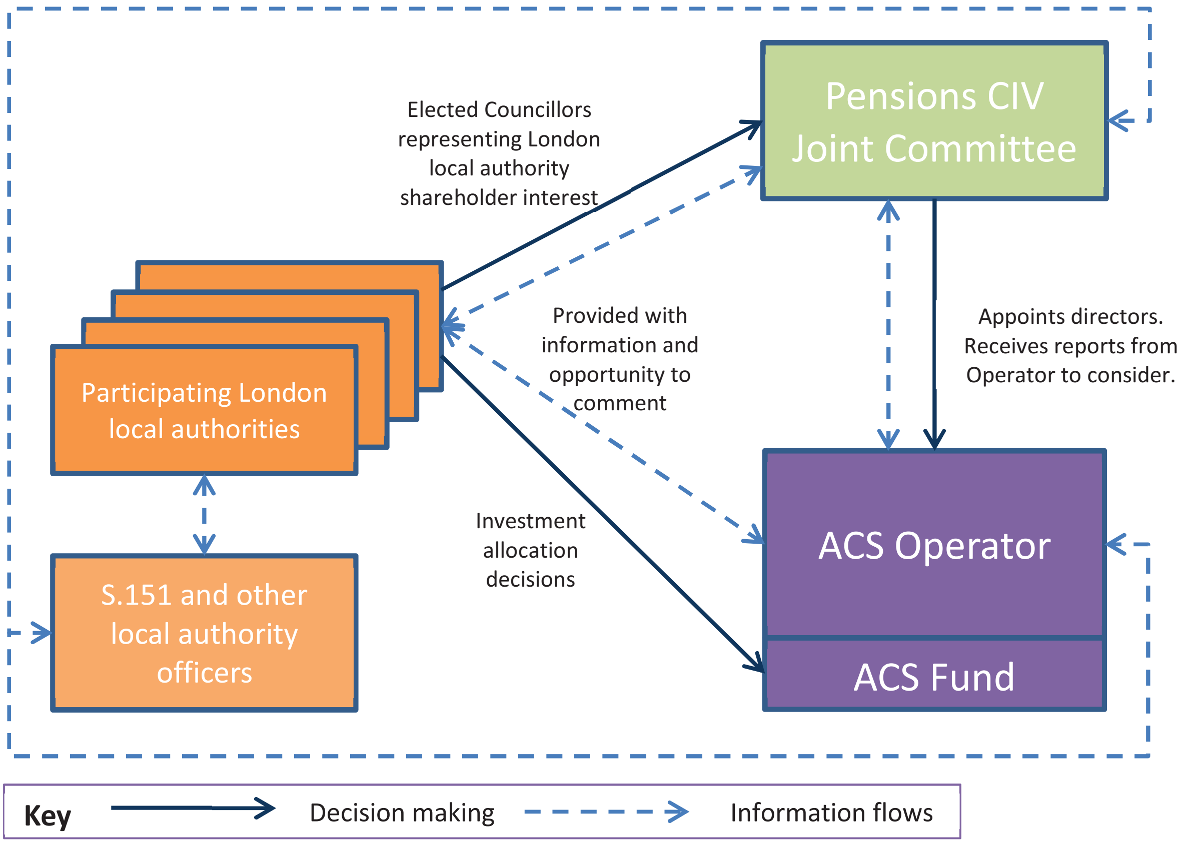
9. In broad terms, the proposed structure is that the boroughs will own all the share capital of the ACS Operator. Initially this will require minimal share capital (£1 per borough) but this capital requirement will increase once the operator is authorised and investments

are made in the ACS. The capital requirements are considered in more detail below (see paragraphs 14-18).

10. A new 'Pensions CIV Joint Committee' will be established under the existing London Councils arrangements to assist in the appointment of directors to the ACS Operator. The Pensions CIV Joint Committee will comprise elected Councillors nominated by participating boroughs as provided for under the existing London Councils Governing Agreement. Information will be provided regularly by the ACS and the ACS Operator to local authorities investing, and their Pension Committees and officers, and the Pensions CIV Joint Committee. Borough treasurers will provide advice to both the borough Pension Committees (as they do now) and to their authority's representative on the Pensions CIV Joint Committee.

11. The governance arrangements and lines of communication between various interested parties are illustrated in the diagram below.

Fig 1 – CIV governance and communication lines



12. The proposed structure has been designed to allow boroughs to have strong oversight and control over the ACS Operator. This oversight and control is achieved at a number of levels including the following:

a) The boroughs will own all the shares in the ACS Operator and will be able to exert influence over the ACS Operator's board and activities through their shareholdings;

b) The ‘Pensions CIV Joint Committee’ will be made up of elected Councillors nominated by their boroughs. This Joint Committee will represent and assist the boroughs having a shareholding in the ACS and will have the power to identify and appoint key directors to the ACS Operator. It would also be a forum to discuss key issues which affect the participating local authorities, both individually and collectively;

c) Subject to regulatory requirements, the board of directors of the ACS Operator is likely to include some representatives of the shareholders of the ACS Operator (expected to be appointed from the elected Councillors who will sit on the Pensions CIV Joint Committee and who will represent all participating local authorities' interests);

d) The ACS operator will require staff (on a part-time basis) to assist in activities including investment manager selection and it is proposed that as many of these roles as possible may be undertaken by existing elected Councillors and officers of boroughs with relevant experience; and

e) Information relating to the performance of investments and the ACS Operator will be made available on a regular basis to boroughs investing and the Pensions CIV Joint Committee representing the boroughs' shareholding interest in the Operator.

13. Should boroughs be minded to proceed with establishing the ACS Operator, at this stage the company can be established with interim directors, with formal appointments for the ongoing directors made in the autumn, prior to FCA approval.

Capital requirements of the ACS Operator

14. Initially the ACS Operator will only require minimal share capital and, as such, it is recommended that each borough that wishes to proceed will acquire £1 of share capital in the company.

15. Immediately before the ACS Operator receives regulatory approval (expected to be 4th quarter 2014 or 1st quarter 2015), it will require capital of c£100,000. It is proposed that this capital would be contributed by those boroughs who choose to move forward with the ACS in Autumn – so for example if 10 boroughs decided to proceed with the ACS in Autumn, this would require a capital contribution of £10,000 per borough.

16. Once the ACS starts receiving investments, it will require additional capital. It is proposed that boroughs who invest pension assets in the ACS, would contribute capital to the ACS Operator in proportion to the assets invested, expected to be c.2 to 3 basis points of assets invested (e.g. for £5bn of assets invested in the ACS, the ACS Operator would require capital of £1m to £1.5m). It should be noted that this contribution is an investment rather than an expense as this capital would be invested in liquid assets such as gilts rather than being used to pay expenses.

17. It should be noted that this contribution is an investment rather than an expense as this capital would be invested in liquid assets such as guilts rather than being used to pay expenses. It is not expected that this should materially impact any return to the boroughs as the funds invested could be from existing pension assets which are currently invested in gilts or similar investments. As such the borough fund could retain

exactly the same investment profile except that a very small proportion of its assets invested via gilts would be held indirectly through the ACS Operator rather than directly as at present.

18. It should be noted that boroughs who contribute £1 of share capital now will be under no obligation to make any further capital payments to the ACS operator. To the extent a borough takes a subsequent decision to invest in the ACS, it is proposed the borough would at that point invest further capital. (see paragraph 15).

Financial case

19. Previous work undertaken by PwC estimated savings in the region of £120m per annum from the creation of a CIV (the ACS), provided there was close to full participation by the 33 London local authorities. These benefits arose from reduced investment management fees, and improved performance. Costs of running the ACS were estimated to be £4.8m if there was full participation from all the authorities. At lower levels of participation, both the financial benefits and the costs would reduce.

20. More work has now been undertaken on potential costs and benefits, based on high level assumptions, and these are summarised in the table below. Additional details on the savings and costs are set out at Annex A. It is clear that, based on the expected savings previously identified, forecast costs should be comfortably covered by savings in reduced management fees.

Fig 2 - Summary of savings and costs

	Assets under management £24bn **£ 000's**	**Assets under management £10bn** **£000's**	**Assets under management £5bn** **£ 000's**
Expected savings per annum	120,000	50,000	25,000
On-going Costs per annum	(6,100)	(3,650)	(2,750)
Establishment Costs	(1,700)	(1,500)	(1,400)

21. Savings and costs have been analysed for assets under management of £24bn, £10bn and £5bn. It is considered that a reasonable minimum target size of assets under management for the ACS is in the range of £5bn. This is based on analysis of existing investments held by LGPF funds undertaken by the PWG and also takes into account that initially the majority of investment mandates are likely to be passive mandates. Over time, it is expected that active mandates and investments into alternatives such as property and some infrastructure assets may be added to the range of investments offered by the ACS.

22. Even at a level of assets under management of £5bn, the expected savings materially outweigh the expected costs. The actual savings and costs will naturally depend on the number of participating boroughs, amount of assets under management and the mix of investments that are selected for the ACS. It is expected that additional work to decide

on new investment managers and to agree costs will begin in the 4th quarter 2014 in order that boroughs can make investment decisions in 1st quarter 2015.

23. There will be professional fees and other costs associated with making the ACS fully operational (described as Establishment Costs in Fig 2 above). £625,000 of these costs has already been funded by boroughs and £344,000 committed to date. It is currently proposed that any additional costs of establishment, over and above the £625,000, would be borne by boroughs that choose to participate further in Autumn.

24. It should be noted that there is no obligation for any boroughs that choose to agree the recommendations set out in this paper to commit to any additional funding of costs. To the extent a borough takes a subsequent decision to invest in the ACS, it is proposed the borough would at that point invest further capital. (see paragraph 15).

Next Steps

25. Broadly, if the recommendations of this paper are agreed, and a number of boroughs wish to participate in the joint arrangements, the following steps will be undertaken:

    a) A new joint committee, (the 'Pensions CIV Joint Committee') will be established under the relevant legislation and existing London Councils Governing arrangements. To the extent all 33 boroughs wish to participate, London Councils Leaders' Committee would fulfil this role instead and the London Councils' Governing Agreement varied accordingly.

    b) The ACS Operator will be established, with participating boroughs having £1 of share capital in the company, and interim directors appointed.

    c) Further work will be undertaken regarding the final design and operation of the ACS Operator and ACS. The documents required by the FCA for the ACS and the ACS Operator to become authorised will be prepared.

26. A proposal will be prepared for Leaders' Committee to consider in the Autumn which will provide a clear timetable and costs for obtaining regulatory approval for the ACS Operator and the ACS, request a commitment for the initial capital of c. £100,000 from those authorities wishing to participate such that the ACS Operator can be authorised and request funding for establishing the initial staffing of the ACS Operator, and to meet any further establishment costs (per paragraphs 23 and 24 above).

Recommendations

27. Leaders' Committee is asked to:

    1. Consider the report and the underlying business case supporting the establishment of a collective investment vehicle, in the form of an authorised contractual scheme (the "ACS"), for local authority pensions in London ("the Arrangements"); AND

    2. Endorse and recommend to each local authority which decides to participate that, they resolve that:

        (a) a private company limited by shares be incorporated to be the Authorised Contractual Scheme Operator (the "ACS Operator"), structured and governed as outlined in this report, and that the local authority agrees –

(i) to become a shareholder in the ACS Operator, and

(ii) to contribute £1 to the ACS Operator as initial capital, and

(iii) to appoint an elected Councillor who will have power to act for the local authority in exercising its rights as a shareholder of the ACS Operator, and

(iv) that Mayor Pipe, Councillors O'Neill and Dombey, Mr Chris Bilsland (Chamberlain, City of London), Mr Chris Buss (Finance Director, LB Wandsworth), Mr Ian Williams (Finance Director, LB Hackney), and Mr John O'Brien (Chief Executive, London Councils) be appointed as the interim Directors of the ACS Operator, subject to the consent of their relevant authorities to the appointments. These directors may be replaced once FCA authorisation is formally applied for; and

(b) a representative body, in the form of a new sectoral joint committee (the "Pensions CIV Joint Committee"), is established (pursuant to the existing London Councils Governing Agreement, dated 13 December 2001 (as amended)) to act as a representative body for those local authorities that resolve, in accordance with 2(a) above, to participate in the Arrangement (or in the alternative, should all 33 London authorities resolve to participate, that Leaders' Committee exercise these functions and the Governing Agreement be varied accordingly); and

(c) All London local authorities respond in writing to the London Councils Chief Executive, by 14 April 2014, or before the day of the local government elections (22 May 2014), to advise of their decisions regarding the matters set out at paragraphs 2(a) and 2(b) above.

Legal Implications

28. The main legal implications are contained in this report and the attached Annex. The detail of the structure and governance of the ACS and its Operator will be firmed up as the preparatory work progresses. The establishment of a joint committee will be in accordance with arrangements under the Local Government Act 1972 and the Local Government Act 2000 to arrange for the joint discharge of decision making by the participating local authorities to support the arrangements for the collective investment vehicle. The Joint Committee will initially be established under the London Councils Governing Agreement, and the Terms of Reference of the new joint committee will provide for shared administrative functions, a forum to discuss key issues and power to appoint key directors of the ACS Operator; and it could be used more broadly if boroughs felt that to be appropriate. Should all 33 London local authorities resolve to participate, Leaders' Committee would discharge the relevant local authority functions and the Governing Agreement formally varied accordingly.

29. The Councils have power to enter into these arrangements as part of their function as an administering pensions authority taking account of its duty to invest in the interests of the pension fund and obligations in the Local Government (Pension Scheme) Management and Investment of Funds Regulations 2009. Additionally Councils have

power to invest further to Section 12 of the Local Government Act 2003 and must act in accordance with principles of best value and their general fiduciary duty.

Financial Implications

30. The Director of Corporate Resources reports that the estimate of possible costs and benefits arising from the establishment of a collective investment vehicle are detailed in full within the Annex of this report and summarised in the table at paragraph 20.

31. These figures are initial estimates and will be firmed up as preparatory work progresses, particularly in relation to the establishment and on-going costs. As detailed in paragraph 23, 25 boroughs have each been invoiced for a sum of £25,000 as a contribution towards establishment costs, amounting to £625,000 in total, with £344,000 of that sum committed to date.

32. There are some governance related issues that require further clarification, particularly surrounding the accounting requirements of the newly proposed Pensions CIV Joint Committee and how this will relate to the existing London Councils financial structures and work will continue to clarify this position.

Equalities Implications

33. There are no equalities implications for London Councils.

Attachments

Annex A: Business Case

Background Papers

13 March 2012, Leaders' Committee report:
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=4796

13 November 2012, Leaders' Committee report:
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5072

11 December 2012, Leaders' Committee report:
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5109

14 May 2013, Leaders' Committee report:
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5252

19 September 2013, Executive report:
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5353

26 November 2013, Executive report:
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5490

10 December 2013, Leaders' Committee report
http://www.londoncouncils.gov.uk/committees/agenda.htm?pk_agenda_items=5495

Business Case

1. At its December 2013 meeting, Leaders' Committee agreed the recommendations of the PWG that a business case and formal proposal should be prepared to proceed with implementation of a Collective Investment Vehicle, in the form of an Authorised Contractual Scheme (ACS). This Annex sets out the proposed business case.

2. This paper sets out further details of the proposed structure of the ACS and potential governance arrangements, including the establishment and capital requirements of the ACS Operator. It then recaps the financial benefits which may arise from operating an ACS, and sets out further details of the expected costs.

Proposed structure

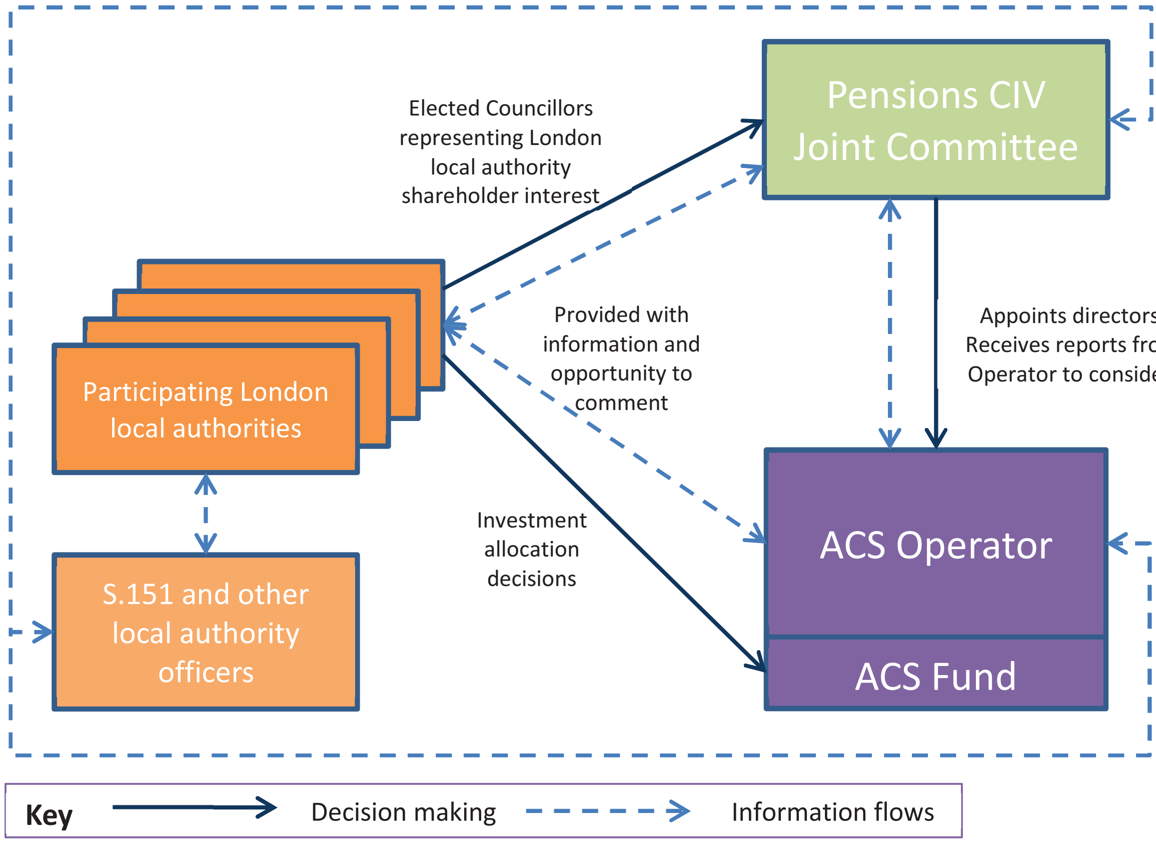
3. It was previously agreed that the most appropriate structure for the CIV is an ACS fund and nothing has emerged to suggest that that recommendation should change. The ACS will require an FCA regulated ACS Operator to be established. The board of directors and employees of this company will have overall responsibility for the operation of the ACS.

4. In broad terms, the proposed structure is that the participating boroughs will own all the share capital of the ACS Operator. Initially this will require minimal share capital (£1 per borough from those who wish to participate) but this capital requirement will increase once the operator is authorised and investments are made in the ACS. The capital requirements are considered in more detail at paragraph 32 onwards.

5. A new 'Pensions CIV Joint Committee' will be established to assist in the appointment of key directors of the ACS Operator, such as the Chairman and Chief Executive Officer. The Pensions CIV Joint Committee will comprise elected Councillors nominated by participating boroughs. Information will be provided regularly by the ACS Operator to investors in the ACS and borough Pension Committees and officers, and the Pensions CIV Joint Committee.

6. The governance arrangements and lines of communication between various interested parties are illustrated in the diagram below.

Fig 1 – CIV governance and communication lines



7. The following sections set out the above arrangements in more detail, setting out the governance arrangements, potential staff requirements, and the proposed process for investment manager selection and asset allocation.

Governance structure of the ACS Operator

8. The process for governance and decision making has been considered in some detail, and there are a range of options for how the governance arrangements could be structured. The precise arrangements would always be open to Council scrutiny and amendment, and subject to FCA requirements, but what is laid out below is seen as appropriate initial proposals to take the project forward at this point. Extensive legal advice has been taken and has been used to formulate the proposals that lead to the framework described below.

9. It is proposed that a new joint committee (the 'Pensions CIV Joint Committee') will be established under both section 102 of the Local Government Act 1972, Section 9EB of the Local Government Act 2000, and clause 3.1 of the existing London Councils' Governing Agreement, to act as a representative body for those local authorities that have chosen to participate, and would be made up of the Leaders (or another nominated elected Councillor) of those councils participating in the ACS. Should all the boroughs participate, this role would be performed by London Councils' Leaders' Committee (and the Governing Agreement would need to be formally varied). In relation to the make-up of this joint committee, it is proposed that boroughs that agree to become a shareholder in the ACS Operator would appoint a representative who will sit

on this committee. Whilst typically the borough Leader might be appointed as the representative on the joint committee, in the event that meetings are required to deal with specialist matters e.g. discussions on investment matters, it may be that a person with appropriate expertise would act as a deputy to attend such meetings, e.g. for investor matters, the Chair of the relevant Borough Pension Committee could be appointed. A deputy would need to be appointed at the same time as the main representative. Provision is made for these arrangements under the existing London Councils Governing Agreement dated 13 December 2001 (in particular refer to clauses 3.1 and 4.5 of the Agreement and Standing Orders).

10. One of the main purposes of the Pensions CIV Joint Committee will be to act as a forum to recommend/approve the appointment of key directors to the board of the ACS Operator. The ability to appoint directors of the ACS Operator ultimately rests with the shareholders (who in practice, the Elected Councillors sitting on the joint committee represent) and analysis is currently on-going to determine the most appropriate methodology for the wishes of the shareholders to be executed in a manner which is acceptable given various constraints that exist within local government, Companies Act 2006 requirements, and FCA regulations.

11. The exact mandate of the joint committee will require further consideration. The frequency of meetings of the joint committee also needs to be decided.

12. Should boroughs be minded to proceed with establishing the ACS Operator, at this stage the company can be established with interim directors, with formal appointments for the ongoing directors made later in the year, prior to FCA approval. It is proposed that, subject to no impediment for the individuals, the members of the Pensions Working Group would sensibly be asked to take the roles of interim directors, augmented by the Chief Executive of London Councils. For clarity that would be Mayor Pipe, Councillors O'Neill and Dombey, Mr Chris Bilsland (Chamberlain, City of London), Mr Chris Buss (Finance Director, LB Wandsworth), Mr Ian Williams (Finance Director, LB Hackney), and Mr John O'Brien (Chief Executive, London Councils). Their appointment would be subject to the consent of their relevant authorities.

13. It is proposed that up to three elected Councillors from the Pensions CIV Joint Committee could be directors of the ACS Operator. The directors have to be approved by the FCA and will have fiduciary duties and responsibilities. The decision as to who could be in these roles is to be decided. It is not a requirement for Elected Councillors sitting on the joint committee to have any director roles, and this will be one of the early matters on which the initial participating boroughs who join the joint committee and participate in the ACS will be asked to decide.

14. The ACS Operator will provide regular information to the participating Borough Pensions Committees about the ACS. The Borough Pensions Committees would be given the right to receive presentations by the investment managers on performance.

15. As illustrated in Figure 1, it is recognised that s.151 officers will provide advice to both their representative joint committee elected Councillor, and their Borough Pension Committee. In addition, it is anticipated that Treasurers may require occasional opportunities to receive information directly from the ACS Operator and to raise any

issues or questions. The Society of London Treasurers is likely to have a role in facilitating discussions with the ACS Operator at an officer level where those matters under discussion collectively affect Treasurers' authorities.

Staff resources

16. In terms of staffing requirements, there are a number of roles required within the ACS Operator, and the precise detail of the final establishment of the ACS Operator will need to be confirmed later. However, in order to understand costs, the following has been assumed. Firstly, there would be 2-3 FTE admin staff, who are likely to be graded at bands B and C on London Councils' salary scales. These staff would assist in the running of the ACS Operator, for example drafting and reviewing reports, and providing support to the meetings of the board of directors, relevant committees of the board, and support teams.

17. At the outset, there will also be a lot of activity in respect of investment management selection. This may require 5 to 6 individuals, with a strong level of understanding of the process for selection of managers. It is thought that this group could comprise of a number of existing borough pensions staff, potentially seconded into the ACS Operator for a period of time. Potentially an external hire may also be required. This group would undertake the activities which would ultimately lead to a recommendation being made to the ACS board as to investment mandates of the ACS and the managers to appoint, in a similar fashion to the existing arrangements within boroughs where pension officers will report to their Pensions Committee. Further details are set out at paragraph 22 onwards.

18. To oversee the activities set out above, and oversee and manage suppliers, it is expected that a chief operating officer would be required. In the first instance, this is likely to be a full time role, however once the ACS Operator and ACS are fully established, the time required may decrease. The need for this role, its responsibilities, and options for filling it, could be considered by the ACS Operator interim directors (see paragraph 12).

19. In addition, a chief executive officer and finance director would be required. These are expected to be part time roles, and could potentially be undertaken within the existing roles of London Councils. These decisions do not need to be taken immediately and, again, could be addressed by the interim directors as one of their early decisions. A compliance director, risk officer, anti-money laundering officer, and chief investment officer will also be required, and how to source these individuals will be considered as an early part of the process. It should be noted that, in addition to the liability of the corporate entity, individuals in these roles need approval from the FCA and have personal liability.

20. To the extent that resource is not available, either from within London Councils or seconded from boroughs, additional third party or professional costs may be incurred. It is anticipated that these costs will be analysed in due course once the key roles have been more fully defined and the availability of suitable internal resources have been considered.

21. The fact that the boroughs will have a significant role both at the level of the ACS Operator and as investors in the ACS means that the FCA will require a robust conflicts of interest policy to be in place.

Investment manager selection and asset allocation

22. There are two key areas of responsibility which will allow boroughs to select the investments they wish to make. Following consultation with boroughs, the ACS Operator will offer a number of mandates to investors and will select a number of managers for this. The final decision over the selection of managers rests with the board of directors of the ACS Operator. The decision regarding asset allocation and whether to invest in the mandates being offered will be at the full discretion of each borough.

23. It is proposed that investment manager selection would be undertaken by an investment advisory team of the ACS Operator as described in paragraph 17 above which would report into the board of directors. There are a range of options for how this is set up, as the team can comprise elected Councillors, officers, and external hires if required. The preferred composition of this group would be decided in due course, but it is expected to be a mix of elected Councillors and officers, probably 6 to 8 in number. The majority of the roles on this group are expected to be part time although as more assets are added to the ACS and additional mandates and alternative investments are added, some of these roles may become full-time.

24. Once the ACS itself is established, it would be at the discretion of the boroughs whether they choose to invest in any or all of the ACS sub-funds. In order to allow individual borough to decide asset allocations between managers, the assumption is that the fund structure will be an umbrella fund, with each sub-fund having a specific investment mandate and investment manager. If a borough decides to invest in a particular mandate, they would simply acquire units in the relevant sub-fund. Please see Appendix A for a visual representation of this structure.

Legal and regulatory considerations

25. This section sets out some of the legal and regulatory considerations in connection with the set-up of the ACS Operator and the ACS, and sets out a timeline for achieving this.

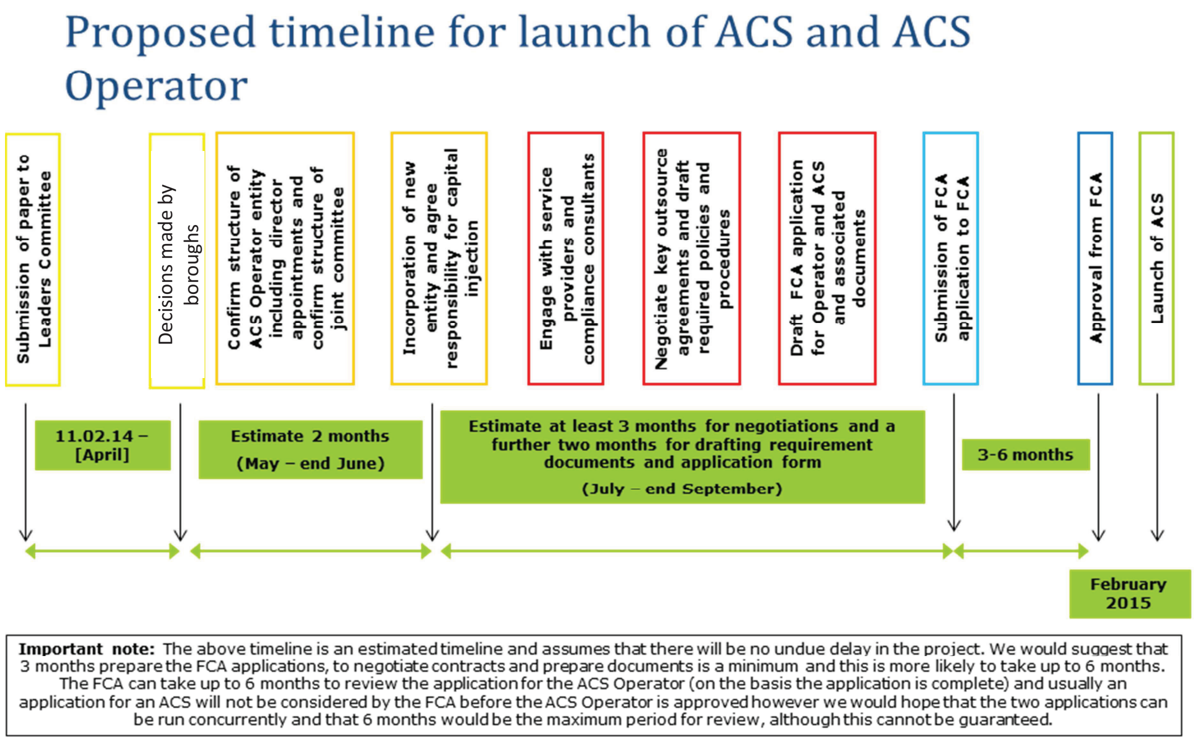
26. The ACS will require a Financial Conduct Authority (FCA) regulated ACS Operator to be established. Typically this is in the form of a limited liability company, which is proposed here. The ACS Operator and the ACS are heavily regulated. There is a separate authorisation process for each of them, involving different divisions of the FCA. The process for the authorisation of the ACS Operator requires detailed information to be supplied in particular around the qualifications of the board and key employees, their ability to carry out the key operational functions or supervise delegates, financial requirements etc. The form requires detailed information. The authorisation process can take between 6 and 12 months. As this application is for local authorities it is hoped that the application for the ACS operator and the ACS would be run concurrently by the FCA and we would hope the authorisation process would take nearer to six months than twelve, however this cannot be guaranteed.

27. The board of directors and employees of the ACS Operator will be responsible for the overall operation of the ACS. In order to meet these obligations it will need to appoint a number of external service providers, including the administrator, the registrar and transfer agent and investment managers. These appointments will need to be reasonably advanced to submit detail and draft documents to the FCA at the time of the application for authorisation.

28. In addition to the corporate entity being authorised individuals performing certain functions as described in this paper also require personal approval by the FCA.

29. We have set out below a proposed timetable for the launch of the ACS Operator and the ACS. This is subject to change and dependent on a number of factors, such as consideration by Leaders' Committee, relevant decisions being taken by the boroughs wishing to participate in the arrangements, selection of key personnel and negotiation of key contracts.

Fig 2. Proposed timetable for launch



30. The proposed timeline emphasises when certain decisions will need to be made. For example the fund mandates and strategies, and you will also note that certain service providers will need to be identified shortly following the incorporation of the ACS Operator entity, so that key commercial terms and service levels can be agreed. As discussed further below, the FCA application forms require in depth detail and draft documents which will take time to agree and complete and as such it is critical to consider these factors at the outset.

31. During the ACS establishment process, some regulatory clarifications will be required although it is not currently expected that there will be any material difficulties. In

particular, it will be important to confirm that a borough will be able to invest substantially all of its pension assets in a single ACS vehicle. Restrictions currently apply to certain collective investment vehicles. Whilst specific reference to ACSs is not made it will be important to ensure that the legislation is either amended or made clear that ACSs (and possibly other collective investment vehicles) which are operated by local authorities are carved out from these restrictions.

Capital requirements of the ACS Operator

32. Initially the ACS Operator will only require minimal share capital and, as such, it is recommended that each borough that wishes to proceed will acquire £1 of share capital in the company.

33. Immediately before the ACS Operator receives regulatory approval (expected to be 4th quarter 2014, see timetable comments at paragraph 30), it will require capital of c. £100,000. The calculation of regulatory capital is complex, and depends on a variety of factors, including the expected fixed overheads of the ACS Operator.

34. It is proposed that the c. £100,000 of ACS capital would be contributed by those boroughs which choose to move forward with the ACS in Autumn – so for example if 10 boroughs decided to proceed with the ACS in Autumn, this would require a capital contribution of £10,000 per borough. It should be noted that this contribution is an investment rather than an expense as this capital would be invested in liquid assets such as gilts rather than being used to pay expenses.

35. Once the ACS starts receiving investments, the ACS Operator will require additional capital, which may be c.2 to 3 basis points of assets invested in the ACS (for £5bn of assets invested in the ACS, the ACS Operator would require capital of £1m to £1.5m). This capital is broadly required at the point in time when the assets under management are due to increase. The total required regulatory capital of an ACS Operator will not exceed 10m euros.

36. Once boroughs choose to invest pension assets in the ACS, it is proposed that they would contribute capital to the ACS Operator in proportion to the assets invested. It is not expected that this should materially impact any return to the boroughs as the funds invested could be from existing pension assets which are currently invested in gilts or similar investments. As such the borough could retain exactly the same profile for its pension investments except that a very small proportion of their assets invested via gilts would be held indirectly through the ACS Operator rather than directly as at present. The precise capital requirements, and the mechanism for the contribution of this capital, will be considered in more detail in the next phase of the project.

37. It should be noted that boroughs who contribute £1 of share capital now will be under no obligation to make any further capital payments to the ACS operator. To the extent a borough takes a subsequent decision to invest in the ACS, it is proposed the borough would at that point invest further capital.

Financial Case

38. Having considered the potential structure and process for establishment, the following sections consider the financial case in more detail. There are a number of areas to

consider. Firstly the potential financial benefits of the ACS, and then the potential costs. These are considered in more detail below. It is clear that, based on the expected savings previously identified, forecast costs should be comfortably covered by savings in reduced management fees.

Financial benefits

39. The 33 London boroughs currently have over £20bn of pension assets under management. Previous work undertaken by PwC estimated savings in the region of £120m per annum from the creation of a CIV, provided there was close to full participation by authorities. Costs of running the ACS were estimated to be between 1 and 5 basis points (0.01% to 0.05%) of assets under management with the estimated costs, for full participation from all 33 London local authorities, estimated to be £4.8m per annum. At lower levels of participation, both the financial benefits and the costs would reduce. More work has now been undertaken on potential costs and benefits, based on high level assumptions, and these are summarised in the table below. It is clear that, based on the expected savings previously identified, forecast costs should be comfortably covered by savings in reduced management fees.

40. The primary cost savings previously identified were in respect of lower investment management fees, and improved performance. Further work since then indicates that there may be further savings in other areas. For example, when investing in a third party fund, it is likely that income from activities such as stock lending and foreign exchange will be earned, however may not be passed on to the boroughs and their pension investments to the same level as could be possible in the ACS. It has been estimated that the income from these activities could be in the region of 10 to 20 basis points. There is no current information available about the level of return that is currently allocated to boroughs in relation to their existing pension investments.

41. Additional analysis of costs has been undertaken since the PwC report. The broad conclusion of this analysis is that, depending on the level of participation, the marginal costs for investing in the ACS are likely to be in the middle of the original 1 to 5 basis point estimate and that there are potential additional savings that could be made.

42. A reasonable minimum target size of assets management for the ACS is considered to be in the range of £5bn of assets. This is based on work undertaken by the PWG, which shows that there are a number of boroughs who currently have very similar investment mandates with exactly the same investment managers. This research suggests that if 6 of the largest similar mandates with identical investment managers across a range of passive and active equity and bond mandates were selected in the ACS, scale of around £3bn could be achieved without any individual borough pension funds materially changing their currently selected mandates or manager. On the assumption that a number of other London boroughs would also be minded to invest in the ACS if it offered these mandates and given the initial interest expressed by boroughs in participating, a minimum target size of £5bn appears a reasonable assumption.

43. Indicative costs and potential savings are set out in the table below, for assets under management of £24bn, £10bn, and the minimum target size of £5bn explained at paragraph 42.

Fig 3. Summary of potential savings and costs

	Assets under management £24bn £ 000's	Assets under management £10bn £000's	Assets under management £5bn £ 000's
Expected savings per annum [1]			
Investment management fees - 15 bps	36,000	15,000	7,500
Improved performance - 35 bps	84,000	35,000	17,500
Total expected savings	**120,000**	**50,000**	**25,000**
On-going Costs per annum [2]			
Custody costs			
Custody costs (at 3.5bp, 4bp and 5bp)	(8,400)	(4,000)	(2,500)
Incurred in existing third party funds ***(3)***	3,600	1,500	750
Net Custody Cost	(4,800)	(2,500)	(1,750)
Other Costs			
Salaries –e.g. COO/Admin	(400)	(400)	(400)
- Audit/advice	(200)	(150)	(100)
- Offices/expenses	(200)	(200)	(200)
- Misc. Advisory	(500)	(400)	(300)
Total On-going Costs	**(6,100)**	**(3,650)**	**(2,750)**
Establishment costs [2][3]			
- Transition advisory including custody selection	(700)	(500)	(400)
- Other misc. fund advisory	(500)	(500)	(500)
- Legal, regulatory, and financial advice (funded already)	(600)	(600)	(600)
Total Establishment Costs	**(1,700)**	**(1,500)**	**(1,400)**

Notes

(1) These savings are as previously reported. They have been allocated on a straight-line basis for assets under management less than £24bn. This is an assumption made for simplicity and any real savings may well be less and will depend on types of mandate, asset mix, etc. There are also other potential areas where financial benefits may arise, such as increased income from activities such as stock lending, which have not been quantified within the above.

(2) All costs (other than custody costs) are estimated on very high level assumptions and may not reflect final costs.

(3) For "other costs" and "Establishment costs", some of these expenses would be incurred in existing investments or on changes of manager/investment. No attempt has been made to estimate these existing costs to date.

Custody costs

44. The main cost associated with running the ACS is from the custody of the assets. Custody costs are calculated as a basis point fee on the amount of assets, with the basis point fee reducing on a sliding scale as the amount of assets under custody increases.

45. In order to consider potential costs, assumptions regarding the potential value of the fund and number of sub-funds and investors have been made. These consider 3 possible scenarios based on the most commonly used asset classes, which are set out below. The assumptions used are not recommendations and are purely for illustration purposes for the business model:

    - sub-funds representing the most frequently used asset classes with minimal uptake by London local authorities investing 50% of total value in these asset classes into the fund,
    - broader range of sub-fund asset classes with a third of London local authorities investing 50% of total value in these asset classes into the fund,
    - all London local authorities investing 75% of total value in these asset classes into the fund.

46. Based on the above, the indicative cost of running the fund may be as follows:

    - 5 investors in 4 sub-funds (made up of mix of passive and active, global equity and UK equity) total £1bn, up to 10bps/minimum charge circa £500k per annum,
    - 11 investors in 10 sub-funds (made up of mix of passive and active, global equity, UK equity, global bonds, & alternatives) total £6bn, up to 5 basis points,
    - 33 investors in 15 sub-funds (made up of mix of passive and active, global equity, UK equity, global bonds, UK bonds & alternatives) total £14bn, up to 3.5 basis points.

47. These costs include Fund Administration (Transfer Agency and Fund Accounting), Depositary and Custody. These costs would reduce where additional services e.g. a proportion of cash, foreign exchange and Securities Lending services are also conducted by the appointed Custodian (which is standard with London boroughs existing custody arrangements). Other factors that feed into the cost consideration include the frequency of investor dealing and frequency of valuation points. It should also be noted that Fund Accounting fees typically operate on a sliding scale with minimum fees per sub-fund, therefore the larger each sub-fund in terms of value the more cost effective.

48. In terms of a cost-benefit analysis, it is important to note that borough pension funds already pay custody fees either directly for existing segregated mandates or indirectly in third party fund investments. Accordingly, the cost-benefit analysis needs to look at the amount by which the custody costs that would be incurred from investing in an ACS exceed current custody costs borne by the boroughs on their existing investments.

49. In relation to existing segregated mandates, it is likely that savings would be achieved through moving such mandates to an ACS as this would reduce custody costs. This is

because most existing segregated mandates are relatively small and accordingly consolidating these mandates in the ACS should increase the amount invested in each mandate which in turn would result in a lower basis point custody charge.

50. In relation to existing third party funds, the cost-benefit analysis is more complex because it is difficult to determine the custody fees that are payable by the investment managers that have established these funds as such numbers are not always publicly available. An estimate of these costs would be in the 1 to 2 basis point range.

51. Based on this analysis, it appears that for higher levels of participation the costs will be lower than previously anticipated. For very low levels of participation (e.g. £1bn) the costs could be higher than the 5 basis point charge previously anticipated. Even at a £1bn level of participation, there may well be financial benefits associated with establishing an ACS but this level of participation is below the minimum level that might reasonably be expected.

52. At a level of assets of £5bn the additional custody costs would be expected to be in the range of 3 to 4 basis points (or £1.5 to £2m per annum), being an ACS custody cost of c.5 basis points less the 1 to 2 basis point charge which would have been incurred on existing investments.

Other costs and benefits

53. Other on-going costs of the ACS are likely to include staff costs, FCA fees, consultancy fees and administration costs including audit and taxation. These fees would be charged directly to the fund, as they would be now. Consultancy fees might include professional advice on investment manager selection. As this would be performed centrally at the ACS level rather than multiple times at individual borough level, it is likely that savings would be achieved in this regard. Admin costs would not be expected to be significant compared to the benefits identified.

54. In relation to staff costs, this is considered in more detail below but on the basis that it is expected that a majority of functions may not be full time and might be performed by existing local authority personnel, additional staff costs are not expected to be significant. For the purposes of the cost benefit analysis undertaken, an estimate of £400,000 per annum has been made. Practically, the roles which might be required are set out below.

Establishment costs

55. There will be a number of establishment costs incurred in setting up the fund. These will be one-off costs in the first year.

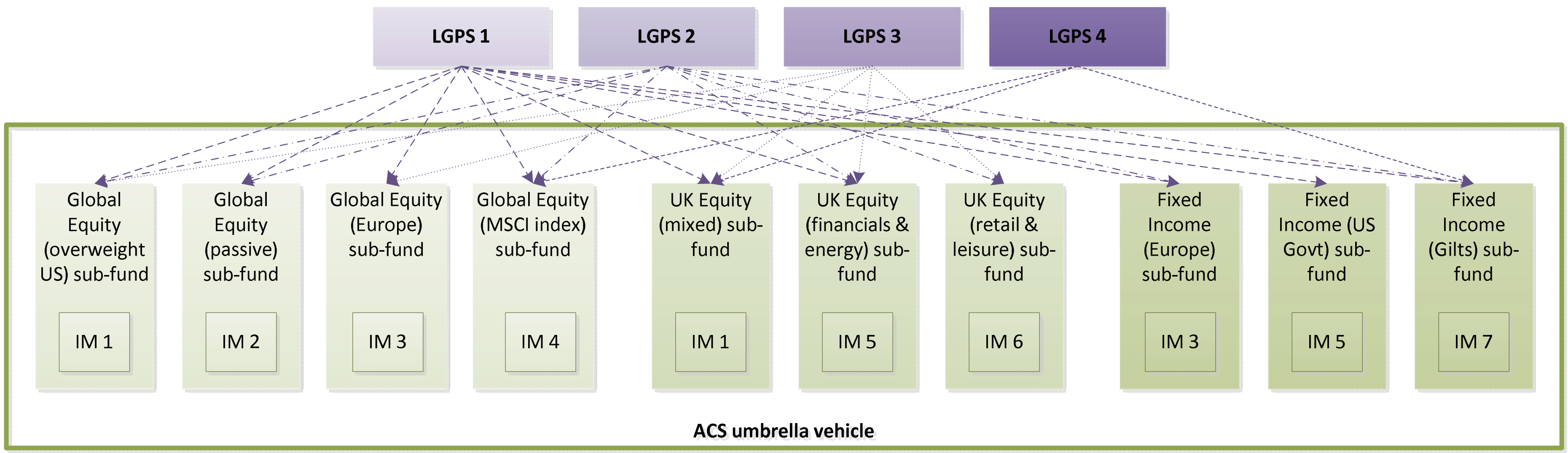
56. £625,000 has already been contributed to these costs by the boroughs, in order to engage professional advisors to perform the necessary financial and regulatory work. It is currently expected that this work will be performed within this existing budget.

57. As the project progresses, additional professional fees are likely to be incurred, for example to assist in training relevant individuals on their regulatory roles and to assist in the development of procedure manuals. It will become clearer in due course where costs may arise in this regard.

58. The transition of assets into the fund will also need to be considered, as assets are moved from existing managers to new managers appointed to the ACS. To a large extent, boroughs already incur similar costs as they transition assets to different managers in the ordinary course of their pension activities. As such these costs may well simply offset existing costs incurred by boroughs although clearly this depends on the level of fees currently charged and the number of transitions. Until further decisions are taken on the mandates that will be launched in the ACS, it is difficult to estimate accurately what these costs might be. An estimate of advisory fees required in connection with this transition management is included within the table, and is based on the experience of advisors on similar projects. It should be noted that the boroughs currently have regular manager transitions, and as such the costs of transition from setting up the ACS should result in lower annual transition costs going forwards.

59. From a tax perspective, the transfer of UK securities into an ACS should not be subject to UK stamp duty reserve tax (SDRT), and a tax clearance can be obtained in advance to give comfort. It is envisaged that the costs of transition would be borne by the pension funds who are moving their assets into the fund, and the cost would depend on the assets being moved. Due diligence will be needed for individual pension funds should they choose to invest, to consider the most appropriate way to transition into the fund.

Appendix A - Indicative ACS umbrella structure



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