# CITY AND COUNTY OF SWANSEA

**NOTICE OF MEETING**

You are invited to attend a Meeting of the

## PENSION FUND COMMITTEE

**At:** **Chamber Meeting Room, Civic Centre, Swansea**

**On:** **Thursday, 24 September 2015**

**Time:** **10.00 am**

**AGENDA**

**Patrick Arran**
**Head of Legal, Democratic Services & Procurement**
**16 September 2015**

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**Contact: Democratic Services: - 01792 636923**

**PENSION FUND COMMITTEE (6)**

**Councillors:**

**Labour Councillors: 4**

| | |
|---|---|
| Phil Downing | Rob C Stewart **(Chair)** |
| Clive E Lloyd | Mark Thomas |

**Liberal Democrat Councillor: 1**

| | |
|---|---|
| John Newbury | |

**Independent Councillor: 1**

| | |
|---|---|
| D Gareth Sullivan | |

**Co-opted Neath Port Talbot Councillor: 1**

| | |
|---|---|
| Peter A Rees | |

**Officers:**

| |
|---|
| Dean Taylor – Director of Corporate Services |
| Mike Hawes – Head of Financial Services |
| Jeff Dong - Finance |
| Deb Smith – Directorate Lawyer |
| Democratic Services |
| Archives |

**Independent Investment Advisors:**

| |
|---|
| Noel Mills |
| Valentine Furniss |

20 Copies

# Disclosures of Interest

**To receive Disclosures of Interest from Councillors and Officers**

## Councillors

**Councillors Interests are made** in accordance with the provisions of the Code of Conduct adopted by the City and County of Swansea. You must disclose orally to the meeting the existence and nature of that interest.

**NOTE:** You are requested to identify the Agenda Item / Minute No. / Planning Application No. and Subject Matter to which that interest relates and to enter all declared interests on the sheet provided for that purpose at the meeting.

1. If you have a **Personal Interest** as set out in **Paragraph 10** of the Code, you **MAY STAY, SPEAK AND VOTE** unless it is also a Prejudicial Interest.

2. If you have a Personal Interest which is also a **Prejudicial Interest** as set out in **Paragraph 12** of the Code, then subject to point 3 below, you **MUST WITHDRAW** from the meeting (unless you have obtained a dispensation from the Authority's Standards Committee)

3. Where you have a Prejudicial Interest you may attend the meeting but only for the purpose of making representations, answering questions or giving evidence relating to the business, **provided** that the public are also allowed to attend the meeting for the same purpose, whether under a statutory right or otherwise. In such a case, you **must withdraw from the meeting immediately after the period for making representations, answering questions, or giving evidence relating to the business has ended**, and in any event before further consideration of the business begins, whether or not the public are allowed to remain in attendance for such consideration (**Paragraph 14** of the Code).

4. Where you have agreement from the Monitoring Officer that the information relating to your Personal Interest is **sensitive information**, as set out in **Paragraph 16** of the Code of Conduct, your obligation to disclose such information is replaced with an obligation to disclose the existence of a personal interest and to confirm that the Monitoring Officer has agreed that the nature of such personal interest is sensitive information.

5. If you are relying on a **grant of a dispensation** by the Standards Committee, you must, before the matter is under consideration:

   i) Disclose orally both the interest concerned and the existence of the dispensation; and
   ii) Before or immediately after the close of the meeting give written notification to the Authority containing:

a) Details of the prejudicial interest;
b) Details of the business to which the prejudicial interest relates;
c) Details of, and the date on which, the dispensation was granted; and
d) Your signature

## Officers

### Financial Interests

1. If an Officer has a financial interest in any matter which arises for decision at any meeting to which the Officer is reporting or at which the Officer is in attendance involving any member of the Council and /or any third party the Officer shall declare an interest in that matter and take no part in the consideration or determination of the matter and shall withdraw from the meeting while that matter is considered. Any such declaration made in a meeting of a constitutional body shall be recorded in the minutes of that meeting. No Officer shall make a report to a meeting for a decision to be made on any matter in which s/he has a financial interest.

2. A "financial interest" is defined as any interest affecting the financial position of the Officer, either to his/her benefit or to his/her detriment. It also includes an interest on the same basis for any member of the Officers family or a close friend and any company firm or business from which an Officer or a member of his/her family receives any remuneration. There is no financial interest for an Officer where a decision on a report affects all of the Officers of the Council or all of the officers in a Department or Service.

# CITY AND COUNTY OF SWANSEA

## MINUTES OF THE MEETING OF THE PENSION FUND COMMITTEE

## HELD AT COMMITTEE ROOM 5, GUILDHALL, SWANSEA ON THURSDAY 2 JULY 2015 AT 10.00 A.M.

**PRESENT**:

| **Councillor(s)**: | **Councillor(s)**: | **Councillor(s)**: |
|---|---|---|
| P Downing | J Newbury | D G Sullivan |
| C E Lloyd | | |

**Neath Port Talbot County Borough Council Councillor**:

P A Rees

**Officers**:

| | | |
|---|---|---|
| J Dong | - | Chief Treasury and Technical Officer |
| K Cobb | - | Accountant |
| S Richards | - | Principal Lawyer |
| J Parkhouse | - | Democratic Services Officer |

**ALSO PRESENT**:

| | | |
|---|---|---|
| N Mills | - | Independent Investment Advisor |
| V Furniss | - | Independent Investment Advisor |
| R Nelson | - | Pricewaterhouse Coopers |
| I Lookey | - | Pricewaterhouse Coopers |

1. **ELECTION OF VICE-CHAIR FOR THE MUNICIPAL YEAR 2015/2016**

**RESOLVED** that Councillor P Downing be elected Vice-Chair for the Municipal Year 2015/2016.

**(Councillor P Downing presided)**

2. **APOLOGIES FOR ABSENCE**

Apologies for absence were received from Councillors R C Stewart and M Thomas.

3. **DISCLOSURES OF PERSONAL AND PREJUDICIAL INTERESTS**

In accordance with the Code of Conduct adopted by the City and County of Swansea, the following interests were declared:

Councillor P Downing - agenda as a whole - my brother works for the Council and contributes to the Pension Fund.

**NOTED** that Councillor P Downing had received dispensation from the Standards Committee in this respect.

Councillor J Newbury - I am in receipt of a Council pension that was passed to me upon my wife's death - personal.

Councillor D G Sullivan - agenda as a whole - I am in receipt of a Local Government Pension - administered by Dyfed Pension Scheme - personal.

4. **MINUTES**

**RESOLVED** that the Minutes of the Pension Fund Committee Meeting held on 12 March 2015 be approved as a correct record.

5. **2015 AUDIT PLAN - CITY AND COUNTY OF SWANSEA**

R Nelson and I Lookey presented the 2015 Audit Plan - City and County of Swansea Pension Fund. It was outlined that under the Code of Audit Practice the external auditor must examine and certify whether the City and County of Swansea Pension Fund Accounting Statements were "true and fair". The purpose of the plan was to set out the proposed work, when it will be undertaken, how much it would cost and who will undertake it. There had been no limitations imposed upon the external auditor in planning the scope of this audit and his responsibilities, along with those of management and those charged with governance were set out at Appendix 1 of the report.

It was added that the external auditor had responsibility to issue a report on the accounting statements for the year ending 31 March 2015 which included an opinion on their "truth and fairness". This provided assurance that the accounts were free from material misstatement, whether caused by fraud or error; comply with statutory applicable requirements; and comply with all relevant requirements for accounting presentation and disclosure. Appendix 1 provided the responsibilities of the external auditor in full and the audit approach undertaken by him. The risks of material misstatement which the auditor considered to significant and which therefore required special audit consideration were set out at Exhibit 2 along with the work the external auditor intended to undertake to address these risks.

The report also highlighted the areas of audit including financial systems, systems of control, management control, potential risk of fraud; the Pension Fund Annual Report; independence of the audit, including threats and safeguards; relationships and investments; and details of the audit fee, Audit Team and timetable.

The Committee expressed concern that in future audits would be undertaken by the Wales Audit Office and not an independent firm. It was noted that the Wales Audit Office was independent of the Welsh Government and that future audits would remain independent.

6. **TRUSTEE AND PENSION FUND COMMITTEE TRAINING - CIPFA CODE OF PRACTICE PUBLIC SECTOR FINANCIAL KNOWLEDGE AND SKILLS**

The Chief Treasury and Technical Officer presented the report to determine an annual training programme for Trustees and officers of the Pension Fund. Reference was made to paragraphs 3.5 and 3.6 which identified the training for Councillors and officers.

The Committee discussed the details contained within the report.

**RESOLVED** that the training identified for Councillors and officers in sections 3.5 and 3.6 of the report be approved.

7. **I-CONNECT ROLLOUT - FUNDING REQUEST**

The Chief Treasury and Technical Officer presented a report which requested approval for funding from the Pension Fund to include more employers in the automatic transfer of data to the Pension Fund using the I-Connect software. It was added that this was required in order to ensure compliance with the Local Government Pension Scheme Regulations 2013 (as amended) and the Pension Regulators Code of Practice 2014.

The Committee discussed the information contained within the report.

**RESOLVED** that the funding to include more employers in the automatic transfer of data to the Pension Fund using I-Connect be approved.

8. **EXCLUSION OF THE PUBLIC**

The Committee was requested to exclude the public from the meeting during consideration of the item(s) of business identified in the recommendation(s) to the report on the grounds that it/they involve(s) the likely disclosure of exempt information as set out in the exclusion paragraph of Schedule 12A of the Local Government Act 1972, as amended by the Local Government (Access to Information) (Variation) (Wales) Order 2007 relevant to the item(s) of business set out in the report.

The Committee considered the Public Interest Test in deciding whether to exclude the public from the meeting for the items of business where the Public Interest Test was relevant as set out in the report.

**RESOLVED** that the public be excluded for the following items of business.

**(CLOSED SESSION)**

9. **TO COMMISSION INVESTMENT STRATEGY REVIEW**

The Chief Treasury and Technical Officer presented a report which sought to commission an investment strategy review of the Pension Fund's investment arrangements. This would ensure that an appropriate investment strategy was implemented in line with risk/return, funding level and cash flow considerations.

**RESOLVED** that an investment review of the City and County of Swansea Pension Fund as outlined in 5.1 of the report be commissioned in accordance with CPRS as outlined in paragraph 4.2 of the report.

10. **INDEPENDENT INDEPENDENT ADVISORS' REPORTS**

The report presented the economic update and market commentary from the perspective of the appointed Independent Investment Advisors. Mr N Mills provided an economic and market update and Mr V Furniss provided an investment report for the quarter ended 31 March 2015.

The content of each report was noted by the Committee and the Independent Advisors were thanked for their reports.

11. **INVESTMENT REVIEW**

The Chief Treasury and Technical Officer provided a "for information" report which presented the investment performance for the quarter year ended 31 March 2015. Attached at Appendix A of the report were the Quarterly Investment Summaries for the Pension Fund for the quarter ended 31 March 2015.

12. **PRESENTATION(S) OF THE FUND MANAGERS**

(1) A presentation was provided by Sue Noffke on behalf of Schroders.

(2) A joint presentation was provided by Andy Brown and Richard Dyson on behalf of Aberdeen.

Questions in relation to the content of the presentations were asked at the end of each presentation by the Committee and responses were provided by the respective Fund Managers.

The contents of the presentations were noted and the Chair thanked each of the Fund Managers for attending the meeting.

The meeting ended at 12.30 p.m.

**CHAIR**

S: Pension Fund Committee - 2 July 2015
(JEP) 9 July 2015

Archwilydd Cyffredinol Cymru
Auditor General for Wales

WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

# Audit of Financial Statements Report

# City & County of Swansea Pension Fund

**Audit year:** 2014-15

**Issued:** September 15

**Document reference:** C15165B

# Status of report

This document was produced by PricewaterhouseCoopers LLP on behalf of Huw Vaughan Thomas, the Auditor General. The team who delivered the work included Kevin Williams, Engagement Leader and Rebecca Nelson, Engagement Manager.

# Contents

Huw Vaughan Thomas, as Auditor General, intends to issue an unqualified audit report on your financial statements. There are some issues to report to you prior to their approval.

# Summary report

## Introduction

**1.** Huw Vaughan Thomas, as Auditor General,  is responsible for providing an opinion on whether the financial statements give a true and fair view of the financial position of the City & County of Swansea Pension Fund as at 31 March 2015 and its income and expenditure for the year then ended.

**2.** We do not try to obtain absolute assurance that the financial statements are correctly stated, but adopt the concept of materiality. In planning and conducting the audit, we seek to identify material misstatements in your financial statements, namely, those that might result in a reader of the accounts being misled.

**3.** The quantitative levels at which we judge such misstatements to be material for the City & County of Swansea Pension Fund are £1,049,500 for the fund account and debtor/creditor balances and £15,377,060 for the net assets statement (excluding debtors & creditors balances).  Whether an item is judged to be material can also be affected by certain qualitative issues such as legal and regulatory requirements and political sensitivity.

**4.** International Standard on Auditing (ISA) 260 requires us to report certain matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action.

**5.** This report sets out for consideration the matters arising from the audit of the financial statements of the City & County of Swansea Pension Fund, for 2014-15, that require reporting under ISA 260.

## Status of the audit

**6.** We received the draft financial statements for the City & County of Swansea (the Authority), which included the draft financial statements of the City & County of Swansea Pension Fund, for the year ended 31 March 2015 on 30 June 2015 and have now substantially completed the audit work. We are reporting to you the more significant issues arising from the audit, which we believe you must consider prior to approval of the financial statements.

## Proposed audit report

**7.** Subject to the satisfactory completion of the outstanding work (see below), it is the Auditor General's intention to issue an unqualified audit report on the financial statements once you have provided us with a Letter of Representation based on that set out in Appendix 1.

**8.** At the date of our presentation of this report the following area of audit work was outstanding:

- Review of the City & County of Swansea Pension Fund Annual Report once it is provided.

- Subsequent events review further to the provision of the Annual Report.

# Significant issues arising from the audit

## Uncorrected misstatements

**9.** There are no misstatements identified in the financial statements, which remain uncorrected.

## Corrected misstatements

**10.** There is a misstatement that has been corrected by management, but which we consider should be drawn to your attention due to its relevance to your responsibilities over the financial reporting process. It is set out with explanations in Appendix 2.

## Other significant issues arising from the audit

**11.** In the course of the audit, we consider a number of matters both qualitative and quantitative relating to the accounts and report any significant issues arising to you. There were some issues arising in these areas this year:

- **We have no concerns about the qualitative aspects of your accounting practices and financial reporting.** Generally, we found the information provided to be relevant, reliable, comparable, material and easy to understand. We concluded that accounting policies and estimates are appropriate and financial statement disclosures unbiased, fair and clear.
- **We did not identify any new issues during the course of the audit.** During the course of the audit, we have examined progress made in relation to the group transfer between the Fund and Powys Pension Fund re Powys College, which we brought to your attention last year. This is explained in further detail below.
- **We did not encounter any significant difficulties during the audit.** We received information in a timely and helpful manner and were not restricted in our work.
- **There were no significant matters discussed and corresponded upon with management which we need to report to you.**
- **There are no other matters significant to the oversight of the financial reporting process that we need to report to you.**
- **We did not identify any material weaknesses in your internal controls but have made some recommendations to enhance the control environment.** This is explained in further detail below.

- **There are no other matters specifically required by auditing standards to be communicated to those charged with governance.**

## Recommendations arising from our 2014-15 financial audit work

**12.** The recommendations arising from our financial audit work are set out in Appendix 3. Management has responded to them.

## Progress re issue identified during the course of the prior year audit

### Powys College Transfer In

**13.** As noted in our prior year report, the employees of the former Powys College transferred to Neath Port Talbot College and, therefore, a fund transfer from the Powys Pension Fund to the City and County of Swansea Pension Fund is required.

**14.** In the prior year, we were advised by the auditors of the Powys Pension Fund that the Fund intended to accrue £8.9m for the bulk transfer of employees of Powys College based on an actuarial estimation of the transfer value. As a corresponding entry, this amount was booked in the financial statements of the City & County of Swansea Pension Fund during 2013/14.

**15.** Management has contacted the actuary for the City & County of Swansea Pension Fund, who has confirmed that, as a result of contributions expected and the change in market value of the investments held, the value of the transfer in should be increased to £9.96m, an increase of £1.06m. Management has therefore posted this increase in transfer value within the draft accounts for 2014/15.

**16.** No cash or investment assets have been transferred to the City & County of Swansea Pension Fund to date and the £9.96m booked is held as a debtor within the current assets section of the City & County of Swansea Pension Fund Financial Statements.

**17.** We recommend that the Pension Fund Committee, along with the Fund actuaries, develop a plan to finalise the arrangements and the transfer of relevant assets to bring this matter to a timely close.

# There are no uncorrected misstatements

**18.** We report to you all uncorrected misstatements other than those of a clearly trivial nature (trivial is defined as entirely inconsequential, whether taken individually or in aggregate, either quantitatively and/or qualitatively). On the basis of the standard methodology applied by the Wales Audit Office, the financial limit for what is considered to be trivial has been calculated at £100,000.

**19.** The Authority has agreed to amend the financial statements for all items we have identified during our audit.

**20.** Appendix 2 contains a summary of the corrections that have been made to the accounts presented for audit.

# Significant Risks

## Significant risks identified at the planning stage

**21.** During the planning stage of our audit and as documented within our Financial Audit Outline, we have considered the Fund's operations and assessed the extent to which we believed there were potential audit risks. We consider an audit risk to be the risk that we may reach an inappropriate opinion on the financial statements. In this report, we summarise the significant matters which we have considered throughout the course of the audit. See table below:



Summary of main audit risks

| Significant Risks | Action Taken |
|---|---|
| **Management override of controls**<br>The risk of management override of controls is present in all entities.<br><br>Due to the unpredictable way in which such override could occur, it is viewed as a significant risk. | We have tested a sample of journals posted to the nominal ledger in the period, back to source documentation, without issue.<br><br>From our consideration of management estimates, no issues have been identified.<br><br>No significant transactions outside the normal course of business were identified.<br><br>We have undertaken unpredictable procedures, to review bank mandates for appropriateness and recalculated the benefits payable to two higher profile retirees.<br><br>No issues were identified. |

| Significant Risks | Action Taken |
|---|---|
| There is a risk of material misstatement due to fraud in revenue recognition and as such is treated as a significant risk | We have tested a sample of revenue journals posted to the nominal ledger in the period, back to source documentation, without issue.<br><br>We have undertaking substantive testing, in terms of both analytical review of contributions received from each scheduled and admitted body and also detailed testing of a sample of contributing active members of the Fund.<br><br>We have reviewed the recognition criteria for one off contributions/bulk transfers.<br><br>No issues were identified. |



## The Auditor General intends to issue an unqualified audit report

**22.** We report any proposed modifications to the standard auditor's report to ensure that you are aware of the reasons for the modifications and have the opportunity to provide any further information and explanations in respect of the matter giving rise to the modification.

**23.** The auditor's report comments on whether the accounts and related notes present fairly the financial transactions of the Fund during the year ended 31 March 2015 and the amount and disposition of the Fund's assets and liabilities as at 31 March 2015, other than liabilities to pay pensions and other benefits after the end of the Fund year.

**24.** Subject to the satisfactory completion of the outstanding work, as noted earlier in this report, it is the Auditor General's intention to issue an unqualified audit report on the financial statements once you have provided us with a Letter of Representation as set out in Appendix 1.

## We did not identify any material weaknesses in your internal controls but have made some recommendations to enhance the control environment

**25.** A material weakness in internal control is defined by ISA 260 as 'a deficiency in design or operation which could adversely affect the entity's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements'.

**26.** We do not, however, normally report information to you concerning a material weakness you know about and have taken appropriate action to correct, unless the weakness is symptomatic of broader weaknesses in the overall control environment and there is a risk that other material weaknesses may occur.

**27.** You should be aware that we do not provide a comprehensive statement of all weaknesses that may exist in the internal controls, or of all improvements that may be made, but have addressed only those matters that have come to our attention as a result of the audit procedures performed.

**28.** We did not identify any material weaknesses in controls. However we did note a number of opportunities to improve controls which are included in Appendix 3 to this report.

### Late payment of pension contributions

**29.** Regulation 81 (1) of the Local Government Pension Scheme Regulations 1997 requires employer authorities to pay employee contributions to the administering authority within 19 days of the end of the month to which they relate. As reported in prior periods, we have continued to identify payments from employers exceeding the 19 day rule. During testing of pension contributions we have noted a total of 15 late payments during the year (2013/14: 30).

**30.** The 15 individual late payments totalled £422,014 with the number of days overdue ranging from 1 to 45 days. Of the 15 late payments identified 7 related to Pelenna Community Council, 2 related to Phoenix Trust, 3 related to Celtic Community Leisure and 3 related to University of Wales Trinity Saint David. The late paying bodies, are consistent with the prior year.

**31.** We recognise that management has communicated with these consistent late payers regularly during the year. We continue to recommend that management, supported by the Pension Fund Committee, reminds the bodies concerned, of their obligations under the Local Government Pension Scheme Regulations 1997 to ensure a timely payment of contributions to the Fund.

### Membership Numbers – Information Flow

**32.** The Pensions department of the Authority is dependent on receiving timely information from the scheduled and admitted bodies. Due to the strict accounts preparation timetable, not all information is received by the pensions' team prior to the preparation of the draft accounts. As reported previously, we have identified membership number variances that are associated with the late provision of information.

**33.** Our review of the 2014/15 opening membership numbers identified that there was a total net difference of 243 members (2014: 366) between the totals carried forward in 2013/14 when compared to the totals brought forward to 2014/15. Discussions with management confirmed that the differences have arisen as a result of the delay in the Fund administration team receiving information from the various scheduled and admitted bodies. We continue to recommend that the Authority reminds all external bodies of the importance of the provision of accurate and timely information to the administration team to ensure the accuracy of the figures within the financial statements.

## Risk of Fraud

**34.** International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

**35.** Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of anti-fraud measures and creation of appropriate "tone at the top"; and
- to investigate any alleged or suspected instances of fraud brought to your attention.

**36.** In presenting this report to you we ask for your confirmation that there have been no changes to your view of fraud risk and that no additional matters have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud is included in the letter of representation, see Appendix 1.

## Independence and objectivity

**37.** As part of the finalisation process, we are required to provide you with representations concerning our independence.

**38.** We have complied with ethical standards and in our professional judgment, we are independent and our objectivity is not compromised. There are no relationships between the Wales Audit Office and the City & County of Swansea Pension Fund that we consider to bear on our objectivity and independence.

# Appendix 1

## Final Letter of Representation

**Auditor General**

Wales Audit Office
24 Cathedral Road
Cardiff
CF11 9LJ

PricewaterhouseCoopers LLP
One Kingsway
Cardiff
CF10 3PW

XX September 2015

## Representations regarding the 2014-15 Financial Statements

This letter is provided in connection with your audit of the financial statements of the City & County of Swansea Pension Fund (the Fund) for the year ended 31 March 2015.

We confirm that to the best of our knowledge and belief, having made enquiries as we consider sufficient, we can make the following representations to you.

## Management representations

### Responsibilities

We have fulfilled our responsibilities for the preparation of the financial statements in accordance with legislative requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15; in particular the financial statements give a true and fair view in accordance therewith.

We acknowledge our responsibility for the design, implementation, maintenance and review of internal control to prevent and detect fraud and error.

### Information provided

We have provided you with:

- full access to:
  - all information of which we are aware that is relevant to the preparation of the financial statements such as books of account and supporting documentation, minutes of meetings and other matters;

- additional information that you have requested from us for the purpose of the audit; and
- unrestricted access to staff from whom you determined it necessary to obtain audit evidence.

- the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud;
- our knowledge of fraud or suspected fraud that we are aware of and that affects the City & County of Swansea Pension Fund and involves:
  - management;
  - employees who have significant roles in internal control; or
  - others where the fraud could have a material effect on the financial statements.
- our knowledge of any allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, regulators or others;
- our knowledge of all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements;
- the identity of all related parties and all the related party relationships and transactions of which we are aware;

## Financial statement representations

All transactions, assets and liabilities have been recorded in the accounting records and are reflected in the financial statements.

Significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable.

Related party relationships and transactions have been appropriately accounted for and disclosed.

All events occurring subsequent to the reporting date which require adjustment or disclosure have been adjusted for or disclosed.

All known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

The financial statements are free of material misstatements, including omissions. The effects of uncorrected misstatements identified during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

# Representations by those charged with governance

We acknowledge that the representations made by management, above, have been discussed with us.

We acknowledge our responsibility for the preparation of true and fair financial statements in accordance with the applicable financial reporting framework. The financial statements were approved by the City & County of Swansea (the Authority) on [insert date].

Signed by

S.151 Officer

Date

Leading Member

Date

# Appendix 2

## Summary of corrections made to the draft financial statements which should be drawn to the attention of the Pension Fund Committee

During our audit we identified the following misstatement that has been corrected by management, but which we consider should be drawn to your attention due to their relevance to your responsibilities over the financial reporting process.

| Value of correction | Nature of correction | Reason for correction |
|---|---|---|
| £2,083,447 | Harbourvest private equity fund was undervalued by this amount within the draft financial statements.<br><br>Management has explained that due to the Harbourvest 90 day reporting period, they initially posted an estimated figure provided by Harbourvest, within the draft accounts. | To adjust the Harbourvest private equity fund valuation within the financial statements to that subsequently confirmed by the investment manager as at 31 March 2015. |

# Appendix 3

## Recommendations arising from our 2014-15 financial audit work

We set out all the recommendations arising from our audit with management's response to them.

| **Matter arising 1 – Powys College Transfer In** | |
|---|---|
| **Findings** | The final value of the transfer from the Powys Pension Fund re Powys College is, as yet, to be finalised. |
| **Priority** | Medium |
| **Recommendation** | Given that Powys College joined the Fund from 1 August 2013 and the fact that the estimated transfer value is currently held in current assets within the financial statements, we recommend that the Pension Fund Committee, along with the Fund actuaries, develop a plan to finalise the arrangements and the transfer of relevant assets to bring this matter to a timely close. |
| ***Management response*** | The bulk transfer entails the submission and validation of historical data re. the staff and liabilities transferred to ensure service records, pensionable pay and appropriate progression has been applied. The valuation and indexation of the appropriate number of transferred fund assets also needs to be finalised by both sides. The final transfer value needs to be agreed by both parties' fund actuaries. The fund actuaries of both parties are in dialogue to finalise the value and the transfer should occur in Q4 2015. |

| **Matter arising 2 – Late payment of contributions** | |
|---|---|
| **Findings** | There have been late receipts of contributions from a number of admitted and scheduled bodies. |
| **Priority** | Low |
| **Recommendation** | We recommend that management reminds any scheduled and/or admitted body that makes a late payment, of their obligations under the Local Government Pension Scheme Regulations 1997 to ensure a timely payment of contributions. We also recommend that appropriate penalties are introduced for those bodies that consistently breach the regulations. This should assist in improving the timeliness of the receipt of contributions. |

| Matter arising 2 – Late payment of contributions | |
|---|---|
| ***Management response*** | The Administering Authority reinforces employer obligations through the adoption of an Administration Strategy and all employers are reminded of the same re. timeliness of contributions and the penalties arising if consistently late. Penalties for late payers have been applied. The total financial effect if considering all late contributions (in extremis) for 2014/15 would be approximately £200 of lost interest. |

| Matter arising 3 – Membership numbers | |
|---|---|
| **Findings** | There was a net difference of 243 member numbers between the closing 13/14 balance and the opening 14/15 balance. |
| **Priority** | Low |
| **Recommendation** | We recommend that the Authority reminds all external bodies of the importance of providing accurate and timely information to the administration team to ensure the accuracy of the figures within the financial statements. |
| ***Management response*** | All employers are reminded of the importance of timely and accurate member information flow within the administration strategy and are reminded at the regular employer roadshows and meetings. |

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Cardiff CF11 9LJ

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24 Heol y Gadeirlan
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# Agenda Item 5a

**Report of the Section 151 Officer**

**Pension Fund Committee – 24 September 2015**

**CITY & COUNTY OF SWANSEA PENSION FUND STATEMENT OF ACCOUNTS 2014/15**

| | |
|---|---|
| **Purpose:** | To approve the statement of accounts for the City & County of Swansea Pension Fund. |
| **Reason for Decision:** | To comply with governance/reporting guidelines. |
| **Consultation:** | Legal, Finance and Access to Services. |
| **Recommendation:** | That The City & County of Swansea Pension Fund Statement of Accounts is approved. |
| **Report Author:** | J Dong |
| **Finance Officer:** | M Hawes |
| **Legal Officer:** | D Smith |
| **Access to Services Officer:** | S Hopkins |

**City & County of Swansea Pension Fund Statement of Accounts 2014/15**

**1 Background**

1.1 The City & County of Swansea Pension Fund Accounts form a distinct and separate component of the Statement of Accounts of the City & County of Swansea as a whole.

**2 Audit**

2.1 The Wales Audit Office in partnership with Price Waterhouse Coopers (PWC) have audited the Pension Fund Statement of Accounts 2014/15 in line with their audit plan presented to Pension Fund Committee on 2nd July 2015.

2.2 PWC have presented their findings earlier on this agenda.

**3 Recommendation**

3.1 The Pension Fund Committee is asked to approve the City & County of Swansea Pension Fund Statement of Accounts 2014/15 as attached at Appendix 1.

**4 Legal Implications**

4.1 There are no legal implications arising from this report.

## 5 Financial Implications

5.1 There are no financial implications arising from this report.

## 6 Equality and Engagement Implications

6.1 There are no equality and engagement implications arising from this report.

**Background Papers:** None.

**Appendices:**

City and County of Swansea – Fund Account for Year Ended 31st March 2015.

## 1. Introduction

The City & County of Swansea Pension Fund is administered by the City & County of Swansea. However it is a separate statutory fund and its assets and liabilities, income and expenditure are not consolidated into the accounts of the Authority. That is, the Pensions Fund's assets and liabilities are distinct.

The summarised accounts of the Pension Fund shown here comprise three main elements:-

- The Fund Account which shows income and expenditure of the fund during the year, split between payments to/contributions from members and transactions relating to fund investments.
- The Net Assets Statement which gives a snapshot of the financial position of the fund as at 31st March 2015.
- The Notes to The Financial Statements which are designed to provide further explanation of some of the figures in the statement and to give a further understanding of the nature of the fund.

## 2 Summary of transactions for the year

**Where the money comes from:-**

| | £'000 |
|---|---|
| Contributions and transfers in | 83,254 |
| Other | 91 |
| | **83,345** |

**And where it goes......**

| | £'000 |
|---|---|
| Pensions Payable | 53,452 |
| Lump sum benefits | 20,460 |
| Refunds and transfers out | 2,703 |
| Administrative expenses | 991 |
| | **77,606** |

| | £'000 |
|---|---|
| Net new money into the Fund | 5,739 |
| Net return on investments | 149,408 |
| Increase in Fund value | **155,147** |

**Section 151 Officer's Certificate**

I hereby certify that the statement of accounts on pages 144 to 180 present fairly the position of the Pension Fund at the accounting date and its income and expenditure for the year ended 31st March 2015.

29th June 2015

## Fund Account For The Year Ended 31st March

| 2013/14 £'000 | Contributions and benefits | Notes | 2014/15 £'000 | £'000 |
|---|---|---|---|---|
| | Contributions receivable : | | | |
| 58,554 | Employers contribution | 3 | 63,647 | |
| 16,133 | Members contribution | 3 | 16,859 | 80,506 |
| 12,705 | Transfers in | 4 | | 2,748 |
| 110 | Other income | 5 | | 91 |
| 87,502 | | | | 83,345 |
| | Benefits payable : | | | |
| -49,588 | Pensions payable | 6 | -53,452 | |
| -17,206 | Lump sum benefits | 6 | -20,460 | -73,912 |
| | Payments to and on account of leavers : | | | |
| -11 | Refunds of contributions | 7 | -116 | |
| -3,125 | Transfers out | 7 | -2,587 | -2,703 |
| -1,022 | Administrative expenses | 8 | | -991 |
| **16,550** | **Net additions from dealing with members** | | | **5,739** |
| | **Returns on investments** | | | |
| 24,456 | Investment income | 9 | | 24,444 |
| 77,463 | Change in market value of investments | 12 | | 132,522 |
| -11,426 | Investment management expenses | 8 | | -7,558 |
| **90,493** | **Net returns on investments** | | | **149,408** |
| **107,043** | **Net increase in the fund during the year** | | | **155,147** |
| 1,277,599 | Opening Net Assets of the Fund | | | 1,384,642 |
| **1,384,642** | **Closing Net Assets of the Fund** | | | **1,539,789** |

## Net Assets Statement As At 31 March

| 31st March 2014 £'000 | | Notes | 31st March 2015 £'000 |
|---|---|---|---|
| | **Investments at market value:** | | |
| 1,335,099 | Investment Assets | 11 | 1,484,960 |
| 13,866 | Cash Funds | 12 | 18,128 |
| 29,232 | Cash Deposits | 12 | 22,512 |
| 2,063 | Other Investment Balances - Dividends Due | 12 | 2,527 |
| **1,380,260** | **Sub Total** | | **1,528,127** |
| 15,097 | Current Assets | 16 | 18,591 |
| -10,715 | Current Liabilities | 16 | -6,929 |
| **1,384,642** | **Net assets** | | **1,539,789** |

The financial statements on pages 144 to 176 summarise the transactions of the Fund and deal with the net assets at the disposal of the Pension Fund Committee. The financial statements do not take account of liabilities and other benefits which fall due after the period end. The actuarial position of the Fund, which does take account of such liabilities, is dealt with in the Statement of the Actuary in the Annual Report of the Pension Fund and a summary is included in Note 18 of this statement, and these accounts should be read in conjunction with this information.

## Notes to the Financial Statements

### 1. Basis of preparation

The financial statements summarise the fund's transactions for the 2014/15 financial year and it's position at year-end 31 March 2015. The financial statements have been prepared in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014/15* which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The financial statements do not take account of liabilities and other benefits which fall due after the period end.

### 2. Accounting Policies

The following principal accounting policies, which have been applied consistently (except as noted below), have been adopted in the preparation of the financial statements:

**(a) Contributions**

Normal contributions, both from the employees and from the employer, are accounted for on an accruals basis in the month employee contributions are deducted from the payroll.

under which they are paid, or in the absence of such an agreement, when received. Under current rules, employers can exercise discretion to give access to a person's pension rights early (other than for ill health). Where this is done, the additional pension costs arising are recharged to the relevant employer and do not fall as a cost to the fund. Under local agreements some Employers have exercised the right to make these repayments over three years incurring the relevant interest costs. As a result total income is recognised in the Fund Account with amounts outstanding from Employers within debtors.

Other Contributions relate to additional pension contributions paid in order to purchase additional pension benefits.

**(b) Benefits**

Where members can choose whether to take their benefits as a full pension or as a lump sum with reduced pension, retirement benefits are accounted for on an accruals basis on the later of the date of retirement and the date the option is exercised.

Other benefits are accounted for on an accruals basis on the date of retirement, death or leaving the fund as appropriate.

**(c) Transfers to and from other Schemes**

Transfer values represent the capital sums either receivable in respect of members from other pension schemes of previous employers or payable to the pension schemes of new employers for members who have left the fund. They are accounted for on a cash basis, or where Trustees have agreed to accept the liability in advance of receipt of funds, on an accruals basis from the date of the agreement.

**(d) Investments**

i) The net assets statement includes all assets and liabilities of the fund at the 31st March.

**2. Accounting Policies (continued)**

ii) Listed investments are included at the quoted bid price as at 31st March.

iii) Investments held in pooled investment vehicles are valued at the closing bid price at 31st March if both bid and offer price are published; or, if single priced, at the closing single price. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income which is reinvested in the fund, net of applicable withholding tax.

iv) Unquoted securities are valued by the relevant investment managers based on the Fund's share of the net assets or a single price advised by the Fund Manager, in accordance with generally accepted guidelines.

v) Unit trusts are valued at the Managers' bid prices at 31st March.

vi) Accrued interest is excluded from the market value of fixed interest securities but is included in accrued investment income.

viii) Transaction costs are included in the cost of purchases and sales proceeds.

ix) Investments held in foreign currencies have been translated into sterling values at the relevant rate ruling as at 31st March.

x) Property Funds/Unit Trusts are valued at the bid market price, which is based upon regular independent valuation of the underlying property holdings of the Fund/Unit Trust.

**e) Financial Instruments**

Pension Fund assets have been assessed as fair value through profit and loss in line with IAS19.

**f) Cash and Cash Funds**

Cash comprises cash in hand and cash deposits. Cash funds are highly liquid investments held with Investment Managers.

**g) Investment Income**

Investment income and interest received are accounted for on an accruals basis. When an investment is valued ex dividend, the dividend is included in the Fund account. Distributions from pooled investment vehicles are automatically reinvested in the relevant fund.

**h) Other**

Other expenses, assets and liabilities are accounted for on an accruals basis.

## 3. Analysis of Contributions

| Total Contributions 2013/14 £'000 | | Total Contributions 2014/15 £'000 |
|---|---|---|
| | **Administering Authority** | |
| **41,711** | City & County of Swansea | **44,048** |
| | **Admitted Bodies** | |
| 11 | Babtie | 0 |
| 235 | Celtic Community Leisure | 397 |
| 13 | Colin Laver Heating Limited | 12 |
| 20 | Swansea Bay Racial Equality Council | 20 |
| 100 | Wales National Pool | 109 |
| 89 | Capgemini | 77 |
| 2,027 | NPT Homes | 2,427 |
| 7 | Phoenix Trust | 1 |
| 1,182 | Grwp Gwalia | 1,320 |
| **3,684** | **Total Admitted Bodies** | **4,363** |
| | **Scheduled Bodies** | |
| 6 | Cilybebyll Community Council | 7 |
| 25 | Coedffranc Community Council | 17 |
| 1,637 | Gower College | 1,696 |
| 1,639 | NPTC Group | 1,764 |
| 74 | Neath Town Council | 66 |
| 24,490 | Neath Port Talbot County Borough Council | 26,901 |
| 21 | Margam Joint Crematorium Committee | 26 |
| 6 | Pelenna Community Council | 5 |
| 14 | Pontardawe Town Council | 15 |
| 34 | Swansea Bay Port Health Authority | 40 |
| 26 | Swansea City Waste Disposal Company | 0 |
| 1,320 | University of Wales Trinity St Davids | 1,558 |
| **29,292** | **Total Scheduled Bodies** | **32,095** |
| **74,687** | **Total Contributions Receivable** | **80,506** |

## 3. Analysis of Contributions (continued)

Total Employer/Employee contributions comprise of:

| 2013/14 £'000 | | | 2014/15 £'000 |
|---|---|---|---|
| | Employers | | |
| 55,436 | | Normal | 58,258 |
| 9 | | Other | 4 |
| 3,109 | | Early Access | 5,385 |
| **58,554** | | **Total** | **63,647** |
| | Employees | | |
| 16,105 | | Normal | 16,824 |
| 28 | | Other | 35 |
| **16,133** | | **Total** | **16,859** |
| **74,687** | | **Total Contributions Receivable** | **80,506** |

## 4. Transfers In

Transfers in comprise of:

| 2013/14 £'000 | | 2014/15 £'000 |
|---|---|---|
| 8,900 | Group transfers from other schemes * | 1,060 |
| 3,805 | Individual transfers from other schemes | 1,688 |
| **12,705** | **Total** | **2,748** |

* Group Transfers from other schemes is in respect of Coleg Powys, who have merged with Neath Port Talbot College (a scheduled body within this Scheme) with effect from 1st August 2013, to form Neath Port Talbot College Group. The total estimated figure of £9.96m, is as a result of a review of the valuation by the Actuary for the City & County of Swansea Pension Fund in March 2015.

## 5. Other Income

Other income comprise of:

| 2013/14 £'000 | | 2014/15 £'000 |
|---|---|---|
| 89 | Bank Interest | 82 |
| 21 | Early Access - Interest | 9 |
| **110** | **Total** | **91** |

## 6. Benefits Payable

By category

| 2013/14 £'000 | | 2014/15 £'000 |
|---|---|---|
| 49,588 | Pensions | 53,452 |
| 15,349 | Commutation and lump sum retirement benefits | 19,106 |
| 1,857 | Lump sum death benefits | 1,354 |
| **66,794** | **Total** | **73,912** |

## 7. Payments to and on account of leavers

Transfers out and refunds comprise of:

| 2013/14 £'000 | | 2014/15 £'000 |
|---|---|---|
| 11 | Refunds to members leaving service | 116 |
| 3,125 | Individual transfers to other schemes | 2,587 |
| **3,136** | **Total** | **2,703** |

## 8. Administrative and Investment Manangement Expenses

All administrative and investment management expenses are borne by the Fund:

| 2013/14 £'000 | | 2014/15 £'000 |
|---|---|---|
| | **Adminstrative Expenses** | |
| 659 | Support Services & Employee Costs | 661 |
| 45 | Actuarial Fees | 10 |
| 43 | Advisors Fees | 43 |
| 58 | External Audit Fees | 48 |
| 25 | Performance Monitoring Services Fees | 26 |
| 23 | Printing & Publications | 24 |
| 166 | Other | 175 |
| 3 | Pension Fund Committee | 4 |
| **1,022** | | **991** |
| | **Investment Management Expenses** | |
| 4,378 | Management Fees | 5,769 |
| 6,915 | Performance Fees | 1,668 |
| 133 | Custody Fees | 121 |
| **11,426** | | **7,558** |
| **12,448** | **Total** | **8,549** |

## 9. Investment Income

| 2013/14 £'000 | | 2014/15 £'000 |
|---|---|---|
| 13,433 | U.K. Equities | 11,736 |
| 6,619 | Overseas Equities | 7,695 |
| 3,055 | Managed Fund - Fixed Interest | 3,528 |
| 1,006 | Pooled Investment vehicles - Property Fund | 1,434 |
| 341 | Pooled Investment vehicles - Private Equity | 48 |
| 2 | Interest | 3 |
| **24,456** | **Total** | **24,444** |

The assets under management by Legal and General are managed wholly in a pooled investment vehicle. The pooled investment vehicles are a combination of equity, bond and money market unit funds which operate on an 'accumulation' basis, i.e. all dividends and investment income are automatically reinvested back into their relevant funds and not distributed as investment income. Therefore, the fund value and change in market value on these funds will reflect both capital appreciation / depreciation plus reinvested investment income.

## 10. Taxation

### a) United Kingdom

The Fund is exempt from Income Tax on interest and dividends and from Capital Gains Tax but now has to bear the UK tax on other income. The fund is reimbursed V.A.T. by H.M. Revenue and Customs and the accounts are shown exclusive of V.A.T.

### b) Overseas

The majority of investment income from overseas suffers a withholding tax in the country of origin.

## 11. Investment Assets

| | 31st March 2014 | | | 31st March 2015 | | |
|---|---|---|---|---|---|---|
| | UK £'000 | Overseas £'000 | Total £'000 | UK £'000 | Overseas £'000 | Total £'000 |
| **Equities** | | | | | | |
| Quoted | 324,568 | 313,060 | 637,628 | 363,504 | 359,488 | 722,992 |
| **Pooled investment vehicles** | | | | | | |
| Managed Funds: | | | | | | |
| Quoted: | | | | | | |
| Equity | 0 | 13,467 | 13,467 | 0 | 14,424 | 14,424 |
| Fixed Interest | 0 | 117,200 | 117,200 | 0 | 111,608 | 111,608 |
| Unquoted: | | | | | | |
| Equity | 128,747 | 194,470 | 323,217 | 128,442 | 234,906 | 363,348 |
| Fixed Interest | 52,409 | 11,862 | 64,271 | 57,746 | 14,814 | 72,560 |
| Index-linked | 20,720 | 0 | 20,720 | 26,518 | 0 | 26,518 |
| Property Unit Trust | 6,107 | 0 | 6,107 | 5,661 | 0 | 5,661 |
| Property Fund | 31,056 | 31,560 | 62,616 | 35,184 | 34,555 | 69,739 |
| Hedge Fund | 0 | 49,060 | 49,060 | 0 | 51,522 | 51,522 |
| Global Tactical Asset Allocation | 0 | 15,529 | 15,529 | 0 | 15,426 | 15,426 |
| Private Equity | 0 | 25,284 | 25,284 | 0 | 31,162 | 31,162 |
| **Total pooled investment vehicles** | 239,039 | 458,432 | 697,471 | 253,551 | 508,417 | 761,968 |
| **Total equities and pooled investment vehicles** | **563,607** | **771,492** | **1,335,099** | **617,055** | **867,905** | **1,484,960** |

## 11. Investment Assets (continued)

An analysis of investment assets based on the class of investment is shown below :

| 31st March 2014 £'000 | Investment assets | 31st March 2015 £'000 |
|---|---|---|
| 181,471 | Fixed interest | 184,168 |
| 20,720 | Index linked securities | 26,518 |
| 453,315 | U.K. equities | 491,946 |
| 520,997 | Overseas Equities | 608,818 |
| 68,723 | Property | 75,400 |
| 49,060 | Hedge Funds | 51,522 |
| 25,284 | Private Equity | 31,162 |
| 15,529 | Global Tactical Asset Allocation (GTAA) | 15,426 |
| **1,335,099** | **Total investment assets** | **1,484,960** |

## 12. Reconciliation of movements in investments

| | | Value at 31st March 2014 | Purchases | Sales | Change in Market Value | Value at 31st March 2015 |
|---|---|---|---|---|---|---|
| | | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Equities** | | | | | | |
| | Aberdeen | 99,347 | 13,608 | -12,444 | 8,663 | 109,174 |
| | JPM | 225,307 | 206,478 | -202,529 | 39,489 | 268,745 |
| | Schroders | 326,441 | 69,081 | -56,342 | 20,317 | 359,497 |
| | L&G | 323,217 | 10,656 | -13,780 | 43,255 | 363,348 |
| | | 974,312 | 299,823 | -285,095 | 111,724 | 1,100,764 |
| **Property** | | | | | | |
| UK | | | | | | |
| | Schroders | 37,163 | 1,108 | -1,928 | 4,502 | 40,845 |
| | Partners | 19,080 | 5,010 | -2,821 | 2,130 | 23,399 |
| | Invesco | 12,480 | 0 | -519 | -805 | 11,156 |
| | | 68,723 | 6,118 | -5,268 | 5,827 | 75,400 |
| **Fixed Interest** | | | | | | |
| Fixed Interest | | | | | | |
| | L&G | 64,271 | 3,160 | -3,155 | 8,284 | 72,560 |
| | Goldman | 117,200 | 3,529 | 0 | -9,121 | 111,608 |
| | | 181,471 | 6,689 | -3,155 | -837 | 184,168 |
| Index-Linked | | | | | | |
| | L&G | 20,720 | 2,580 | -625 | 3,843 | 26,518 |
| | | 20,720 | 2,580 | -625 | 3,843 | 26,518 |
| **Hedge Funds** | | | | | | |
| | BlackRock | 25,684 | 0 | -370 | 1,316 | 26,630 |
| | Fauchier | 23,376 | 0 | -380 | 1,896 | 24,892 |
| | | 49,060 | 0 | -750 | 3,212 | 51,522 |
| **Private Equity** | | | | | | |
| | HarbourVest | 25,284 | 8,950 | -11,665 | 8,593 | 31,162 |
| | | 25,284 | 8,950 | -11,665 | 8,593 | 31,162 |
| **Allocation** | | | | | | |
| | BlackRock | 15,529 | 0 | -167 | 64 | 15,426 |
| | | 15,529 | 0 | -167 | 64 | 15,426 |
| **Cash funds** | | | | | | |
| | L&G | 13,830 | 4,872 | -3,708 | 95 | 15,089 |
| | Schroders | 36 | 3,360 | -358 | 1 | 3,039 |
| | | 13,866 | 8,232 | -4,066 | 96 | 18,128 |
| **Total** | | 1,348,965 | 332,392 | -310,791 | 132,522 | 1,503,088 |
| **Cash** | | **29,232** | | | | **22,512** |
| **Other Investment Balances - Dividends Due** | | **2,063** | | | | **2,527** |
| **TOTAL** | | **1,380,260** | | | **132,522** | **1,528,127** |

## 12. Reconciliation of movements in investments (continued)

Transaction costs are included in the cost of purchase and sales proceeds. Identifiable transaction costs incurred in the year relating to segregated investments amounted to £233k (2013/14: £388k). Costs are also incurred by the Fund in relation to transactions in pooled investment vehicles. Such costs are taken into account in calculating the bid/offer spread of these investments and are not separately identifiable.

## 13. Concentration of Investments

The following investments represented 5% or more of the Fund's net assets at 31st March 2015:

| | Value as at the 31st March 2014 | Proportion of Net Asset | Value as at the 31st March 2015 | Proportion of Net Asset |
|---|---|---|---|---|
| | £'000 | % | £'000 | % |
| L&G UK Equity Index | 128,747 | 9.3 | 128,442 | 8.4 |
| Goldman Sachs Global Libor Plus II | 117,200 | 8.5 | 111,608 | 7.3 |
| L&G North America Equity Index | 76,747 | 5.5 | 96,721 | 6.3 |

## 14. Realised Profit on the Sale of Investments

| 2013/14 £'000 | | 2014/15 £'000 |
|---|---|---|
| 15,280 | U.K. Equities | 12,266 |
| 27,909 | Overseas Equities | 20,755 |
| 0 | Property Fund | 906 |
| 3 | Cash Fund | 0 |
| **43,192** | **Net Profit** | **33,927** |

## 15. Fixed Interest and Index Linked Investments

The fixed interest and index-linked investments are comprised of:

| 31st March 2014 £'000 | | 31st March 2015 £'000 |
|---|---|---|
| 115,086 | UK Public Sector | 121,764 |
| 87,105 | Other | 88,922 |
| **202,191** | | **210,686** |

## 16. Current Assets and Liabilities

The amounts shown in the statement of Net Assets are comprised of:

| 31st March 2014 £'000 | | 31st March 2015 £'000 |
|---|---|---|
| | **Current Assets** | |
| 613 | Contributions - Employees | 654 |
| 2,011 | Contributions - Employers | 2,167 |
| 2,120 | Early Access Contributions Debtor | 4,168 |
| 9,232 | Transfer Values | 10,349 |
| 1,121 | Other | 1,253 |
| **15,097** | | **18,591** |
| | **Current Liabilities** | |
| -4,321 | Investment Management Expenses | -956 |
| -3,873 | Commutation and lump sum retirement benefits | -3,428 |
| -688 | Lump sum death benefits | -436 |
| -895 | Transfers to Other Schemes | -530 |
| -538 | Payroll Deductions - Tax | -577 |
| 0 | SLA Recharge | -620 |
| -400 | Other | -382 |
| **-10,715** | | **-6,929** |
| **4,382** | **Net** | **11,662** |

Analysed as:

| 31st March 2014 £'000 | | 31st March 2015 £'000 |
|---|---|---|
| | **Current Assets** | |
| 774 | Central Government Bodies | 1,386 |
| 13,655 | Other Local Authorities | 16,105 |
| 2 | Public Corporations & Trading Funds | 0 |
| 666 | Other Entities and Individuals | 1,100 |
| **15,097** | | **18,591** |
| | **Current Liabilities** | |
| -38 | Central Government Bodies | -33 |
| -2,677 | Other Local Authorities | -1,209 |
| -8,000 | Other Entities and Individuals | -5,687 |
| **-10,715** | | **-6,929** |
| **4,382** | **Net** | **11,662** |

## 16. Current Assets & Liabilities (continued)

### Early Access Debtor

| | Instalment Due 2015/16 £'000 | Instalment Due 2016/17 £'000 | Instalment Due 2017/18 £'000 | Instalment Due 2018/19 £'000 | Total £'000 |
|---|---|---|---|---|---|
| Early Access Principal Debtor | 3,665 | 241 | 241 | 21 | **4,168** |
| Early Access Interest Debtor | 17 | 19 | 19 | 2 | **57** |
| **Total (Gross)** | **3,682** | **260** | **260** | **23** | **4,225** |

## 17. Capital and Contractual Commitments

As at 31st March 2015 the Scheme was committed to providing funding to appointed managers investing in unquoted securities. These commitments amounted to £38.7m (2013/14 : £40.3m).

## 18. Statement of the Actuary for the year ended 31 March 2015

### Introduction

The Scheme Regulations require that a full actuarial valuation is carried out every third year. The purpose of this is to establish that the City & County of Swansea Pension Fund (the Fund) is able to meet its liabilities to past and present contributors and to review employer contribution rates. The last full actuarial investigation into the financial position of the Fund was completed as at 31 March 2013 by Aon Hewitt Limited, in accordance with Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008.

### Actuarial Position

1. The valuation as at 31 March 2013 showed that the funding ratio of the Fund had increased since the previous valuation with the market value of the Fund's assets at that date (of £1,227.6M) covering 81% of the liabilities allowing, in the case of current contributors to the Fund, for future increases in pensionable pay.

2. The valuation also showed that the aggregate level of contributions required to be paid by participating employers with effect from 1 April 2014 was:

- 16.2% of pensionable pay. This was the rate calculated as being sufficient, together with contributions paid by members, to meet the liabilities arising in respect of service after the valuation date.

**Plus**

- 5.7% of pensionable pay to restore the assets to 100% of the liabilities in respect of service prior to the valuation date over a recovery period of 25 years from 1 April 2014, if the membership remains broadly stable and pay increases are in line with the rate assumed at the valuation of 3.9% p.a.

3. In practice, each individual employer's position is assessed separately and contributions are set out in Aon Hewitt Limited's report dated 31 March 2014 (the "actuarial valuation report"). In addition to the contributions shown above, payments to cover additional liabilities arising from early retirements (other than ill-health retirements) will be made to the Fund by the employers.

4. The funding plan adopted in assessing the contributions for each individual employer was in accordance with the Funding Strategy Statement in force at the time. The approach adopted, and the recovery period used for each employer, is set out in the actuarial valuation report.

5. The valuation was carried out using the projected unit actuarial method for most employers and the main actuarial assumptions used for assessing the funding target and the contribution rates were as follows.

**18. Statement of the Actuary for the year ended 31 March 2015 (continued)**

| | |
|---|---|
| Discount rate for periods in service | |
| Scheduled and subsumption bodies | 5.6% a year |
| Orphan bodies | 5.2% p.a |
| Discount rate for periods after leaving service | |
| Scheduled and subsumption bodies | 5.6%p.a. |
| Orphan bodies | 3.9%p.a. |
| Rate of pay increases | 3.9% p.a. |
| Rate of increases to pension accounts | 2.4% p.a. |
| Rate of increase in pensions in payment (in excess of Guaranteed Minimum Pension) | 2.4% p.a. |

The assets were valued at market value.
Further details of the assumptions adopted for the valuation were set out in the actuarial valuation report.

6. The valuation results summarised above are based on the financial position and market levels at the valuation date, 31 March 2013. As such the results do not make allowance for changes which have occurred subsequent to the valuation date.

7. The formal actuarial valuation report and the Rates and Adjustments Certificate setting out the employer contribution rates for the period from 1 April 2014 to 31 March 2017 were signed on 31 March 2014. Contribution rates will be reviewed at the next actuarial valuation of the Fund due as at 31 March 2016 in accordance with Regulation 62 of the Local Government Pension Scheme Regulations 2013.

8. This Statement has been prepared by the current Actuary to the Fund, AON Hewitt Limited, for inclusion in the accounts of the Fund. It provides a summary of the results of their actuarial valuation which was carried out as at 31 March 2013. The valuation provides a snapshot of the funding position at the valuation date and is used to assess the future level of contributions required.

This Statement must not be considered without reference to the formal actuarial valuation details fully the context and limitations of the actuarial valuation.

Aon Hewitt Limited does not accept any responsibility or liability to any party other than our client, the City and County of Swansea, the Administering Authority of the Fund, in respect of this Statement.

9. The report on the actuarial valuation as at 31 March 2013 is available from the Fund's following address:

http://www.swanseapensionfund.org.uk/wp-content/uploads/2012/01Swansea-valuation-report-310313.pdf

Aon Hewitt Limited
June 2015

**18. Actuarial Present Value of Promised Retirement Benefits - Statement of the Actuary for the year ended 31 March 2015 (continued)**

**Definitions**

**Admission Body**

An employer admitted to the Fund under an admission agreement.

**Orphan Body**

This is an admission body or other employer whose participation in the Fund may cease at some future point in time, after which it is expected that the Administering Authority will have no access to future contributions in respect of the employer's liabilities in the Fund once any liability on cessation has been paid.

**Scheduled Body**

Employers which participate in the Fund under Schedule 2 of the Administration Regulations.

**Subsumption and subsumption body**

When an admission body or other employer ceases participation in the Fund, so that it has no employees contributing to the Fund and once any contribution on cessation as required by the regulations has been paid, the Fund will normally be unable to obtain further contributions from that employer (eg if future investment returns are less than assumed). It is however possible for another long term employer in the Fund (generally a scheduled body) to agree to be a source of future funding should any funding shortfalls emerge on the original employer's liabilities. The long term employer effectively subsumes the assets and liabilities of the ceasing employer into its own assets and liabilities. In this document this is known as subsumption. In this document the admission body or other employer being subsumed is referred to as a subsumption body and its liabilities are known as subsumed liabilities.

**Certificate of the Actuary Regarding the Contributions Payable by the Employing Authorities in 2014/15**

In accordance with Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008 (the "Administration Regulations"), we certify that contributions should be paid by Employers at the following rates for the period 1st April 2014 to 31st March 2017.

i) A common rate of 16.2% of Pensionable Pay.

ii) Individual adjustments which, when added to or subtracted from the common rate, produce the following Employer contribution rates:

**18. Actuarial Present Value of Promised Retirement Benefits - Statement of the Actuary for the year ended 31 March 2015 (continued)**

| Employer | Year Commencing 1 April | | |
|---|---|---|---|
| | 2014 % Pensionable Pay | 2015 % Pensionable Pay | 2016 % Pensionable Pay |
| **Scheduled bodies** | | | |
| City & County of Swansea | 22.4 | 22.4 | 22.4 |
| Neath Port Talbot County Borough | 22.5 | 23.0 | 24.0 |
| Pontardawe Town Council | 19.7 | 19.7 | 19.7 |
| Cilybebyll Community Council | 20.5 | 20.5 | 20.5 |
| Pelenna Community Council | 21.9 | 23.6 | 25.3 |
| Swansea Bay Port Health Authority | 22.4 | 22.4 | 22.4 |
| | | | |
| Neath Port Talbot Homes | 16.2 | 16.2 | 16.2 |
| Grwp Gwalia Cyf | 20.4 | 20.4 | 20.4 |
| Colin Laver Heating Limited | 19.7 | 19.7 | 19.7 |
| Swansea Bay Racial Equality Council | 27.2 | 30.8 | 34.3 |
| Celtic Community Leisure | 11.1 | 11.1 | 11.1 |
| Wales National Pool | 14.5 | 14.5 | 14.5 |
| Cap Gemini | 18.7 | 18.7 | 18.7 |

| Employer | Contribution rate 1 April 2014 to 31 March 2017 % Pensionable Pay | Additional monetary amount Year commencing 1 April | | |
|---|---|---|---|---|
| | | 2014 £ | 2015 £ | 2016 £ |
| **Scheduled bodies** | | | | |
| Margam Joint Crematorium Committee | 19.2 | 4,600 | 4,800 | 5,000 |
| Coedffranc Community Council | 19.2 | 3,700 | 3,850 | 4,000 |
| Neath Town Council | 19.2 | 15,100 | 15,700 | 16,300 |
| Gower College | 15.4 | 164,400 | 170,800 | 177,500 |
| NPTC Group | 14.7 | 151,900 | 157,800 | 164,000 |
| **Admission bodies** | | | | |
| Trinity St Davids | 22.4 | 225,000 | 450,000 | 481,000 |

The contributions shown above represent the minimum contributions to be paid by each Employer. Employers may choose to pay additional contributions from time to time subject to the Administering Authority's agreement.

Where payments due from an Employer are expressed as monetary amounts, the amounts payable by that Employer should be adjusted to take account of any amounts payable, in respect of surplus or shortfall to which those monerary payments relate, by new employers created after the valuation date which have been credited with proportions of the assets and liabilities of the relevant Employer. Any adjustment should be as advised by the Fund Actuary.

Additional contributions may be required in respect of any additional liabilities that arise under the provisions of Regulations 30, 31, 35 and 38 of the 2013 Regulations, payable over a period of up to three years and Employers will be notified of such contributions separately by the Administering Authority.

The contributions rates for the City & County of Swansea and for Neath Port Talbot County Borough Council have been set as a percentage of pay. However, minimum monetary contribution amounts for these employers have been agreed with the Administering Authority and if the contributions actually received fall below this minimum level additional payments will be required.

Contribution rates for Employers commencing participation in the Fund after 31 March 2013 will be advised separately.

## 19. Related party transactions

£661k (£659k 2013/14) was paid to the City & County of Swansea for the recharge of Administration, I.T., Finance and Legal Services during the year.

Contributions received from admitted and scheduled bodies as detailed on page 150.

The City & County of Swansea acts as administering Authority for the City and County of Swansea Pension Fund (formerly the West Glamorgan Pension Fund).

Transactions between the Authority and the Pension Fund mainly comprise the payment to the Pension Fund of employee and employer payroll superannuation deductions, together with payments in respect of enhanced pensions granted by Former Authorities.

The Pension Fund currently has 32 scheduled and admitted bodies. Management of the Pension Scheme Investment Fund is undertaken by a panel. The panel is advised by two independent advisors.

### Governance

There are 7 councillor members of the pension committee who are active members in the City & County of Swansea Pension Fund. The benefit entitlement for the Councillors is accrued under the same principles that apply to all other members of the Fund.

## 20. Additional Voluntary Contributions

Some members of the Fund pay voluntary contributions to the fund's AVC providers, The Prudential, to buy extra pension benefits when they retire. These contributions are invested in a wide range of assets to provide a return on the money invested. Some members also still invest and have funds invested with the legacy AVC providers, Equitable Life and Aegon.

The Pension Fund accounts do not include the assets held by The Prudential, Equitable Life or Aegon. AVCs are not included in the accounts in accordance with section 4(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093) but are disclosed as a note only.

| AVC Provider | Value of Funds at 1st April 2014 | Purchases at Cost (Contributions In/Out) | Sale Proceeds | Change in Market Value | Value of Funds at 31st March 2015 |
|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| | | | | | |
| Prudential | 2,738 | 1,504 | -1,172 | 142 | 3,212 |
| Aegon | 1,440 | 54 | -112 | 61 | 1,443 |
| Equitable Life | 373 | 2 | -43 | 15 | 347 |
| | | | | | |
| **Totals** | **4,551** | **1,560** | **-1,327** | **218** | **5,002** |

## 21. Membership

The Pension Fund covers City & County of Swansea employees (except for teachers, for whom separate pension arrangements apply), and other bodies included in the schedule.

Detailed national regulations govern the rates of contribution by employees and employers, as well as benefits payable. At 31st March 2015 there were 16,285 contributors, 11,261 pensioners and 9,801 deferred pensioners.

| Membership statistics | 31st March 2011 | 31st March 2012 | 31st March 2013 | 31st March 2014 | 31st March 2015 |
|---|---|---|---|---|---|
| | Number | Number | Number | Number | Number |
| Contributors | 14,524 | 14,179 | 14,586 | 15,576 | 16,285 |
| Pensioners | 9,600 | 10,027 | 10,432 | 10,833 | 11,261 |
| Deferred Pensioners | 7,614 | 8,204 | 8,815 | 9,663 | 9,801 |
| **Total** | **31,738** | **32,410** | **33,833** | **36,072** | **37,347** |

**See Appendix 1 for current year analysis**

## 22. Fair Value of Investments

### Financial Instruments

The Fund invests mainly through pooled vehicles with the exception of three segregated equity mandates. The managers of these pooled vehicles invest in a variety of financial instruments including bank deposits, quoted equity instruments, fixed interest securities, direct property holdings and unlisted equity and also monitor credit and counterparty risk, liquidity risk and market risk.

### Financial Instuments - Gains & Losses

Gains and losses on financial instruments have been disclosed within note 9, 12 and 14 of the pension fund accounts.

### Fair Value – Hierarchy

The fair value hierarchy introduced as part of the new accounting Code under IFRS7 requires categorisation of assets based upon 3 levels of asset valuation inputs -

- Level 1 - quoted prices for similar instruments.
- Level 2 - directly observable market inputs other than Level 1 inputs.
- Level 3 - inputs not based on observable market data.

The table on the following page shows the position of the Fund's assets at 31st March 2014 and 2015 based upon this hierarchy:

## 22. Fair Value of Investments (continued)

### FAIR VALUE - HIERARCHY

| | 31 March 2014 | | | | 31 March 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Market Value £'000 | Level 1 £'000 | Level 2 £'000 | Level 3 £'000 | Market Value £'000 | Level 1 £'000 | Level 2 £'000 | Level 3 £'000 |
| **Equities** | | | | | | | | |
| UK Equities | 324,588 | 324,588 | - | - | 363,504 | 363,504 | - | - |
| Overseas Equities | 313,080 | 313,080 | - | - | 359,488 | 359,488 | - | - |
| **Pooled Investment Vehicles** | | | | | | | | |
| Fixed-Interest Funds | 117,200 | - | 117,200 | - | 111,808 | - | 111,808 | - |
| UK Equity | 128,747 | - | 128,747 | - | 128,442 | - | 128,442 | - |
| Overseas Equity | 207,937 | - | 207,937 | - | 249,330 | - | 249,330 | - |
| Fixed Interest | 64,271 | - | 64,271 | - | 72,580 | - | 72,580 | - |
| Index-linked | 20,720 | - | 20,720 | - | 28,518 | - | 28,518 | - |
| Property Unit Trust | 6,107 | - | 6,107 | - | 3,039 | - | 3,039 | - |
| Property Fund | 62,616 | - | 31,056 | 31,560 | 72,361 | - | 37,806 | 34,555 |
| Hedge Fund | 49,060 | - | - | 49,060 | 51,522 | - | - | 51,522 |
| Global Tactical Asset Allocation | 15,529 | - | - | 15,529 | 15,428 | - | - | 15,428 |
| Private Equity | 25,284 | - | - | 25,284 | 31,162 | - | - | 31,162 |
| Cash | 43,058 | 43,058 | - | - | 40,640 | 40,640 | - | - |
| Other Investment Balances - Dividends Due | 2,063 | 2,063 | | | 2,527 | 2,527 | - | - |
| **Total** | 1,380,260 | 682,789 | 576,038 | 121,433 | 1,528,127 | 766,159 | 629,303 | 132,665 |

## 23. INVESTMENT RISKS

As demonstrated above, the Fund maintains positions indirectly via its investment managers in a variety of financial instruments including bank deposits, quoted equity instruments, fixed interest securities, direct property holdings, unlisted equity products, commodity futures and other derivatives. This exposes the Fund to a variety of financial risks including credit and counterparty risk, liquidity risk, market risk and exchange rate risk.

**Procedures for Managing Risk**

The principal powers to invest are contained in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 and require an Administering Authority to invest any pension fund money that is not needed immediately to make payments from the Pension Fund. These regulations require the Pension Fund to formulate a policy for the investment of its fund money. The Administering Authority's overall risk management procedures focus on the unpredictability of financial markets and implementing restrictions to minimise these risks. The Pension Fund annually reviews its Statement of Investment Principles (SIP) and corresponding Funding Strategy Statement (FSS), which set out the Pension Fund's policy on matters such as the type of investments to be held, balance between types of investments, investment restrictions and the way risk is managed.

The Fund continues to review its structure. A key element in this review process is the consideration of risk and for many years now the Fund has pursued a policy of lowering risk by diversifying investments across asset classes, investment regions and fund managers. Furthermore, alternative assets are subject to their own diversification requirements and some examples are given below.

- Private equity - by stage, geography and vintage where funds of funds are not used
- Property - by type, risk profile, geography and vintage (on closed ended funds)
- Hedge funds – multi-strategy and or funds of funds

**Manager Risk**

The Fund is also well diversified by managers with no single active manager managing more than 25% of Fund assets. On appointment, fund managers are delegated the power to make such purchases and sales as they deem appropriate under the mandate concerned. Each mandate has a benchmark or target to outperform or achieve, usually on the basis of 3-year rolling periods. An update, at least quarterly, is required from each manager and regular meetings are held with managers to discuss their mandates and their performance on them. There are slightly different arrangements for some of the alternative assets. Some private equity and property investment is fund, rather than manager-specific, with specific funds identified by the investment sub group after careful due diligence. These commitments tend to be smaller in nature than main asset class investments but again regular performance reports are received and such investments are reviewed with managers at least once a year.

## 23. INVESTMENT RISKS (continued)

### Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Fund. As noted above almost all the Fund's investments are through pooled vehicles and a number of these are involved in derivative trades of various sorts including futures, swaps and options. Whilst the Fund is not a direct counterparty to such trades and so has no direct credit risk, clearly all derivative transactions incorporate a degree of risk and the value of the pooled vehicle, and hence the Fund's holding, could be impacted negatively by failure of one of the vehicle's counterparties. However, part of the operational due diligence carried out on potential manager appointees concerns itself with the quality of that manager's risk processes around counterparties and seeks to establish assurance that these are such as to minimise exposure to credit risk.

There has been no historical experience of default on the investments held by the Pension Fund.

Within the Fund, the areas of focus in terms of credit risk are bonds and some of the alternative asset categories.

- The Fund's active fixed-interest bond portfolio £111,608k is managed (by Goldman Sachs) on an unconstrained basis and has a significant exposure to credit, emerging market debt and loans. At 31st March 2015, the Fund's exposure to non-investment grade paper was 16.1% of the actively managed fixed income portfolio.

- On private equity the Fund's investments are almost entirely in the equity of the companies concerned. The Fund's private equity investments of £31,162K are managed by Harbourvest in a fund of funds portfolio.

On hedge fund of funds and multi-strategy vehicles, underlying managers have in place a broad range of derivatives. The Fund's exposure to hedge funds through its managers at 31st March 2015 is set out below with their relative exposure to credit risk.

| | March 2015 £'000 | Credit Exposure |
|---|---|---|
| Permal | 24,892 | 18.5% |
| Blackrock | 26,630 | 22.4% |

### Liquidity Risk

The Pension Fund has its own bank accounts. At its simplest, liquidity risk is the risk that the Fund will not be able to meet its financial obligations when they fall due, especially pension payments to its members. At a strategic level the Administering Authority, together with its consulting actuary, reviews the position of the Fund triennially to ensure that all its obligations can be suitably covered.

## 23. INVESTMENT RISKS (continued)

Ongoing cash flow planning in respect of contributions, benefit payments, investment income and capital calls/distributions is also essential. This is in place with the Fund's position updated regularly.

Specifically on investments, the Fund holds through its managers a mixture of liquid, semi-liquid and illiquid assets. Whilst the Fund's investment managers have substantial discretionary powers regarding their individual portfolios and the management of their cash positions, they hold within their pooled vehicles a large value of very liquid securities, such as equities and bonds quoted on major stock exchanges, which can easily be realised. Traditional equities and bonds now comprise 83% of the Fund's value and, whilst there will be some slightly less liquid elements within this figure (emerging market equities and debt for example), the funds investing in these securities offer monthly trading at least – often weekly or fortnightly.

On alternative assets the position is more mixed. Most are subject to their own liquidity terms or, in the case of property, redemption rules. Closed-ended funds such as most private equity vehicles and some property funds are effectively illiquid for the specific period (usually 10 years), although they can be sold on the secondary market, usually at a discount.

The table below analyses the value of the Fund's investments at 31st March 2015 by liquidity profile.

| | Amounts at 31st March 2015 £000s | Within 1 month £000s | 1-3 months £000s | 4-12 months £000s | > 1 Year £000s |
|---|---|---|---|---|---|
| **Equities** | | | | | |
| UK Equities | 363,504 | 363,504 | 0 | 0 | 0 |
| Overseas Equities | 359,488 | 359,488 | 0 | 0 | 0 |
| **Pooled Investment Vehicles** | | | | | |
| Fixed-Interest Funds | 111,608 | 111,608 | 0 | 0 | 0 |
| UK Equity | 128,442 | 128,442 | 0 | 0 | 0 |
| Overseas Equity | 249,330 | 249,330 | 0 | 0 | 0 |
| Fixed Interest | 72,560 | 72,560 | 0 | 0 | 0 |
| Index-linked | 26,518 | 26,518 | 0 | 0 | 0 |
| Property Unit Trust | 3,039 | 0 | 0 | 3,039 | 0 |
| Property Fund | 72,361 | 0 | 0 | 37,806 | 34,555 |
| Hedge Fund | 51,522 | 0 | 0 | 51,522 | 0 |
| Global Tactical Asset Allocation | 15,426 | 0 | 0 | 15,426 | 0 |
| Private Equity | 31,162 | 0 | 0 | 0 | 31,162 |
| Deposits with banks and other financial institutions | 40,640 | 40,640 | 0 | 0 | 0 |
| Other Investment Balances - Dividends Due | 2,527 | 2,527 | 0 | 0 | 0 |
| **Total** | 1,528,127 | 1,354,617 | 0 | 107,793 | 65,717 |

## 23. INVESTMENT RISKS (continued)

It should be noted that different quoted investments are subject to different settlement rules but all payments/receipts are usually due within 7 days of the transaction (buy/sell) date. Because the Fund uses some pooled vehicles for quoted investments these are often subject to daily, weekly, 2-weekly or monthly trading dates. All such investments have been designated "within 1 month" for the purposes of liquidity analysis. Open-ended property funds are subject to redemption rules set by their management boards. Many have quarterly redemptions but these can be held back in difficult markets so as not to force sales and disadvantage continuing investors. For liquidity analysis purposes, a conservative approach has been applied and all such investments have been designated "within 4-12 months".

Closed-ended funds have been designated illiquid for the purposes of liquidity analysis. However, these closed-ended vehicles have a very different cash flow pattern to traditional investments since the monies committed are only drawn down as the underlying investments are made (usually over a period of 5 years) and distributions are returned as soon as underlying investments are exited (often as early as year 4). In terms of cash flow, therefore, the net cash flow for such a vehicle usually only reaches a maximum of about 60-70% of the amount committed and cumulative distributions usually exceed cumulative draw downs well before the end of the specified period, as these vehicles regularly return 1½ to 2½ times the money invested. At the same time, it has been the Fund's practice to invest monies on a regular annual basis so the vintage year of active vehicles ranges from 2000 to 2013.

This means that, whilst all these monies have been designated closed-ended and thereby illiquid on the basis of their usual "10-year life", many are closer to maturity than implied by this broad designation. As can be seen from the table, even using the conservative basis outlined above, around 88% of the portfolio is realisable within 1 month and 96% is realisable within 12 months.

### Market Risk

Market risk is the risk that the fair value or future cash flows of a financial institution will fluctuate because of changes in market price. The Fund is exposed to the risk of financial loss from a change in the value of its investments and the consequential danger that its assets will fail to deliver returns in line with the anticipated returns underpinning the valuation of its liabilities over the long term.

- The risks associated with volatility in the performance of the asset class itself (beta);
- The risks associated with the ability of managers, where allowed, to move away from index weights and to generate alpha, thereby offsetting beta risks by exceeding market performance.

The table on the following page sets out an analysis of the Fund's market risk positions at 31 March 2015 by showing the percentage invested in each asset class and through each manager within each main asset class, the index used as a benchmark and the target set for managers against this benchmark.

## 23. INVESTMENT RISKS (continued)

| Asset Class | Asset Allocation | Fund Manager | | Benchmark | Performance target |
|---|---|---|---|---|---|
| | | Passive | Active | | |
| UK Equities | 34% +/- 5% | 14%<br>L&G | 20%<br>Schroders | FTSE allshare | +3% p.a. over rolling 3 year |
| Overseas Equities | 34% +/- 5% | 13%<br>L&G | 21%<br>JP Morgan & Aberdeen | MSCI World all share (ex UK) | +3% p.a. over rolling 3year |
| | | | Aberdeen | MSCI Frontier Markets Index | +% p.a. over rolling 3year |
| Global Fixed Interest | 15% +/- 5% | 6%<br>L&G | 9%<br>Goldman Sachs | Libor | LIBOR +3% |
| Property | 5% +/- 5% | - | 5%<br>Schroders, Partners & Invesco | IPD UK Pooled Property Fund Index | + 1% p.a. over rolling 3 year. 8% absolute return |
| Hedge Funds | 5% +/- 5% | - | 5%<br>Blackrock & Permal (formerly Fauchier) | LIBOR | +4% |
| Private Equity | 3% +/- 5% | - | 3%<br>Harbourvest | FTSE allshare | +3% p.a. over 3 year rolling |
| Global Tactical Asset Allocation | 2% +/- 5% | - | 2%<br>BGI/Blackrock | LIBOR | +4% over 3 yr rolling |
| Cash | 2% +/- 5% | - | 2%<br>In house and cash flows of fund managers | 7day LIBID | - |
| TOTAL | 100% | 33% | 67% | | |

The risks associated with volatility in market values are managed mainly through a policy of broad asset diversification. The Fund sets restrictions on the type of investment it can hold through investment limits, in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The Fund also adopts a specific strategic benchmark (details can be found in the Fund's SIP summarised above) and the weightings of the various asset classes within the benchmark form the basis for asset allocation within the Fund. Under normal conditions there is quarterly rebalancing to this strategic benchmark within fixed tolerances. This allocation, determined through the Fund's asset allocation, is designed to diversify and minimise risk Market risk is also managed through manager diversification – constructing a diversified portfolio across multiple investment managers. On a daily basis, managers will manage risk in line with the benchmarks, targets and risk parameters set for the mandate, as well as their own policies and processes. The Fund itself monitors managers on a regular basis (at least quarterly) on all these aspects.

## 23. INVESTMENT RISKS (continued)

### Price Risk

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

The fund is exposed to share and derivative price risk. This arises from investments held by the fund for which the future price is uncertain. All securities investments present a risk of loss of capital. Except for shares sold short, the maximum risk resulting from financial instruments is determined by the fair value of the financial instruments. Possible losses from shares sold short is unlimited.

Following analysis of historical data and expected investment return movement during the financial year, and in consultation with the fund's investment advisors, the council has determined that the following movements in market price risk are reasonably possible. Had the market price of the fund investments increased/decreased in line with the potential market movements, the change in the net assets available to pay benefits in the market price as at 31 March 2015 would have been as follows:

**Price Risk**

| Asset Type | Value (£) | % Change | Value on Increase | Value on Decrease |
|---|---|---|---|---|
| UK Equities | 491,946 | 10.52% | 543,699 | 440,193 |
| Overseas Equities | 608,818 | 9.35% | 665,742 | 551,894 |
| Bonds & Index-Linked | 210,686 | 2.67% | 216,311 | 205,061 |
| Cash | 40,640 | 0.01% | 40,644 | 40,636 |
| Property | 75,400 | 3.00% | 77,662 | 73,138 |
| Alternatives | 98,110 | 4.06% | 102,093 | 94,127 |
| Other Investment Balances | 2,527 | 0.00% | 2,527 | 2,527 |
| Total Assets | 1,528,127 | 6.64% | 1,629,595 | 1,426,659 |

*The % change for Total Assets includes the impact of correlation across asset classes*

and as at 31st March 2014 :

Price Risk

| Asset Type | Value (£) | % Change | Value on Increase | Value on Decrease |
|---|---|---|---|---|
| UK Equities | 453,315 | 12.59% | 510,387 | 396,243 |
| Overseas Equities | 520,997 | 12.13% | 584,194 | 457,800 |
| Bonds & Index-Linked | 202,191 | 2.47% | 207,185 | 197,197 |
| Cash | 43,098 | 0.02% | 43,107 | 43,089 |
| Property | 68,723 | 2.61% | 70,517 | 66,929 |
| Alternatives | 89,873 | 3.00% | 92,569 | 87,177 |
| Other Investment Balances | 2,063 | 0.00% | 2,063 | 2,063 |
| Total Assets | 1,380,260 | 8.35% | 1,495,512 | 1,265,008 |

*The % change for Total Assets includes the impact of correlation across asset classes*

## 23. INVESTMENT RISKS (continued)

### Currency Risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the fund (£UK). The fund holds both monetary and non-monetary assets denominated in currencies other than £UK.

In consultation with the fund's investment advisors, the council has determined that the following movements in currencies are reasonably possible. The following represents a sensitivity analysis associated with foreign exchange movements as at 31 March 2015:

| Currency | Value (£'000) | % Change | Value on Increase | Value on Decrease |
|---|---|---|---|---|
| Australian Dollar | 4,585 | 8.87 | 4,992 | 4,178 |
| Brazilian Real | 4,706 | 11.69 | 5,256 | 4,156 |
| Canadian Dollar | 10,030 | 6.65 | 10,697 | 9,363 |
| Chinese Renminbi Yuan | 10,870 | 7.91 | 11,730 | 10,010 |
| Danish Krone | 1,608 | 6.19 | 1,707 | 1,509 |
| EURO | 93,099 | 6.15 | 98,824 | 87,374 |
| Hong Kong Dollar | 7,953 | 7.74 | 8,569 | 7,337 |
| Indian Rupee | 5,092 | 10.78 | 5,641 | 4,543 |
| Indonesian Rupiah | 2,688 | 11.65 | 3,001 | 2,375 |
| Israeli Shekel | 832 | 7.35 | 893 | 771 |
| Japanese Yen | 55,482 | 11.02 | 61,599 | 49,365 |
| Mexican Peso | 2,717 | 9.42 | 2,973 | 2,461 |
| Norwegian Krone | 640 | 8.64 | 695 | 585 |
| Peruvian New Sol | 798 | 6.97 | 854 | 742 |
| Singapore Dollar | 4,864 | 5.89 | 5,151 | 4,577 |
| South African Rand | 1,899 | 10.72 | 2,103 | 1,695 |
| South Korean Won | 6,927 | 6.62 | 7,385 | 6,469 |
| Swedish Krona | 7,672 | 7.30 | 8,232 | 7,112 |
| Swiss Franc | 21,024 | 9.34 | 22,988 | 19,060 |
| Taiwan Dollar | 5,201 | 6.62 | 5,545 | 4,857 |
| Thai Baht | 674 | 8.08 | 728 | 620 |
| Turkish Lira | 586 | 9.85 | 644 | 528 |
| US Dollar | 196,965 | 7.78 | 212,292 | 181,638 |
| North America Basket | 96,721 | 7.41 | 103,891 | 89,551 |
| Europe ex UK Basket | 53,891 | 5.66 | 56,939 | 50,843 |
| Asia Pacific ex Japan Basket | 22,034 | 6.44 | 23,453 | 20,615 |
| Emerging Basket | 52,894 | 6.80 | 56,489 | 49,299 |
| Total Currency * | 672,452 | 5.81 | 711,488 | 633,416 |

* The % change for Total Currency includes the impact of correlation across the underlying currencies

## 23. INVESTMENT RISKS (continued)

and as at 31 March 2014:

| Currency Risk (by currency) | | | | |
|---|---|---|---|---|
| **Currency** | **Value (£'000)** | **% Change** | **Value on Increase** | **Value on Decrease** |
| Australian Dollar | 5,099 | 9.80% | 5,599 | 4,599 |
| Brazilian Real | 8,090 | 12.69% | 9,117 | 7,063 |
| Canadian Dollar | 9,422 | 6.04% | 9,991 | 8,853 |
| Danish Krone | 1,415 | 6.26% | 1,504 | 1,326 |
| EURO | 89,647 | 6.31% | 95,304 | 83,990 |
| Hong Kong Dollar | 6,029 | 7.98% | 6,510 | 5,548 |
| Indian Rupee | 5,766 | 10.84% | 6,391 | 5,141 |
| Indonesian Rupiah | 2,094 | 11.05% | 2,325 | 1,863 |
| Israeli Shekel | 628 | 6.94% | 672 | 584 |
| Japanese Yen | 36,631 | 11.54% | 40,858 | 32,404 |
| Mexican Peso | 2,357 | 10.03% | 2,593 | 2,121 |
| Norwegian Krone | 745 | 8.79% | 810 | 680 |
| Singapore Dollar | 3,181 | 5.71% | 3,363 | 2,999 |
| South African Rand | 2,236 | 11.31% | 2,489 | 1,983 |
| South Korean Won | 6,251 | 6.56% | 6,661 | 5,841 |
| Swedish Krona | 6,347 | 7.03% | 6,793 | 5,901 |
| Swiss Franc | 27,523 | 7.42% | 29,565 | 25,481 |
| Taiwan Dollar | 4,873 | 5.63% | 5,147 | 4,599 |
| US Dollar | 162,996 | 8.07% | 176,150 | 149,842 |
| Other | 7,091 | 5.21% | 7,460 | 6,722 |
| North America Basket | 76,747 | 7.61% | 82,587 | 70,907 |
| Europe ex UK Basket | 50,213 | 6.01% | 53,231 | 47,195 |
| Asia Pacific ex Japan Basket | 18,817 | 6.11% | 19,967 | 17,667 |
| Emerging Basket | 43,402 | 6.37% | 46,167 | 40,637 |
| **Total Currency*** | **577,600** | **5.13%** | **607,210** | **547,990** |

****The % change for Total Currency includes the impact of correlation across the underlying currencies***

### Interest Rate Risk

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represents the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Actuary, as part of their triennial valuation and dictated by the Funding Strategy Statement, will only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing. Progress is analysed at three yearly valuations for all employers.

**24. Further Information**

Further information about the fund can be found in Appendicies 2 to 4. Information can also be obtained from the Chief Treasury & Technical Officer, Civic Centre, Oystermouth Road, Swansea SA1 3SN or on www.swanseapensionfund.org.uk.

**25. Financial Position**

The accounts outlined within the statement represent the financial position of the City and County of Swansea Pension Fund at 31st March 2015.

**Appendix 1**

## SCHEDULE OF EMPLOYING BODIES AND CONTRIBUTION RATES FOR THE PERIOD 1ST APRIL 2014 TO 31ST MARCH 2015

| | Contributors | Pensioners | Deferred Benefits | Employer Contribution Rate (% of Pensionable Pay) plus additional annual monetary amount |
|---|---|---|---|---|
| **Administering Authority** | Number @ 31/03/15 | Number @ 31/03/15 | Number @ 31/03/15 | |
| City & County of Swansea | 8,650 | 4,721 | 4,235 | 22.4% |
| **Scheduled Bodies** | | | | |
| Neath Port Talbot County Borough | 5,327 | 3,187 | 4,011 | 22.5% |
| Briton Ferry Town Council | 0 | 1 | 1 | - |
| Cilybebyll Community Council | 7 | 0 | 1 | 20.5% |
| Clydach Community Council | 0 | 0 | 1 | - |
| | 2 | 3 | 1 | 19.2% (+ £3,700) |
| Gower College | 453 | 199 | 376 | 15.4% (+ £164,400) |
| Lliw Valley BC | 0 | 253 | 27 | - |
| Margam Joint Crematorium Committee | 5 | 13 | 5 | 19.2% (+ £4,600) |
| NPTC Group | 553 | 191 | 314 | 14.7% (+ £151,900) |
| Neath Port Talbot Waste Management Co. Ltd. | 0 | 1 | 0 | - |
| Neath Town Council | 13 | 15 | 7 | 19.2% (+ £15,100) |
| Pelenna Community Council | 2 | 1 | 3 | 21.9% |
| Pontardawe Town Council | 5 | 1 | 0 | 19.7% |
| Swansea Bay Port Health Authority | 2 | 10 | 1 | 22.4% |
| Swansea City Waste Disposal Company | 0 | 18 | 3 | - |
| University of Wales Trinity St Davids | 234 | 116 | 187 | 22.4% (+ £225,000) |
| West Glamorgan County Council | 0 | 2,321 | 308 | - |
| West Glamorgan Magistrates Courts | 0 | 37 | 19 | - |
| West Glamorgan Probation Service | 0 | 56 | 9 | - |
| West Glamorgan Valuation Panel | 0 | 5 | 0 | - |
| **Admitted Bodies** | | | | |
| BABTIE | 0 | 3 | 12 | - |
| Celtic Community Leisure | 298 | 28 | 117 | 11.1% |
| Colin Laver Heating Limited | 2 | 0 | 2 | 19.7% |
| Swansea Bay Racial Equality Council | 2 | 0 | 1 | 27.2% |
| The Careers Business | 0 | 4 | 11 | - |
| Wales National Pool | 54 | 3 | 39 | 14.5% |
| West Wales Arts Association | 0 | 2 | 0 | - |
| Capgemini | 11 | 1 | 4 | 18.7% |
| NPT Homes | 435 | 33 | 54 | 16.2% |
| Phoenix Trust | 0 | 1 | 4 | - |
| Grwp Gwalia | 230 | 37 | 48 | 20.4% |
| **Total** | **16,285** | **11,261** | **9,801** | |

**Appendix 2**

**Legislative Changes in the Local Government Pension Scheme (LGPS) during 2014/15**

The Communities and Local Government Department (CLG) issued the following key Statutory Instruments, which were effective during 2014/15 :

**S12013-2356** - The Local Government Pension Scheme Regulations 2013. These Regulations set up a new legal regime for the LGPS and are effective form 1 April 2014.

**S12014-525** - The Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014. These Regulations provide for the transition of existing LGPS members, as at 31 March 2014, into the new Scheme and are effective from 1 April 2014.

**S12014-1146** - The Local Government Pension Scheme (Offender Management) (Amendment) Regulations 2014 which were effective from 1 June 2014, were made to facilitate the continued membership of the LGPS for probation staff, following restructure. Greater Manchester Pension Fund (GMPF) was appointed as the appropriate administering authority for all current and former staff involved in the provision of probation services. The City & County of Swansea Pension Funds does not contain any active members in the Probation Service due to a previous restructure, however it is currently working with GMPF to ensure the smooth transfer of a pensioner and deferred records.

**S12015-57** - The Local Government Pension Scheme (Amendment) (Governance) Regulations 2015 were effective in part from 20 February 2015 with the remainder effective from 1 April 2015. The regulations provide new governance arrangements for the Secretary of State to establish a national scheme advisory board and for administering authorities to establish local pension boards.

**S12015-755** - The Local Government Pension Scheme (Amendment) Regulations 2015. The regulations were laid before Parliament on 19 March 2015 and are effective from 11 April 2015. They amend the Local Government Pension Scheme Regulations 2013 and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014, to provide clarity or improvement.

**Appendix 3**

**Investment Fund Management**

The investment of the Fund is the responsibility of the Pension Fund Committee. The Committee as at 31st March 2015 comprised of :

- 7 Council Members (one member from Neath Port Talbot CBC representing other scheme members) advised by:
- Section 151 Officer
- Chief Treasury & Technical Officer
- 2 Independent Advisers.

The Committee, after taking account of the views of the independent advisers and appointed actuary to the Fund, is responsible for determining broad investment strategy and policy, with appointed professional fund managers undertaking the operational management of the assets.

The fund has implemented a fully diversified investment approach with a view to reducing the volatility of investment returns, whilst maintaining above benchmark growth. The fund employs the services of specialist managers to outperform in each asset class invested in.

The investment managers are:

- Global Equities - JP Morgan Asset Management, L&G and Aberdeen Asset Managemen
- Global Bonds - Goldman Sachs Asset Management and L&G
- Fund of Hedge Funds - BlackRock and Fauchier Partners
- Fund of Private Equity Funds - Harbourvest
- Property - Invesco
- Fund of Property Funds - Partners Group and Schroders Investment Management
- Global Tactical Asset Allocation (GTAA) - BlackRock (ex BGI)

**Appendix 4**

**Other Fund Documents**

The City & County of Swansea Pension Fund is required by regulation to formulate a number of regulatory documents outlining its policy. Copies of the :

- Statement of Investment Principles
- Governance Statement
- Funding Strategy Statement
- Communication Policy

are available on request from the City & County of Swansea Pension Fund website http://www.swanseapensionfund.org.uk/

**Report of the Section 151 Officer**

**Pension Fund Committee – 24 September 2015**

**ALL WALES COLLABORATION**

| | |
|---|---|
| **Purpose:** | To present to the committee, the report by Mercers commissioned by the Society of Welsh Treasurers Sub Group re. Collaboration in the Welsh LGPS and<br>To seek approval to jointly procure a single passive index manager for all 8 Welsh LGPS funds |
| **Policy Framework:** | None |
| **Reason for Decision:** | To progress the collaborative agenda and to reduce costs |
| **Consultation:** | Legal, Finance & Delivery and Access to Services. |
| **Recommendations:** | It is recommended that: |
| 1) | The report by Mercers in Appendix 1 is received and noted |
| 2) | The joint procurement exercise outlined in Appendix 2 to collaboratively procure a single passive index manager on behalf of all 8 Welsh LGPS is approved |
| **Report Author:** | Jeff Dong |
| **Finance Officer:** | Mike Hawes |
| **Legal Officer:** | Debbie Smith |
| **Access to Services Officer:** | Sherill Hopkins |

**1 Introduction**

1.1 LGPS Reform has been on the government agenda for some time and there has been discussion with CLG via LGA throughout the last parliament with how best to take reform forward with options ranging from do nothing, through establishing procurement frameworks, working collaboratively, pooling investments through to merging funds on a regional basis or on a single national basis all the way through to realising the assets and making it an unfunded scheme like the other public sector schemes.

1.2 The consensus and the feedback from LGA was that the government was leaning towards a pooling of investments approach. As such, the Society of Welsh Treasurers Pension Sub Group ( SWTPSG) commissioned some work by the consultants Mercers with how best to implement this on an All Wales basis. The final report ( May 2015) is attached at Appendix 1.

1.3 The key points of the report are:

Spend time to develop a share set of principles for collaboration.

Pursue a more collaborative approach in order to avail the key benefits which include economies of scale and lower costs, increased consistencies, enhanced governance and operational management across the Welsh Funds.

Select a single provider for passive assets to obtain immediate cost savings. A pooling structure would not be required to achieve these gains.

Establish a pooling framework to extend on collaboration beyond passive assets.

Adopt a regulated (pooling) vehicle along with a model that supports leveraging the infrastructure of a third party provider (rather than building such infrastructure internally).

Consider framing the new collaborative framework as optional for each Welsh Fund but target mandates that are common to all to ensure strong uptake and an engaged and simple approach.

Consider active equity as the immediate mandate to commence under the new collaborative framework. The analysis conducted highlights that mandates offer the greatest potential for cost savings and improved net of fees returns.

Agree a set of next steps to take forward the project, including a workshop / training session and development of a project plan, including the potential tender process to assess suitable partners / providers to support the new collaborative framework.

## 2 Chancellor's Announcement July 2015

2.1 The Chancellor's Summer statement in July 2015 included the government's stated intentions for LGPS reform:

*"The government will work with Local Government Pension Schemes administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious plans are required to pool."*

## 3 Current Position

3.1 As recommended in the Mercer report, it was agreed by the SWTPSG to jointly procure a passive index manager for all 8 Welsh funds which would result in fee savings for all 8 Welsh funds.

3.2 A report outlining the approach to be adopted agreed by all 8 Welsh funds is attached at Appendix 2. This report will be presented at all 8 Welsh pension fund decision making bodies for approval

**4 Financial Implications**

4.1 The cost of the procurement exercise will be shared equally amongst the 8 Welsh Pension Funds

**5 Legal Implications**

5.1 The procurement exercise will be in accordance with Regulation and OJEU requirements where required

**6 Equality Impact Implications**

6.1 An EIA Screening has been undertaken and no E&EIs have been identified

**Appendices:**

**Appendix 1- Mercer- All Wales Collaboration**
**Appendix 2 – All Wales Passive Index Manager Joint Procurement Exercise**

MERCER

TALENT • HEALTH • RETIREMENT • INVESTMENTS

# ALL WALES COLLABORATION

FINAL REPORT

MAY 2015



MARSH & McLENNAN COMPANIES

# CONTENTS

# 1

# Executive Summary


This paper outlines the background and relevant details to support the eight Welsh LGPS Funds ("the Welsh Funds") in their considerations in establishing a collaborative governance and investment framework. The paper recommends that the Welsh Funds:

- Spend time to develop a shared set of principles for collaboration.

- Pursue a more collaborative approach in order to avail of key benefits that include economies of scale and lower costs, increased consistencies, enhanced governance and operational management across the Welsh Funds.

- Select a single passive provider for passive global equities to obtain immediate cost savings. A pooling structure would not be required to achieve these gains.

- Establish a pooling framework to extend on collaboration beyond passive global equities

- Adopt a regulated (pooling) vehicle along with a model that supports leveraging the infrastructure of a third party provider (rather than building such infrastructure internally). In addition, the paper suggests that the Welsh Funds should look to appoint a provider with appropriate experience who can provide an optimal level of governance and operational support, reducing both the risk and cost of developing internal resources and capabilities to operate the new framework.

- Consider framing the new collaborative framework as optional for each Welsh Fund but target mandates that are common to all to ensure strong uptake and an engaged and simple approach.

- Consider both active global equity and UK equity as the two immediate mandates to commence with the new collaborative framework. The analysis outlined in the paper highlights that these two mandates are consistent across the vast majority of funds and offer the greatest potential for cost savings.

- Agree a set of next steps to take forward the project, including a workshop / training session and development of a project plan, including the potential tender process to assess suitable partners/providers to support the new collaborative framework.

# 2

## Background and aims of this report

### Background

We begin at the point at which the eight LGPS Funds in Wales have decided that there is merit in exploring whether investing collectively is worthwhile and how it might be achieved.

The previous report on this issue, compiled by PwC, suggested that there would likely be savings (or improvements in net return) if assets were pooled. We agree with this concept, although clearly there are many variables here; not least of which is the issue of the degree of take up within any collective arrangement.

The previous report suggested that savings of between £1.6m and £4.4m could potentially be made (depending upon the investment model adopted). The obvious starting point therefore is to consider whether any quantum of those savings could be made by keeping things simple and leveraging existing arrangements. We do this in Section 5.

We have not looked to repeat any of the work carried out previously (although we do provide an analysis of the current situation in Section 5 for context). It is a matter of fact that the majority of investment managers will levy lower fees if dealing with a single large pool of assets relative to a larger number of smaller mandates.

Investing collectively will also likely allow the Welsh Funds to access asset classes and build strategies (cost effectively) that can make more sense with scale. Alternative assets are the obvious example.

Nonetheless, we are also cognisant of the fact that numbers showing cost savings can be open to interpretation and are heavily assumption dependent. It has to be accepted that there are also qualitative arguments that come into play too. For example, we would argue that a more focused, nimble / market aware approach could be taken under a collective, professionalised structure that would not be possible under a single Fund approach operating under a typical “Four Committee meetings per year” arrangement.

Investing collectively can take many forms, and we have assumed that a regulated entity of some description is the most sensible route; however this is discussed further in Section 7.

With a regulated entity however comes a plethora of operational and compliance related issues, which leads to the question of whether to “build” that entity or to “rent” the associated infrastructure. Regardless of either building the capabilities to manage an investment vehicle in-house or appointing a partner with existing infrastructure, it is critical that the Welsh Funds establish an appropriate governance and investment framework to support the decision-making process (both taking and implementing decisions) to ensure that the collaborative framework operates efficiently.

**This report**

This report develops a business case for the **establishment of a governance structure and investment framework** that will allow the eight Welsh LGPS funds to invest collaboratively. We have approached this project on the assumption that participation will be optional and that asset allocation will remain a local decision; in short we have looked at options that are flexible enough to cope with the many or the few.

The vision, as we see it, is to create a vehicle, which forms part of a collaborative investment framework across the Welsh Funds, whereby efficiencies are maximised (both in investment fees, investment returns and operational efficiency) by having participants' investment needs optimised through such a vehicle. Creating a flexible vehicle will, we believe, maximise participation.

The business case will:

- set out governance requirements in establishing a collaborative investment framework;
- highlight possible options for the structure of a collective investment vehicle, within the new framework;
- identify how in practice such a vehicle can be implemented and managed on an ongoing basis;
- consider financial savings and costs that could be anticipated;
- identify any practical difficulties which would need to be overcome;
- set out next steps and project plan to set up the new framework.

In addition we will:

- consider any legislative implications;
- identify a clear Governance model.

Integral to this whole project is the issue of "building" versus "renting" the chosen structure and both will be considered. However, no degree of asset pooling can occur without first considering governance structures and so we consider this early in the report.

# 3

## Are the benefits of collaboration proven?

In order for collaboration to be proven to be effective, the overall ‘result’ needs to lead to improved investment returns net of fees.

Fee savings are tangible, but arriving at improved investment returns may require a different approach to decision making and a long term outlook, and the impact of these factors are less simple to calculate, particularly over short term periods.

In short, we suggest that by delegating the implementation of investment manager decisions to a collective vehicle (in which each Fund will have representation and control across decision-making), individual Committees will be free to spend more time on the issues that really impact the bottom line; namely investment and funding policies. Of course the impact here is virtually impossible to quantify except over the long term, but various academic research suggests that if governance is improved (often by focusing on the big picture items) then there is a significant return premium to be earned. (This is discussed further in Section 4).

LGPS funds are long term investors and we do believe there is a premium therein. We have carried out analysis that supports the theme of investing for the long term through engaged ownership and its financial benefits are well supported. Putting in place a structure which looks to deal with leakages arising from a short term outlook can increase asset values by as much as 25% over a 20 year accumulation period (Ambachtsheer, 2013). We would argue that a collective vehicle funded by a number of committed, long term investors could have the potential to reap the rewards if the right principles are established at outset.

The opportunity to collaborate has the potential to allow the Funds (in aggregate) to achieve things that perhaps weren’t possible in isolation and in turn provide greater flexibility and choice. Let’s take Alternatives and specifically “Real Assets” as an example. This is an increasing area of focus for LGPS funds with their inflation linked liabilities, but one that can present difficulties for individual funds to properly access the best of the market without the appropriate scale. A carefully considered collective vehicle, tailored for the needs of the LGPS, would have distinct merits – managed by the LGPS for the LGPS.

Collaboration also allows operational efficiencies to be realised. Currently eight Funds are independently diverting internal resources and paying fees to external providers. Where there is commonality in services required, whether it investment related (e.g. a manager selection requirement for a particular asset class) or operational (e.g. use of a custodian) collaboration can drive operational efficiencies of a significant magnitude.

There will always be a tipping point in terms of economies of scale becoming diseconomies, but unfortunately there is no definitive evidence that quantifies a particular level. For example, significant scale may mean that smaller boutique managers do not have capacity to come on board. At current asset levels, we would not envisage this to be an issue for the Welsh Funds, but it will be one to watch over time.

In practical terms, there are an increasing number of pension schemes both exploring and adopting collaborative governance and investment frameworks. A number of our clients, with similar challenges to the Welsh Funds have implemented such solutions and are achieving the benefits of collaboration (economies of scale and lower costs, enhanced governance and increased speed of decision making, efficient implementation and improved performance) on an ongoing basis.

**Summary:**

- The key benefits to collaboration are:
    - Increased scale to reduce cost and improve diversification potential;
    - Improve consistent and simplification of investment arrangements;
    - Co-ordinated governance to improve operational management of Welsh Funds, including speed and implementation of decision-making.

# 4

## Governance issues and a shared vision?

Key to any potential collaborative project is whether each individual Fund is on board and willing to commit to a shared set of principles. With this in place, a sensible governance structure will be easier to achieve.

It is worth noting that we are not recommending any degree of compulsion for any individual Welsh Fund to invest in a collaborative entity. However, regardless of whether a structure is built or rented, each Fund (and its associated Committees), if deciding to use the structure, will need to be on board with the concept of delegation to a collective entity of some description in terms of manager selection, monitoring and implementation. With this in mind, we would suggest that it is crucial that a joint vision or set of principles is established at outset that local Committees can buy into and reference at future points.

We would strongly recommend that after consideration of this report, the eight Funds prioritise the establishment of a shared set of principles. Issues to resolve will include:

- What is the primary aim of collaboration?
  - Cost savings
  - Pursuit of excellence – governance and investments
  - Defence against merger
  - Implementation of a long term investment philosophy
- How will success be measured?
- Will decisions require a majority or full consent?
- Will all Funds approach engagement with Committees collectively or individually (at outset and on an ongoing basis)?
- How will operational issues such as procurement be dealt with?
- How often and where will the group meet, and with the difficulties presented by geography and travel, will sub groups for potentially separate work streams be established?
- What asset classes / mandates to include in the initial collaboration framework?

***Governance***

Good governance is crucial.

There is academic research that suggests the existence of a good governance premium; ranging from 0.05% p.a. (Clarke, 2007) to 1-3% p.a. (Ambachtsheer 2007, Watson Wyatt 2006)

“Pension Fund Governance can make a positive difference to financial performance, cost efficiency, and the trust of stakeholders in the institution” (Clark, 2007)

There are several reasons as to the relevance of a governance premium in this case. In the first instance, by delegating investment manager issues to a collective entity, the more important considerations of funding and investment policies can be given more time by Committees (locally) at each Welsh Fund. Of course this assumes that all Funds do use the collective entity to a significant degree. Second, the governance structure of the collective entity itself is of utmost importance in terms of the role it plays in efficient decision making and implementation.

Any collective entity will have an Investment Committee of some description that will need a Terms of Reference to determine its precise make up and roles / responsibilities and this will become more tangible once a collective model is established. In the meantime, we would make the following initial suggestions:

- All Funds participating will require representation, but on the grounds that it is our opinion (and experience) that smaller groups tend to operate more efficiently, we would recommend that each Fund has just one representative;

- Depending on the structure chosen, it may be that an independent chair and a secretary are considered. Otherwise, it may be worth considering having a rotating chair with perhaps each Fund's representative serving as chair for six months;

- To maximise the professionalism of decision making, we would suggest that the Fund representatives are Officers with investment experience / expertise rather than elected officials;

- It may be worth considering having an elected official from each local Pensions Committee form a Consultative Committee that could receive periodic reports from the Investment Committee.

**Summary:**

- Key to any potential collaborative project is whether each individual Fund is on board and willing to commit to a shared set of principles.

- We would suggest that these principles are formalised at outset and are focused around:

    - Aims of collaboration
    - Measures of success
    - Decision making process
    - Engagement at a local level
    - Operational considerations

- In putting in place an appropriate governance structure, a balance needs to be struck between retention of issues at a local level (where appropriate); but the need to delegate aspects where it "makes sense" to do so.

# 5

## Increasing efficiency within the existing arrangements

It would seem sensible before embarking on a project requiring change, to consider whether there are efficiencies that can be easily exploited within the existing arrangements.

We have considered the following areas:

- Investment manager fees (based on commonalities across current assets / manager structure);
- Other expenses (e.g. custodian and consulting costs).

***Investment manager fees***

An obvious place to start is to review the aggregate investment manager fees currently in place across the eight Funds. We set out below a summary of asset allocation and the manager fees paid at an aggregate level.

| | Assets (£bn) | % of assets | Total fee (£m) | Average fee |
|---|---|---|---|---|
| **UK Equity** | **2.5** | **20.7** | **11.7** | **0.47%** |
| Active | 1.3 | 10.8 | 10.9 | 0.82% |
| Passive | 1.2 | 9.9 | 0.6 | 0.05% |
| **Global Equity** | **4.4** | **36.0** | **15.6** | **0.35%** |
| Active | 3.3 | 27.3 | 14.6 | 0.44% |
| Passive | 1.1 | 8.8 | 1.0 | 0.09% |
| **Emerging Market Equity** | **0.4** | **3.2** | **1.9** | **0.47%** |
| Active | 0.2 | 2.0 | 1.7 | 0.69% |
| Passive | 0.2 | 1.2 | 0.2 | 0.13% |
| **Property** | **0.8** | **6.5** | **3.8** | **0.35%** |
| **Diversified Growth / Balanced funds** | **0.7** | **5.6** | **1.6** | **0.24%** |
| **Alternatives** | **1.2** | **10.0** | **11.1** | **0.91%**[1] |
| **Bonds** | **2.2** | **17.9** | **4.0** | **0.18%** |
| Corporate bonds | 1.6 | 13.0 | 3.5 | 0.22% |
| Government bonds | 0.6 | 4.9 | 0.6 | 0.10% |
| **Total** | **12.2** | **100.0** | **49.7** | **0.40%** |

Source: All Wales. May not sum due to rounding. Based on data as at 30 September 2014.

[1] Approximate – based upon the data provided. Where fees were not provided an estimate has been made. Underlying manager fees have been excluded unless explicitly provided.

In establishing any potential cost efficiencies within the existing asset structure we reviewed the following areas:

- Aggregate fees – how do fees of the eight Funds in aggregate compare to other large mandates?
- Commonalities within active UK and global equity strategies
- Potential for savings within passive mandates
- Initial thoughts on alternatives
- Implications for bond portfolio

A summary of our findings is below. Further detail on each aspect is outlined in the appendix.

| | **Comment** |
|---|---|
| Aggregate fees | Current fees are generally competitive across the board compared to our Global Fee Survey (used to benchmark fees relative to the industry). However, the Fee Survey does not provide information on mandates of the scale possible across the eight Welsh funds collectively. |
| Commonalities within active UK and global equity strategies | There is limited commonality between the Funds' manager line-up, and even where there are consistencies at a manager level, due to the client specific requirements in the majority of cases there is little scope to enable Funds to leverage any economies of scale under the current structure.<br><br>Given the allocations and consistency of UK and global equity across the schemes, these mandates offer the greatest scope for initial collaboration. |
| Potential for savings within passive mandates | Fees are relatively good value compared to other passive mandates globally. However, specific to the LGPS we are aware of the leading passive managers becoming increasingly commercial to win (or retain business).<br><br>We believe there is potential for fee savings in Wales as a collective seeking to negotiate with the leading passive managers. Based on halving the existing fees (based on our experience this would not be unsurprising), this could lead to savings of £800,000 p.a.<br><br>We would caution however that other factors (such as profits on stock lending and costs of trading) would also need consideration. |
| Initial thoughts on alternatives | It is very difficult to quantify any potential for immediate cost savings through leveraging any commonalities due to complex structures in place. There is also little point in attempting to renegotiate fees with private markets managers given the Funds are "locked in" to these investments.<br><br>There is potential for significant savings should Funds collaborate on alternatives under a revised model – but the "model" will need to be in place first. |

| | **Comment** |
|---|---|
| Implications for bond portfolios | The make-up of the individual Funds' bond portfolios are wide ranging, and can broadly be categorised into UK Government, UK Corporate and Global bonds.<br><br>There is little commonality between mandates and so little scope to harvest significant fee savings. We do however note that from a strategic perspective the case for holding bonds in the current environment is changing. Therefore to the extent to which these mandates are up for review there may be more potential for collaboration going forward. |
| Other expenses | The Funds incur other expenses of c£1.6m p.a., with the largest expenses relating to custodian and consulting costs.<br><br>We would view custody as an area where fee savings could be made. From the data provided, there are at least 3 named custodians (HSBC, BNY Mellon and Northern Trust) and by looking to procure a single custodian we would expect significant savings to be made as a result of incredibly aggressive pricing in the market. We would suggest any wins here are considered as part of the wider collective investment model for Wales as opposed to a stand-alone custodian decision being made. |

**Summary:**

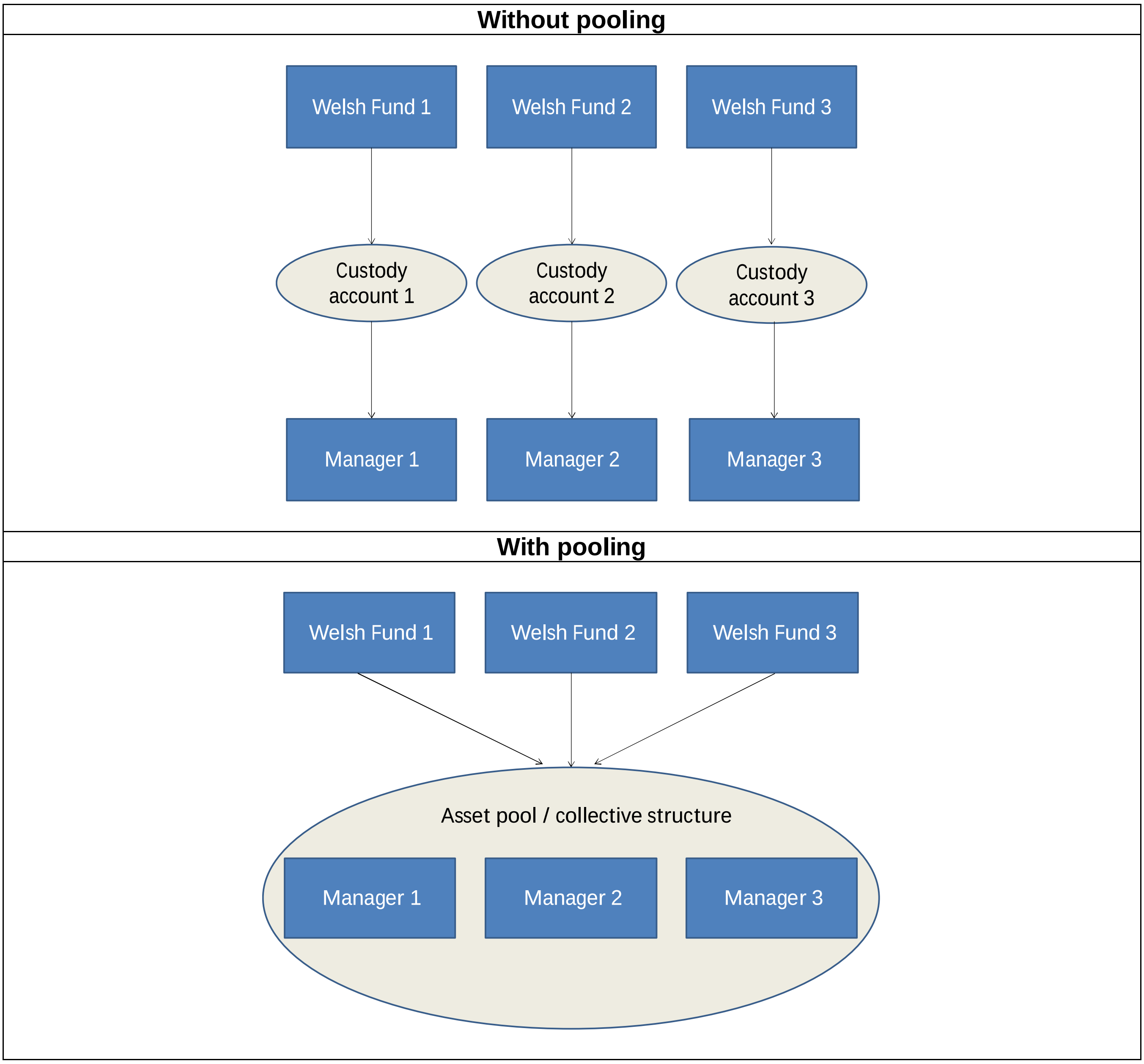
- We have investigated the potential for cost efficiencies in respect of investment manager fees and other expenses under the existing arrangements. Given the allocations and consistency of UK and global equity across the funds, these mandates offer the greatest scope for initial collaboration.
- The diversity across mandates suggests that there are limited initial savings to be made without aggregating assets in some way. The exception would be the passively managed funds, which could achieve savings of c£800,000 p.a. should the funds appoint a common manager.
- There is also potential fee savings to be made in respect of appointing a common custodian. We would however suggest that this is considered as part of the wider collective investment model being considered for Wales under the buy or rent structure.

# 6

## Asset Pooling

In technical terms, asset pooling is the commingling of assets from multiple investors into one vehicle.  Investment managers and pension schemes tend use the following five structures to commingled assets:

- Corporations
- Trusts
- Insurance companies
- Partnerships
- Contractual arrangements



### *Main Challenges in Asset Pooling*

A significant challenge in successfully pooling assets is achieving scale to cover set-up costs, ongoing operating expenses and governance costs. Scale is also required to make the structures efficient and have a reasonable expense ratio on an ongoing basis. Another large challenge is collaborating with local fiduciaries and internal stakeholders to obtain approvals and support for the asset solution. A smaller challenge is to align the investments and asset classes to the right vehicle to ensure smooth operations and quality accounting; however, if scale cannot be achieved running multiple funds and structures become expensive.

### *Potential Benefits in Asset Pooling*

In our experience, schemes pool assets to realise the following benefits:

- Ability to leverage larger plan scale to smaller plans reducing fees and operating costs
- Better diversifications and investment opportunity set for smaller plans
- Investment decisions taken by people with experience and expertise
- Greater control over investment decisions
- Better risk management over investments and liabilities
- Faster investment decision-making and greater ability to respond to dynamic markets across all investor plans in a short time frame
- Improved transparency and governance
- Reduced governance resource demands at a local level
- Reduced administrative, legal and transition costs associated with changing managers or portfolio construction

It is important to highlight that achieving the benefits above depends on the operational management and implementation efficiency of the new structure.

# 7

## Available structures

In establishing a collaborative investment framework, the assets of the plan will be required to be "pooled" in some form. This pooling aspect can be achieved through an unregulated or regulated structure.

***Unregulated Structures***

An unregulated structure is not subject to the same level of oversight and governance as the regulated vehicle. Options include:

- Increase efficiency of existing arrangements i.e. selecting common managers and negotiating lower fees (as discussed in section 5) ;
- Common Investment Funds.

At first glance, a common investment fund may feel like a more simple solution. However, it doesn't solve any governance issues for the eight Welsh Funds. There would need to be a lead authority or a joint body of some description that would take responsibility for manager selections, reporting and monitoring, transitions, and unitisation.

From a risk perspective, a regulated structure with proper operational controls and expertise will provide a more robust solution and establish a professional framework that would stand up to best practice and ensure the Welsh Funds are meeting appropriate standards.

***Regulated Structures***

Some of the key factors / drivers to be considered in determining the most suitable regulatory regime include:

- Investor type – retail or institutional
- The investment strategy to be adopted within the Fund i.e. asset classes and investment approach
- Required degree of flexibility and control
- Future proofing

Options available include:

- UCITS, or;
- Qualifying Investor Alternative Investment Fund ("QIAIF") (replacing the Non-UCITS QIF effective 22 July 2013)

### *UCITS*

UCITS (Undertakings for Collective Investment in Transferable Securities) are defined under a European Union directive which covers the coordination of national laws, regulations and administrative provisions in relation to collective investment in securities.

In general, UCITs operate on the basis of their availability to the "man in the street" and their investment & borrowing powers are not negotiable. However, they are also used by institutional investors for whom the drawbacks noted below are not significant.

- Restrictions on the investment and borrowing powers of the UCITS and on the use by the UCITS of leverage and financial instruments.
- Where financial derivative instruments are utilised by a UCITS, the UCITS must establish an extensive risk management process ("RMP") which must be approved by the Regulator.
- Higher cost of legal & regulatory compliance e.g. RMP, UCITS IV Business Plan and the production of Key Investor Information Document (KIID).
- UCITs can be sold without any material restriction to any retail investors in the EU. This is subject to compliance with local regulatory rules.

A UCITS fund may be established through any one of the following vehicles:

- An investment company;
- A unit trust; and
- A tax transparent fund.

### *QIAIF ("Non-UCITS")*

Non-UCITS are generally intended for institutional investors and have few investment restrictions.

The Welsh Funds could self-impose any investment restrictions through the fund's investment guidelines rather than having to adhere to strict regulatory imposed guidelines. Non-UCITS offer:

- Greater flexibility with respect to investment styles and restrictions;
- Extensive risk management process not required;
- Quicker upfront and ongoing change approval process with Central Bank;
- Compliance with domestic legislation.

It is likely that the QIAIF is the most suitable regulatory regime to meet the Welsh Funds' requirements.

### *Recommendation*

The decision as to which fund vehicle, regulatory framework or structure is most appropriate for the Welsh Funds will be dependent upon a variety of considerations including:

- Investment Strategy (now and in the future);
- Foreign Tax Considerations;

- Whether the fund would be offered to new investors over time;
- Speed of Authorisation.

The key factor for the Welsh Funds is investment strategy; and in particular the likelihood of investment in alternative asset classes. The non-UCITS regulatory structure would provide necessary advantages of investment flexibility and future-proofing.

However, the decision to choose an appropriate vehicle will depend on the “build” v “rent question. If the Welsh Funds choose the “rent” model i.e. to leverage the existing infrastructure of a third party, then the vehicle chosen would be made in conjunction with, and the input and support of, the appointed partner.

***Vehicle Domicile***

Within Europe, the leading (and proven) fund domiciles are Ireland and Luxembourg; although we note the recently available option of a UK Authorised Contractual Scheme. The choice of vehicle between Ireland and Luxembourg is finely balanced and we would suggest that this issue is investigated further as and when the Welsh Funds move towards asset pooling.

**Summary:**

The main decisions in respect of a chosen collaboration structure are as follows:

- ***Regulated or unregulated:*** We would suggest that a regulated structure with proper operational controls and expertise will provide a more robust solution.

- ***Type of regulated vehicle:*** If a regulated vehicle is agreed upon, the options relate to whether a UCITS or QIAIF (“non-UCITS”) structure is adopted. We would recommend a QIAIF as this provides fewer investment restrictions and provides the Welsh Funds with flexibility to self-impose their own investment restrictions as opposed to having to adhere to regulatory imposed guidelines.

- ***Vehicle Domicile***: We would suggest that this issue is investigated further as and when the Welsh Funds move towards asset pooling – but the leading fund domiciles are currently Ireland and Luxembourg based.

# 8

# Build or rent?

## Management Company and Governance

In order to establish a Welsh fund / vehicle, a Management Company will be required.

The Management Company is responsible for the running of the fund but generally delegates its main day-to-day functions (fund management, custody and fund administration). The Management Company has a fiduciary responsibility for the fund and must exercise oversight and appoint all delegates. The Regulator needs to be satisfied as to the suitability of the management company, its directors, shareholders and share capital.

The main duties of the Management Company are to:

- Issue the Prospectus (which contains details of the underlying investments and certain required disclosures). This is approved by the Regulator and must be kept up to date;
- Appoint appropriate advisors;
- Monitor investment performance
- Administer the subscriptions and redemption of units;*
- Value the assets, calculate the net asset value per unit and keep books of account;*
- Prepare the annual report and accounts;*
- Make necessary filings and ensure compliance with applicable regulatory and legal requirements.

In practice, the items marked with an asterisk (*) are often delegated to an Administrator.

The options for the Management Company are:

1. Establish your own Management Company;
2. Use the Management Company of a third party custodian;
3. Access the Management Company of third party provider to tailor a Welsh solution.

### Option 1 – Establish a Management Company (the "build" option)

We outline here the requirements, timelines, costs and ongoing obligations associated with the establishment of a management company and related regulated fund structure (the "**Fund**"). The management company could be located in any of the main jurisdictions for fund domiciles (Ireland, Luxembourg, for example and most recently the UK). The principles, cost and timelines are broadly similar regardless of the choice of fund domicile.

In summary, the following practical elements should be considered when deciding whether to establish a fund:

**1. Initial set–up of a regulated Fund, to include the Management Company being authorised in accordance with AIFMD (Alternative Investment Fund Managers Directive).**

The essential elements of the authorisation process which would need to be undertaken are outlined below:

1. Choose an appropriate legal structure for the Fund
2. Choose regulatory framework for the Fund
3. Establish Management Company
4. Put in place required governance structure
5. Appoint Directors
6. Alternative Investment Fund Manager entity selection and authorisation * *for prudence we have assumed AIFM license is applicable*
7. Appoint all 3rd Party Service Providers
    a. Investment Manager appointment and authorisation
    b. Administrator / TA
    c. Depository
    d. External Legal Counsel
    e. External Tax advisors
    f. External Auditor
8. Appoint External Directors
9. Fund Approval (Regulatory)
10. Fund Set up and launch (Operational)

***Timing***

As a guide, we estimate that the minimum timeframe involved to establish a fund and related entities is **12-18 months**. This timeframe, however, would be prolonged considerably if the appointment of any external service provider, such as the investment manager or administrator to the Fund, were to trigger the OJEU Process (and it is more than likely that this would be the case). The timeframe is also contingent on a dedicated team of internal and external resources working on this project on a full-time basis and all aspects of the project going to plan.

The timing will be dependent on the level of complexity. Whilst the regulatory authorisation timeframes are not extensive, the level of preparation in terms of making key decisions, drafting and negotiating contractual documentation, and establishing all of the required structures in place requires the majority of resources, in terms of time, cost and key personnel.

### *Costs*

In addition to the external tax and legal costs that we expect will be incurred (estimated to be in the region of £0.5m to £0.8m) considerable resources, both internal and external (in the form of consultants) in terms of time and costs need to be considered.

We estimate total resource related costs (internal and external) to be in the region of £2.7 to £3.1 m bringing the total initial cost estimate to between £3.2m and £3.9m.

This estimate is based on Mercer's own experience and cannot be relied upon as a definitive figure and is also contingent on no OJEU processes being triggered.

### *Capital Requirements*

Under AIFMD, the initial capital requirement for the Management Company is estimated to be between £3 - £6 million. This amount is subject to regulatory change and ongoing monitoring by the Welsh Funds.

## 2. On-going considerations

Having established a Management Company and related Fund, the Welsh Funds have ultimate fiduciary responsibility.

While certain functions may be outsourced, there is a requirement that the Fund is not a "letter box" entity. The Management Company will need to satisfy the Regulator on an ongoing basis that it has adequate management resources to conduct its activities effectively and employs personnel with the skills, knowledge necessary for the discharge of the responsibilities allocated to them.

There are considerable ongoing governance, oversight and reporting requirements to be undertaken by the Welsh Funds as a result of the establishment of regulated entities and funds. Examples include:

- Board representation and quarterly Board meetings
- Required governance structure and committees, internal policies and procedures to mitigate risk
- Oversight of all service providers
- Regulatory reporting and filings

The Welsh Funds will be subject to the Regulator's supervision, which is carried out as follows:

- Analysis of returns submitted to the Regulator
- Risk-rating of companies
- Themed and general inspections
- Review meetings
- Regular correspondence and engagement with companies under Central Bank supervision

The Welsh Funds will need to ensure sufficient ongoing internal resources are available to accommodate all of the ongoing requirements.

The Regulator has the power to impose sanctions on regulated entities for breaches of regulatory requirements ranging from substantial fines to, ultimately, the loss of authorisation. It is therefore crucial that any regulated entity has access to an adequately resourced and experienced team of compliance professionals. As is common with regulators around the world, the Central Bank is increasingly focused on supervision and enforcement.

**We have provided an overview of the steps and costs only. If more detail is required we would be happy to provide additional information.**

## Option 2 – Access the Management Company of a third party provider (the "rent" option)

The second option would be to use the standalone, pre-existing Management Company of a Custodian or an Investment Manager (for example).

As the Management Company is legally responsible for appointing the custodian, administrator and investment managers, it would be important to ensure that a suitable governance framework was established which would ensure that the Welsh Funds' preferences for investment managers could be satisfactorily accommodated without compromising the Management Companies' legal obligations. In addition, there is the potential for conflict as the Management Company would effectively be overseeing themselves in the role of custodian and fund administrator.

This approach would provide the benefits of avoiding to "build" an internal management company and therefore avoid the associated cost and complexity outlined in Option 1.

However, it should also be noted, that while a Custodian and/or Investment Manager may be able to provide a Management Company and infrastructure, the needs to support a collaboration framework are typically wider. The Welsh Funds would still require internal resources to support the governance and operations layer outside the Management Company to cover project management, manager appointments and implementation and asset transition.

A custodian would not typically have the internal investment expertise or capabilities to provide this wider support. In addition, the appointment of an investment manager in this role may create challenges with other investment managers managing the assets of the Welsh Funds in that they would need to provide their stock holdings and undertake fee negotiations (typically confidential information) with a competitor.

Notwithstanding this, Option 2 would be a viable option where the Welsh Funds would like to establish an internal team (significantly less than would be required under Option 1) to co-ordinate their investment arrangements.

The costs of Option 2, along with those of Option 3 for comparison are covered below, and we have also provided a comparison of included "services" between the two options.

## Option 3 – Access the Management Company of third party provider to tailor a Welsh solution (a further "rent" option)

The third option is for a third party provider to tailor a solution for Wales using their existing infrastructure and in addition, to support the operational co-ordination of the new framework on a day to day basis. Ideally a provider would be found who has experience of this role with other UK pension schemes and has established a number of different umbrella fund structures. This means that the Welsh Funds would not need to go through the full legal process of establishing a fund - the provider could simply launch a bespoke fund via an umbrella structure.

In addition, Option 3 would not require the development of internal Wales' resources as the appointed provider would provide the expertise, project management and operational governance to set up and operate the new arrangement on behalf of the Welsh Fund.

## Some thoughts on the differences between Options 2 and 3

The difference between Option 2 and Option 3 is that the latter allows for an integrated investment advisory support to the Welsh Investment Committee decision-making process, along with implementation in terms of set up, execution of manager appointments / replacements, transitions and rebalancing etc. Depending on the specification requirements of the provider, it would also allow for operational due diligence of the underlying investment managers and real time risk / portfolio reporting of manager's portfolios. Depending on the chosen provider, Option 3 would also allow for additional scale in terms of securing lower manager fees.

Specifically, Option 2 would **not** allow for the following:

- manager fee reductions (no access to global buying power)
- manager selection and implementation
- portfolio construction, analysis, (manager allocations, manager styles)
- expertise to connect holistically with each Fund's liabilities
- the support of decision-making that needs to be integrated with implementation

It is also unlikely that Option 2 would provide support in terms of co-ordinating and execution between managers, transition managers, custodians, pension advisors, legal advisors. It is therefore likely to require specialist / specific Officer support; perhaps in the form of a dedicated project manager.

We suggest a more framework based approach with a single provider that can support the full remit to the Welsh Funds to ensure all of these parties are co-ordinated and ensure an efficient set up and **effective ongoing investment governance around the collaborative framework.**

Further, we believe there to be a number of advantages to Option 3:

1. It is arguably the most efficient option in terms of timing and cost;
2. The provider will have a dedicated team of professionals across investments, operations, legal, compliance and risk management;
3. Specialist transition management services;
4. Independent oversight of the Administrator/Custodian;
5. Because the Management Company and fund are not public bodies, we understand (and have taken advice to the effect) that there would be no requirement to procure third party providers via the OJEU process;
6. Depending on the provider chosen and the investment managers that are ultimately used, there is the potential for even greater fee savings than the collective Welsh assets would bring. (For example, the Welsh Funds would likely also leverage the provider's scale of assets under management with many managers);
7. Lower operating, administrative, legal and governance costs at inception and on-going;
8. No set-up costs for the Welsh Funds to cover;
9. Lower internal resource requirements to manage and monitor the vehicles and underlying managers;
10. Limited operational risk;
11. Limited regulatory risk;
12. Flexibility – there will be minimum asset sizes required to make this option viable (and also attractive to providers) but it may mean that individual Funds do not need to sign up at outset.

Under this option, the Welsh Funds should have flexibility to determine the make-up and the Terms of Reference of the Investment Committee of the Management Company. There will be some stipulations / parameters from the provider on the basis of the regulatory requirements of the structure itself. The key point here however is that the Welsh Funds would have majority representation on the Investment Committee and would therefore be predominantly responsible for investment manager appointments and portfolio structure (for example the asset allocation within an equity fund).

Because the set up costs of this option are absorbed by the provider (and probably recouped by way of a minimum ongoing fee once assets are invested) there are no cost implications for Funds who decide not to participate from the outset. This does however assume that a minimum scale is achieved via those Funds who do invest.

It is also worth raising the issue of ongoing advice in terms of manager selection and implementation, and monitoring. Under Option 3, all these items are covered and there would be no requirement for individual Funds who are committed to engage these services at a Fund level. Of course, it may be the case that existing Fund consultants and advisors are engaged to provide advice on the recommendations of the Investment Committee to the collective structure, but that would be an individual Fund choice.

Nonetheless, we understand that, in order to fully assess the differences between Options 2 and 3, the Welsh Funds may wish to seek proposals from interested parties along with associated cost estimates.

***Costs of rental (Options 2 and 3) versus current approach***

We outline below the indicative costs associated with the existing approach compared with either of the two rental options.

As a starting point, and for simplicity, we have taken the eight Funds' **active global equity** allocation and assessed the potential costs of a collaborative approach according to various levels of take up. (We consider equities in totality later in the report).

There are several reasons for starting with one asset class only:

- It is more tangible in the sense that the simpler we make it, the fewer assumptions that are needed;
- We think that by starting with one asset class and getting a structure in place, it is more likely that any collaboration project will actually get off the ground;
- Global equity is arguably far less controversial (and easier for a collective to agree on) than a wider ranging project such as "alternatives";
- Once a robust governance structure is in place, more complex decisions such as the structure of an alternatives portfolio have a proper forum for discussion.

| Take up by Welsh Funds | 100% | | 50% | | 25% | |
|---|---|---|---|---|---|---|
| **Current Approach** | (%) | (£m) | (%) | (£m) | (%) | (£m) |
| Manager Fees | 0.44% | 14.6 | 0.44% | 7.3 | 0.44% | 3.7 |

| **Option 2 - Custodian Approach** | (%) | (£m) | (%) | (£m) | (%) | (£m) |
|---|---|---|---|---|---|---|
| Manager Fees | 0.37% | 12.5 | 0.41% | 6.8 | 0.42% | 3.5 |
| Structural Fee | 0.04% | 1.4 | 0.06% | 1.0 | 0.10% | 0.8 |
| Implementation Fee | Not included as part of the service and potentially difficult to quantify. Items for inclusion include investment advice (for manager selection), transition fees, advice on terms of reference for Committees, monitoring of custodian / third party provider. For illustrative purposes 0.01% = £0.33m which may be useful when considering the associated advisory and procurement services still required under this model. | | | | | |
| Total | | 13.8 | | 7.8 | | 4.4 |
| **Potential saving per annum** | | **0.8** | | **-0.5** | | **-0.7** |

| **Option 3 – Tailored Approach** | (%) | (£m) | (%) | (£m) | (%) | (£m) |
|---|---|---|---|---|---|---|
| Manager Fees | 0.31% | 10.4 | 0.31% | 5.2 | 0.31% | 2.6 |
| Structural Fee | 0.08% | 2.7 | 0.12% | 2.0 | 0.15% | 1.3 |
| Implementation Fee | Nil | - | Nil | - | Nil | - |
| Total | | 13.1 | | 7.2 | | 3.9 |
| **Potential saving per annum** | | **1.5** | | **0.1** | | **-0.2** |

Numbers may not sum due to rounding

**To note:**

***Additional savings / benefits***

The savings quoted are in relation to manager fees only and for one asset class only.

Alternative assets are the area where anecdotally the largest savings could be made but this would be a longer term project first in terms of running off existing commitments and second building a long term collective strategy.

Over time, for a Fund committing a significant proportion of assets, there would be associated reductions in fees for:

- Custody
- Reporting
- Procurement / manager selections

Based on each Fund committing to the collective arrangement, we estimate an additional £0.1m of savings per annum per Fund (or £0.8m collectively).

In addition, the additional premia discussed earlier in terms of ***long term investment philosophy*** and the ***governance premium*** should also be considered.

### *Additional costs*

There would also be transaction costs in migrating to the new arrangement. However, in practice, we would expect the fund to be built around existing high quality managers where appropriate.

There would also be the costs of procurement and internal resource to be incorporated.

### *The implementation fee*

Options 2 and 3 have an "implementation fee" row within the above table. Option 3 includes all associated services in relation to the final product i.e. in this case a global equity fund for Wales.

Option 2 would need the Welsh Funds to undertake, or outsource, the following tasks:

- Advice in relation to manager selection and portfolio construction
- Procurement of managers
- Transition services

### *Assumptions*

The key assumptions outlined in the analysis are as follows:

- Current approach:

  We have assumed the current manager fees (including performance fees) represent the cost of the typical manager fees under the existing arrangements. Where take up is reduced, we have assumed the basis points fee remains the same.

- Option 2 – Custodian approach:

  We have assumed that, based on the size of assets in place (£3.3bn), should manager appointments be made as a collective the costs could reduce, in basis point terms to 0.37% p.a. should all global equities be moved into this structure. The fees secured under the 50% and 25% take up options are higher to reflect the discounts being secured with managers reducing.

  The structural fee in adopting this approach with a custodian increases (in basis point terms) as take up rates fall.

- Option 3 – Tailored approach:

  We have assumed that using a third party provider, the fees secured with managers would be the same regardless of the take up. This is owing to the buying power already being in place from a global organisation with extensive assets under management

  In line with Option 2, the structural fee in adopting this approach with a custodian increases (in basis point terms) as take up rates fall.

The numbers outlined here are indicative and would be dependent upon the managers and structural platform used.

Clearly the above relates solely to actual monetary cost savings and does not allow for any potential for improved decision making and the extent to which this translates to improved investment returns.

In order to provide clarification of the potential savings that could be made across ***all*** active equities, we set out below similar analysis which includes UK and emerging markets actively managed equity strategies, in addition to solely considering the global equity analysis provided in the draft report.

| Take up by Welsh Funds | 100% | | 50% | | 25% | |
|---|---|---|---|---|---|---|
| **Current Approach** | (%) | (£m) | (%) | (£m) | (%) | (£m) |
| Manager Fees* | 0.47 | 22.9 | 0.47 | 11.5 | 0.47 | 5.7 |

| **Option 2 - Custodian Approach** | (%) | (£m) | (%) | (£m) | (%) | (£m) |
|---|---|---|---|---|---|---|
| Manager Fees* | 0.41 | 20.0 | 0.44 | 10.7 | 0.45 | 5.5 |
| Structural Fee | 0.03 | 1.3 | 0.04 | 1.0 | 0.06 | 0.8 |
| Implementation Fee | Not included as part of the service and potentially difficult to quantify. Items for inclusion include investment advice (for manager selection), transition fees, advice on terms of reference for Committees, monitoring of custodian / third party provider. For illustrative purposes 0.01% = £0.49m which may be useful when considering the associated advisory and procurement services still required under this model. | | | | | |
| Total | 0.43 | 21.3 | 0.48 | 11.7 | 0.51 | 6.3 |
| **Potential saving per annum** | - | **1.6** | - | **-0.3** | - | **-0.5** |

| **Option 3 – Tailored Approach** | (%) | (£m) | (%) | (£m) | (%) | (£m) |
|---|---|---|---|---|---|---|
| Manager Fees* | 0.35 | 17.0 | 0.35 | 8.5 | 0.35 | 4.3 |
| Structural Fee | 0.06 | 3.2 | 0.08 | 2.0 | 0.11 | 1.3 |
| Implementation Fee | Nil | - | Nil | - | Nil | - |
| Total | 0.41 | 20.2 | 0.43 | 10.5 | 0.46 | 5.6 |
| **Potential saving per annum** | - | **2.7** | - | **1.0** | - | **0.1** |

Numbers may not sum due to rounding

* Note that the actual UK manager fees for the Welsh Funds over recent history is 0.82% p.a. inclusive of performance fees. We recognise that this fee is higher than would be expected over the longer term and have assumed 0.5% p.a. would be a more appropriate figure. This provides a degree of prudence in the above cost savings.

### *Recommendation*

In short we would discount the build option on the grounds of timings and resource constraints and would recommend that consideration is given to Option 2 or 3. The differences between Option 2 and 3 relate to the desire for the Welsh Funds to establish an internal team to co-ordinate and manage day to day the various components of the new collaborative arrangements. This is the key question that should be considered (along with the cost) between Option 2 and 3.

Given our knowledge of the Welsh Funds, we would see Option 3 as the best fit with the existing and desired governance arrangements of the Funds. From our experience and the growing trend across the market place, this would be optimal to support the key objective of cost efficiency, consistency and ongoing governance and operational efficiencies in both setting up and operating the new framework.

We would **further recommend** that the Welsh Funds consider the following question:

Is there a need for a “big bang” solution (i.e. having a collaborative approach that covers all asset classes from day 1) or should a solution be phased or incremental?

We would strongly recommend that consideration is given to the latter, on the following grounds:

- Although the costs savings associated with a single asset class are clearly lower than the entire asset allocation, starting singularly means that a platform and governance structure can be built that will allow more complex decisions to be given proper consideration.

- We would predict that by starting with an asset class such as equity and allowing others to follow, the project will have a much shorter timescale to fruition.

The above two bullet points also reflect the view that Option 3 would support the best fit for the Welsh Funds at this time.

**Summary:**

- In order to establish a Welsh fund / vehicle, a Management Company will be required – this can be **"built"** or the structure could be **"rented"** from an existing provider.

- The estimated costs of build would be c£4million and it would take at least 12-18 months to establish, plus any procurement time in addition. The internal resource required to build would also be significant. On this basis, **we have discounted "build" as a viable option for Wales.**

- There are two main ways in which the Funds could "rent" a Management Company – either solely purchasing the infrastructure (option 2) or by using a tailored third party approach, which would also incorporate governance and operational oversight (option 3). **The upfront costs, internal team requirements, and timescales are significantly reduced under the rental option and is therefore our favoured approach.**

- There are **expected to be cost savings associated with collaboration** and we have provided information using active global equities as a starting point. The costs do however vary depending upon take up and the solution sought (from an increase in fees of £0.7m p.a. to a reduction of fees of £1.5m p.a.). The savings would increase as more asset classes are incorporated. In addition, the additional benefits in terms of long term investment philosophy and the governance premium should also be considered.

- The **key question to decide between Options 2 and 3 relates to the desire to develop internal resources and priority for cost-efficiency** across the Welsh Funds. Both internal resourcing and cost would be higher under Option 2. Given our understanding of the key objectives of the Welsh Funds we would view Option 3 as the best fit at this time. This would also align with market trends and best practice.

- **Costs savings are expected to be increased further if other asset classes are adopted over time** – most notably from alternatives, albeit noting that this is likely to be a longer term project first in terms of running off existing commitments and second building a long term collective strategy.

- In setting up an appropriate course of action, we would **strongly advocate a phased / incremental approach to collaboration** (e.g. using global equities as a starting point); as opposed to a "big bang" solution (which might cover all asset classes from day 1). This would reduce the timescales for implementation and the level of complexity in the shorter term.

- We would suggest that the **next step for the Welsh Funds would be to invite non-binding proposals from potential "rental" providers** in order that a comparison of services and costs can be made.

# 9

## Legal issues

The advice in this section of the report has been provided by Sackers

### *Advice from Sackers*

#### *Background and summary*

The purpose of this section is to identify the high level legal considerations raised by the proposals outlined in the rest of this paper (for the purpose of this section, the "Proposals"). In particular, the Proposals include the possibility of establishing a bespoke Welsh investment vehicle (the "Welsh Fund") and either creating or appointing a management company to manage that vehicle.

The principal questions are:

- do the Councils have power to implement the Proposals;
- how do the proposals interact with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("Investment Regulations"); and
- what procurement obligations apply?

In summary, we have not identified any legal show stoppers which would prevent the Councils proceeding. However, we do identify a number of points which we should draw to the Councils' attention. These points do not affect our overall conclusions, but do raise some issues which will need to be addressed should the Councils decide to continue.

#### *Power to implement proposals*

**Outline of proposals**

From the legal perspective, the Councils must each be satisfied that they have the necessary statutory powers to proceed with the Proposals.

The Proposals could involve:

- the establishment of a Welsh Fund;
- appointing a third party management company and potentially "building" that company under one of the options;
- active engagement in the governance of the Welsh Fund and/or the management company, most likely via a joint committee operating through a formal delegation; and
- the investment of all or part of the pension fund assets into the newly created Welsh Fund.

### Exercise of powers and proper delegations

Subject to our comments relating to the Investment Regulations, we are satisfied that the Councils have power to take each of the steps outlined above provided they are satisfied that the proposals are in the best interests of each sections' members and their respective rate payers.

Care should, however, be taken to ensure that the appropriate decision maker within each Council is engaged and that proper delegations are put in place. These activities (particularly the establishment of a Welsh Fund and/or management company) go well beyond ordinary investment decision making.

Each Council will need to consult its own constitution and delegation arrangements to ensure that a decision to engage with these proposals is made at the appropriate level (i.e. we imagine this would be a full Council decision rather than an investment sub-committee decision unless very clear delegations have already been put in place).

Governance arrangements will need further thought depending on the preferred structure. However the Councils may ultimately need to establish a joint committee to discharge their duties in relation to the Welsh Fund and management company. This delegation will need to follow the relevant statutory and Council procedures.

### Strategic management and ongoing monitoring

The Councils cannot, in our view, divest themselves of ongoing responsibility for:

- strategic management; and
- on-going monitoring.

The proposals do not envisage either scenario, but the Councils will want to ensure that they can demonstrate their ongoing governance role in both respects and structure any ongoing (joint) investment committee documentation with these high-level principles in mind.

### LGPS investment limits

The Proposals could involve the use of a Welsh Fund and each Council's commitment to that vehicle would, in our view, be treated as an investment. The Investment Regulations limit the amount that any one LGPS section may invest by reference to the legal structure of the underlying investment. For example, investment in any single partnership is limited to 2% or 5% of the section's assets.

The Welsh Fund will need to be structured through a vehicle which gives the participating Councils as much flexibility as possible in the context of the Investment Regulations. In theory, we envisage that the Councils will want the option of investing up to 100% of their scheme assets through the Welsh Fund. The Investment Regulations do not contemplate a joint investment structure and there is therefore no specific exception or easement designed to assist Councils who wish to collaborate in this way.

There are a limited number of options for achieving the desired outcome. One such option involves structuring the Welsh Fund as a contractual vehicle such as an English authorised contractual fund or an Irish or Luxembourg common contractual fund (as distinct from shares in a company, units in a unit trust or a limited partnership interest).

The Investment Regulations state that the Schedule 1 limits "shall have effect for the purpose of limiting the making of investments of the types described in the table"[1]. The Investment Regulations do not refer in any way to contractual schemes which are therefore not investments "of the type described in the table". The effect of this appears to be that there is no applicable limit to the amount an administering authority can invest in this type of vehicle, provided the authority is satisfied that the investment is otherwise reasonable for the scheme.

While we are not aware of any alternative reading of these provisions, our interpretation does have the effect of apparently circumventing the intended limits set out in the Investment Regulations. It is therefore possible that the legislation could be amended to address this or that, if the investment were challenged in court, a judge might be disposed to favour another interpretation of the Investment Regulations.

As the Councils are no doubt aware, prior to the recent election DCLG, confirmed their intention to review the Investment Regulations. We do not yet know if they will make any changes or what those changes might be.

The Councils will also want to be mindful of potential reputational risks though, in this instance, there has been considerable public/political pressure on Councils to work collaboratively.

***Management Company***

A key consideration for the Councils will be establishing the parameters of their control over the management company of any new investment vehicle. Much of the work around the London Council's proposed common investment fund has focused on this aspect.

The Proposals suggest:

> **Option 1 – the "build" option**. This is the option being pursued by the London Councils, who will be shareholders to the management company of the common contractual vehicle. In addition to the employment, contractual and operational issues which would flow from establishing the company, the new management company would need to go through the (onerous) process of becoming FCA authorised.
>
> **Option 2 and 3 – the "rent options".** Both options involve establishing a joint governance structure to supervise the activities of a third party manager with control of the investment company. The management company will be appointed by the Welsh Fund. We envisage that this relationship would need to be supplemented by an investment management agreement between the management company and the Councils (either individually or through a properly constituted joint committee).
>
> The Councils should appreciate that their relationship with the management company will be different depending on whether the management company is a company established and owned by the Councils (as with option 1) or whether they have selected a third party provider and contractually agreed the services to be provided by a third party, as with options 2 or 3. Option 1 is likely to be more onerous in terms of establishment and (possibly) ongoing operation, but it will potentially allow much greater control of the manager from the legal perspective. The Councils should form a clear view of how actively they wish to be involved in the running of the management company, or whether they would prefer to accept a greater degree of reliance on a third party.

[1] Regulation 14(1) of the Investment Regulations.

As noted above, in either scenario, the Councils will want to be very clear that they are retaining ultimately responsibility of the management company's activities and will need to retain strategic control over the activities of the management company.

***Procurement***

**Procurement considerations for the Councils**

The Councils will also wish to take into account is obligations under the Public Contracts Regulations 2015 (the "**Procurement Regulations**"). Again, the obligations under the Procurement Regulations will flow from the plans ultimately adopted by the Councils and we deal with different possibilities below.

| **Activity** | **Comments** | **OJEU applies?** |
|---|---|---|
| Establishment of the Welsh Fund | To the extent that the establishment of the Welsh Fund is carried on in-house, there no actual outsourcing and therefore no procurement obligation.<br><br>In practice, the Council is likely to engage the assistance of its professional advisors. To the extent to which this involves additional/extended appointments, the usual procurement rules will apply. | ✗<br><br>✓ |
| Creating and/or appointing a third party management company. | The establishment of a management company should be regarded the same way as establishing the Welsh Fund (see above).<br><br>The <u>appointment</u> of a management company by the Councils may depend on how the management company is established. It is possible that the management company may fall within the *Teckel* exception if it is created by the Councils (and assuming the Welsh Fund is not offered to other investors).<br><br>The alternative option is that the appointment is under the exception in Regulation 10(e) which excludes*: "financial services in connection with the issue, purchase, sale or a transfer of securities or other instruments in particular transactions by the contracting authorities to raise money or capital".* | ✗<br><br>✗ |

| | | |
|---|---|---|
| The investment of (potentially all of) the pension fund assets into the newly created regulated or unregulated structure. | In our opinion, it is not necessary to follow a statutory procurement process. There are two possible arguments to support this conclusion:<br><br>It could be argued that an investment decision should not be characterised as a contract for the supply of services or goods and therefore falls completely outside the scope of the Regulations; or<br><br>If the Regulations do apply, then an investment decision of this sort also falls into the exemption for "financial services in connection with the issue, purchase, sale or transfer of securities" under Regulation 10(e). | × |

We are aware that other local authorities choose to go through procurement processes in relation to their investment decisions even where there may be no strict legal obligation to do so under the Regulations. They do this either for reputational reasons or because they regard doing so as consistent with their broader duties to ratepayers. Given the likely profile of this decision, the Councils may wish to procure some aspects of the services for these reasons even in the absence of a legal obligation to do so.

**Procurement considerations for the Welsh Fund and management company**

A further consideration is that the management company and the Welsh Fund are each likely to outsource some of their service (e.g. custody) and make further investments in third party products. This may require further consideration, particularly if the “build” option is pursued. The procurement Regulations cover *"bodies governed by public law"*, which has a broader definition than might be expected in that it includes:

> *“bodies that have all of the following characteristics: (a) they are established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character; (b) they have legal personality; and (c) they have any of the following characteristics: (i) they are financed, for the most part, by the State, regional or local authorities, or by other bodies governed by public law; (ii) they are subject to management supervision by those authorities or bodies; or (iii) they have an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law".*

The Councils will want to keep these requirements in mind in establishing the structure of the Welsh Fund and management company and it may be appropriate to seek counsel’s opinion depending on the likely impact of this point.

**Statement of Investment Principles**

Each Council’s statement of investment principles would need to be amended to reflect these proposals.

## Pensions Boards

The Councils will be aware of the new Local Pensions Board roles and may wish to take steps to establish the boards' buy-in and parameters for their involvement in any joint structure. Local Pensions Boards can now be established jointly between a number of administering authorities. If the Councils are considering a joint investment structure, it might make sense to also establish a joint Local Pensions Board.

## Tax

Please note that we are not providing tax advice as to the efficiency of the proposed Welsh Fund. The Councils will want to ensure that the proposed Welsh Fund is appropriate from this perspective.

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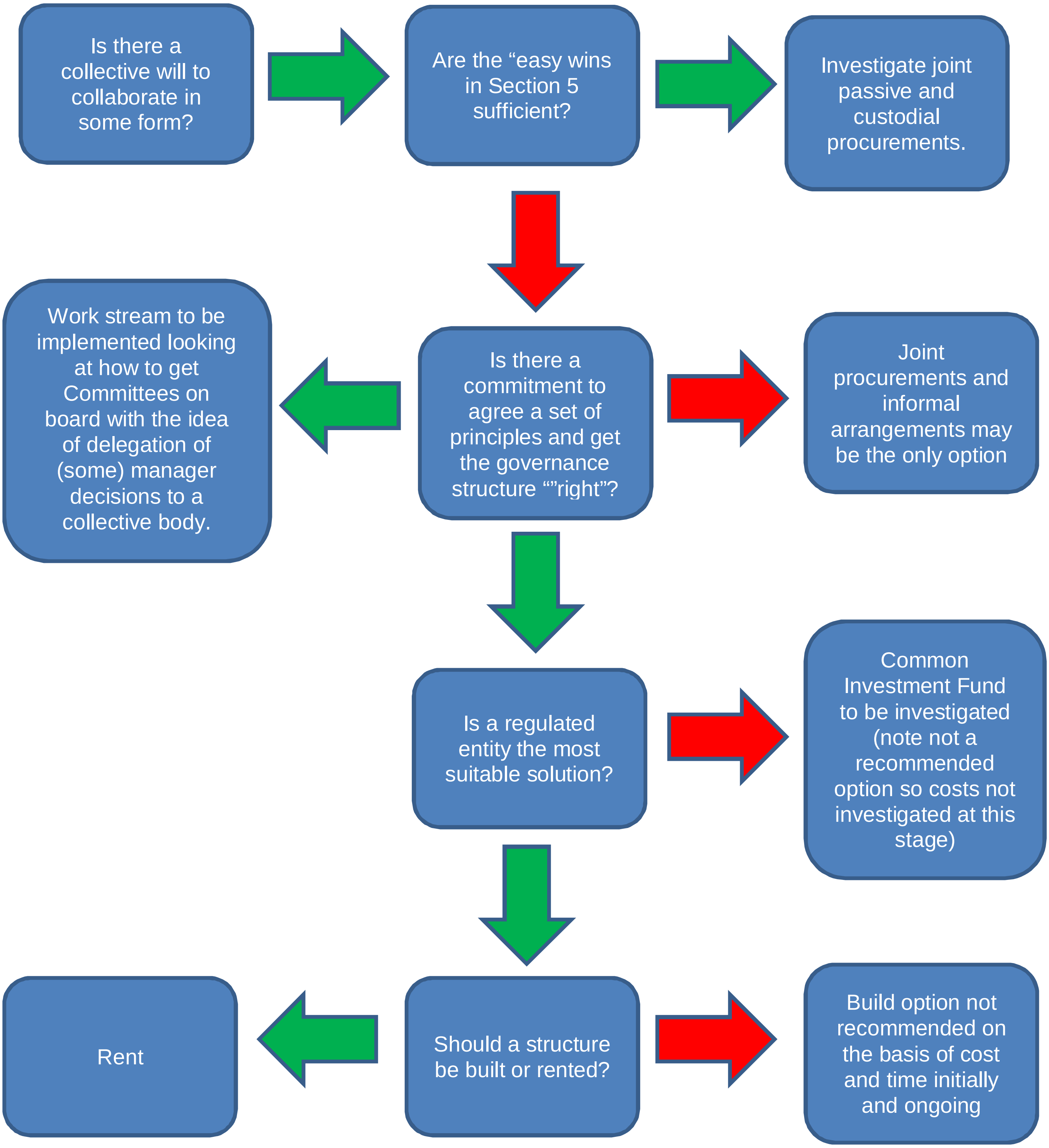
## Where to start?

We would suggest the following series of questions are worked through as a starting point:



For the purposes of this report, we have assumed that the "rent" option is preferred and in which case, the first step will be to define a set of principles and to consider how the governance structure would work. This was covered in Section 4.

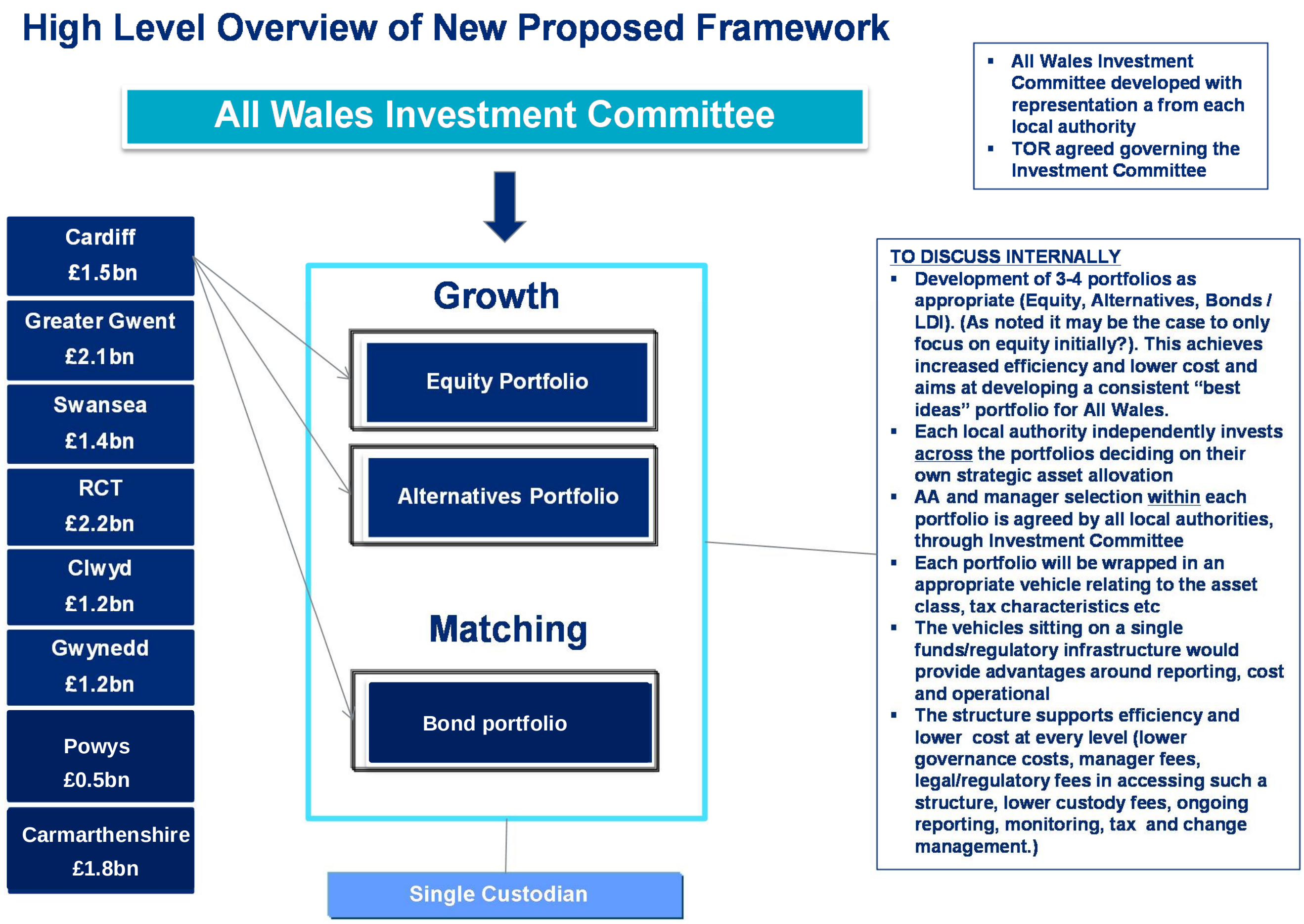
The next consideration is whether there are any legal barriers to implementation (Covered in Section 9).

Next is whether the structure be Option 2 or 3 (as detailed in Section 8).

Once this decision is made, we would suggest that proposed specifications and costings are sought from potential providers. We would expect that an OJEU process will be required to ultimately appoint a provider; although this will of course take time so it is crucial that the general specification of services required is clear at outset to avoid unnecessary analysis of unsuitable tenders.

In order to do this however, thought would need to be given as to the asset classes that would be available through the collective structure and the level of participation that would be likely. However, initially, it may be worthwhile considering the selection of a singular asset class (one that has scale and would have an impact on cost) such as global equity to get the project up and running. Once a platform is established, then more asset classes can be added.

The graphic below illustrates the resultant structure.



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## Summary and Recommendations

There are significant savings to be made; both direct and indirect, some more quantifiable than others, through pooling assets and investing collectively.

**Governance and delegation**

For the Welsh Funds to use a collective structure there must be a shared vision and we would suggest that a set of principles are established at outset.

We believe that there is a premium to be achieved through good governance and sufficient time should be spent in establishing the correct construct of an investment committee of a collective investment structure.

We further believe that there is a real opportunity here to establish a collective with long term principles of investment at its heart; a philosophy that in itself has been show to add real value.

**Steps that could be taken without the need for a collective structure**

In the particular circumstances that the Welsh Funds find themselves (most notably little cross-over of existing mandates), we conclude that there are few "easy wins" in terms of leveraging existing mandates. We do however recommend that a joint procurement is effected for passive management and possibly custodial arrangements (once decisions have been made on a collective structure).

We would suggest that a single passive manager for Wales would not need to operate under a collective structure and that savings of around £800,000 p.a. could be made if all Funds participated at current levels of assets under passive management. It is likely that this would need to be procured under OJEU due to the additional services deployed by passive managers, such as swing management / rebalancing roles. We have not allowed for transition costs in this instance, on the grounds that passive mandates ought to be transferred between managers on an in-specie basis.

In addition, we note that a joint custodian procurement, presumably utilising the National LGPS Custodian Framework, could harvest further savings. ***However, this is not a step we would suggest considering until decisions are made on collective investing***.

**A collective structure**

We have recommended, for reasons of future proofing and efficiency, that ***a regulated vehicle is the optimal solution*** for any collective vehicle.

We would further recommend that ***a structure is "rented"*** (i.e. leveraging the existing infrastructure of a third party) ***as opposed to "built"*** (on the grounds of cost, resource and time). An increasing number of sophisticated institutional investors across Europe are moving in this direction.

The attraction of a rental model lies in its ***flexibility***; there will be minimum asset sizes that need to be committed in order to make it a viable proposition for the provider, but by no means do all eight Funds need to commit all of their assets to make it work. We suggest that a rental model using active global equity as a starting point will offer tangible savings; more so if UK equity is included.

This feels like an “easy win”; a starting point to try out a collective arrangement whilst a longer term plan on more complex assets is determined.

There are reduced or no set up costs to be incurred under Options 2 and 3, other than procuring the provider, by the Funds. These are bourne by the provider who will likely charge a minimum ongoing fee for an initial period in order to cover this; just an ongoing operating cost, which means that Funds need only commit (and pay) when they are ready to invest. Of course the cost savings would be greater the more Funds that invest, but we would suggest that the idea of a platform being available to rent / use when needed may be more attractive than compulsion to use a model that has been expensive to build independently.

Under the right model / provider, there would be no “give up” in innovation; the Funds would be free to consider a range of options and perhaps these are more plentiful in the alternative assets space. Indeed, there is the future option here of the Welsh funds running solutions for LGPS funds e.g. an LGPS real assets fund may have real appeal to funds outside of Wales. However, we would contend that Option 3 lends itself more readily to this idea on the grounds that providers in this mould will have relevant experience in creating bespoke strategies for similar clients (whereas Option 2 providers will simply provide the operational infrastructure once All Wales have developed ideas, taken advice, chosen managers etc).

The next step will be to assess the options that are available from the various providers under this model and we can help formulate a template for discussion if required.

### Critical Mass

Under the rental model, critical mass will be determined by the minimum fee set down by the chosen provider, but it will also depend on the time period over which savings need to be demonstrated.

For example, if half of the Funds (by asset value) commit to looking at global equities first under a rental model, then the immediate fee savings may be net neutral and a commitment would be needed towards a longer term aim of adding additional asset classes.

### Legal Issues

Sackers’ high level advice confirms that the use of a contractual vehicle (such as a CCF or UK ACS) should not, in their view, be subject to any limits under Schedule 1 of the LGPS Investment Regulations. They have not identified any show-stopper legal issues with the use of a manager, either rented or built.

Sackers have also confirmed their view that there is no legal obligation to go through a formal Procurement Regulations 2015 (or “OJEU”) procedure in respect of the initial investment into a bespoke pooled vehicle or in respect of the appointment of a “rented” manager. However, they note that some Councils choose to go through a procurement obligation for policy and/or reputational reasons even where the Regulations do not require this.

### Recommendations

- To consider the appointment of a single passive manager across the eight Welsh Funds (regardless of any decision to proceed with a collective structure; although noting that this could just as easily fall under the collective structure for ease).

For actively managed assets:

- To avoid compulsion; a collection of the willing with a shared set of principles is likely to result in a more robust, focused arrangement;
- To be clear on guiding principles;
- To consider the governance structure;
- To consider the set-up of a regulated vehicle;
- To consider leveraging the infrastructure of a third party provider to tailor a Welsh solution. Given our knowledge of the Welsh Funds we would suggest Option 3 provides the most suitable fit to meet existing needs.
- To start with a single asset class, with a view to adding more complex propositions once the structure and its governance arrangements are up and running. Given our analysis, both UK and global equity would offer a strong starting point to fit into the new collaborative framework given the allocation and consistency of these mandates across the schemes and the potential to leverage material cost savings.
- We would suggest a training workshop to discuss the details and workings of the new framework to be set up for the summer period. A separate session would be required for Officers and key Committee members. (Mercer would be able to provide these workshops under the terms of the contract i.e. there would be no additional fee).
- After the workshops, the next step for the Welsh Funds would be to invite non-binding proposals from potential providers in order that a comparison of services and costs can be made. Appendix B contains suggested areas for questioning.

**Next steps**

We would see the next steps of the project being as follows:

| **Stage** | **Time scale** |
|---|---|
| Development of guiding principles | Q2 2015 |
| Training for Key Councillors of each Fund's Committee on principles and options<br>(Mercer would be able to provide this at no additional fee) | Summer 2015 |
| Workshop / training for Officers on the operational aspects of the "rent" option.<br>(Mercer would be able to provide this at no additional fee) | Summer 2015 |
| Draft of specification for providers<br>(Suggestions found in Appendix B) | Q2 2015 |
| Draft Terms of Reference for All Wales Investment Committee | Q2 / Q3 2015 |
| Each Fund to work through constitutional issues in terms of delegation to All Wales Investment Committee | Q2 / Q3 2015 |
| Initial due diligence meetings with providers | Q3 2015 |
| OJEU Process to begin (if required) | Q3 2015 |

**Jo Holden**
**May 2015**

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## Important Notices

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# Appendix A

## Increasing efficiency within the existing arrangements

As summarised in section 5, we set out below further detail on the current arrangements in place.

***Aggregate fees***

Putting aside any differences in manager line up between Funds, and any implications of regional equity structures (compared to global mandates), we outline below a broad comparison of the aggregated Funds' assets and fees compared to what we might typically expect based on our Global Fee Survey in 2014, which benchmarked our experience of clients fees' globally.

The intention of the comparison is to stop any "glaring" disparities or areas to explore further.  There will likely be a number of differences in the specifics of the Welsh Funds mandates relative to those included in the survey and the analysis is intended as a guide, but it may point out whether there are any obvious issues relative to peers.

Note we have excluded alternatives (including property) due to the wide variation in mandates which make it difficult to do a like for like comparison.  We have however included performance fees in order to compare like with like.

| | Assets (£bn) | ALL WALES Total fee (£m) | ALL WALES Average fee | MERCER FEE SURVEY Total fee (£m) | MERCER FEE SURVEY Average fee |
|---|---|---|---|---|---|
| **UK Equity** | **2.5** | **11.7** | **0.47%** | **-** | **-** |
| Active | 1.3 | 10.9 | 0.82% | 6.1 | 0.45% |
| Passive | 1.2 | 0.6 | 0.05% | 1.2 | 0.10% |
| **Global Equity** | **4.4** | **15.6** | **0.35%** | **-** | **-** |
| Active | 3.3 | 14.6 | 0.44% | 18.6 | 0.56% |
| Passive | 1.1 | 1.0 | 0.09% | 1.4 | 0.13% |
| **Emerging Market Equity** | **0.4** | **1.9** | **0.47%** | **-** | **-** |
| Active | 0.2 | 1.7 | 0.69% | 1.9 | 0.77% |
| Passive | 0.2 | 0.2 | 0.13% | 0.2 | 0.16% |
| **Bonds** | **2.2** | **4.0** | **0.18%** | **-** | **-** |
| Corporate bonds | 1.6 | 3.5 | 0.22% | 3.6 | 0.23% |
| Government bonds | 0.6 | 0.6 | 0.10% | 0.9 | 0.15% |

**Key:** Green – Paying less than expected fees, Red – Paying more than expected fees

The key findings from this comparison are as follows:

- Fees are generally competitive across the board compared to the fee survey; although UK equities do look high (albeit there is a large performance related element). This is not unsurprising given our experience of fee negotiations with managers within the LGPS.

- Please note we have included performance related fees which impact both the UK and Global equity strategies shown. Clearly, the nature of performance fees can be volatile and therefore a meaningful comparison may differ from year to year.

- Whilst not captured within the Mercer fee survey itself we are aware of developments within passive managers over recent years in providing significant reductions to LGPS clients (both before and following the London CIV discussions). We cover this later in this section.

- Whilst fees are generally competitive, it is worth noting that the fee survey generally stops at asset sizes of £250m. It supports the argument that there would be further savings to make with large enough mandate; although we recognise that this may be seen as an anecdotal argument.

### *Active UK and global equity strategies*

We do believe that consolidation of mandates across the eight Funds could reduce fees. Further, where there are already similar mandates in place with a particular investment manager this *could* (manager permitting) lead to some fee savings without having to change the structure. The area where this has the most potential is actively managed equity strategies.

Based on the data provided, c40% of the eight Funds' assets are managed in active UK, global or regional equity funds. However, whilst a significant proportion of the assets across all Funds held in actively managed equities, there is a limited commonality in their underlying structures.

The table below highlights the detail of the underlying structures in order to demonstrate the commonality between Funds. This shows that there are limited similarities in manager line-up, and even when there are consistencies at a manager level, due to client specific requirements in the majority of cases there is little commonality to enable Funds to leverage any economies of scale.

| | **Total number of mandates** | **Total number of managers** | **Difference** |
|---|---|---|---|
| UK active equity strategies | 8 | 7 | 1 common manager |
| Regional (ex UK) active equity strategies | US: 1<br>European: 3<br>Asia-Pac: 2<br>Japan: 3<br>Emerging markets*: 7 | US: 1<br>European: 2<br>Asia-Pac: 2<br>Japan: 3<br>Emerging markets*: 3 | US: 0<br>European: 1<br>Asia-Pac: 0<br>Japan: 0<br>Emerging markets*: 4 common managers |
| Global active equity strategies | 13 | 10 | 2 common managers (one manager used within 3 Funds) |

** includes Frontier markets*

- In the event that Funds are invested in the same asset class with a common manager, there is potential for fee savings should Funds join together to request fee reductions. To the extent that there are common mandates (in a pooled fund) there could be potential savings if a manager has a tiered fee scale and is willing to view common mandates as one (e.g. for reporting purposes).

However, as outlined above, there is limited commonality at a mandate level. When "looking through" the underlying structures, even where there is some commonality by manager, due to the use of segregated accounts with specific Fund objectives, there is likely to be little to no efficiencies in reporting as each account will be treated separately. We therefore believe it is unlikely to harvest any meaningful saving in approaching managers in this way.

- Should Funds be willing to lose some flexibility, either by moving away from segregated accounts to a pooled fund structure (where there is already existing commonality at a manager level); or by reviewing their manager appointment in place (perhaps by looking to run a joint procurement process), this has the potential for fee savings. However, there would be transition costs associated with any change in mandate; and the upfront costs of running any procurement exercise. Practically, this approach is not "future proofed" as it may store up problems for later as and when individual Funds wish to make local decisions – for example, if one Fund looks to terminate a manager whilst another wishes to retain an appointment.

Overall, we believe there are limited savings to be made under the existing structure for actively managed equity mandates under the current individual Fund structure. We have spoken to managers where there is a high degree of commonality with mixed results. Aberdeen would be unlikely to reduce fees for a joint entity as their fees are already well below their standard fee scales. BlackRock would look at fees if reporting to a single entity. Baillie Gifford's tiered fee structure would result in reduced fees should there be efficiencies in reporting.

As noted earlier, fees at a local level are already relatively competitive based on each individual Fund size and there is limited commonality to improve fees further without making additional structural change.

***Passive mandates***

Around 20% of the Fund's assets (predominately equities) are passively managed. Unlike actively managed strategies, passive mandates can arguably be viewed more as a "commodity" and we would therefore expect local Funds to be more comfortable in moving away from an existing provider if this led to meaningful cost efficiencies.

When reviewing the Fund's assets compared to other passive mandates globally (as outlined earlier), fees appear to offer relatively good value.

However, specific to the LGPS, we are aware of the leading passive managers becoming increasingly commercial to win (or retain) business. We therefore believe there is potential for fee savings in Wales as a collective seeking to negotiate with the leading passive managers in aggregate.

Where managers are willing to view the eight Funds as an informal collective, this would likely lead to extremely competitive pricing (even further than those already well negotiated fees).

For example, should the existing fees be halved (based on our experience of a selection of similar sized mandates this would not be unsurprising), this would lead to savings of £800,000 p.a. As this would not require a huge amount of resource to investigate, this may be something which the Funds are willing to pursue further.

It should however be noted that investment manager fees are not the only costs associated with passive management. There are other factors to consider in reviewing any appointments – including:

- Profits on stock lending – to what extent does the manager take a proportion of these?

- Bid/offer spreads – as the passive mandates are the most common ‘holding ground’ for mandates during any asset allocation re-structure, ensuring any move in and out of passive assets is carried out with minimal transaction costs should also be considered.

We would suggest that a cost benchmarking exercise is carried out as part of any next steps resulting from this report before any procurement is undertaken.

***Initial thoughts on alternatives***

The collective Funds’ alternative asset portfolios was the area that was most difficult to quantity any potential for cost savings through leveraging any commonalities.

In particular, there were extreme disparities within the structures in place, fee structures are complex (owing to underlying manager fees which are not always typically accounted for) and the approach to alternatives was inconsistent, which is not entirely unexpected. However, from experience, there is little point in attempting to renegotiate fee arrangements with the private asset managers given the Funds are “locked in” to these investments.

Whilst we would not expect much merit from pursuing fee reductions based on the current structure, there is a potential for reviewing how Funds can collaborate on alternatives under a revised model. This is considered later within the report.

The majority of the Funds’ property allocation are UK based, but there is little commonality at a manager level to pursue fee negotiations. Property is also too illiquid to be a first port of call for any immediate change in structure – particularly given the majority of the mandates in place are pooled arrangements where the individual Fund has little to no control. DGFs are yet to form a significant allocation (c1% of total assets) with already competitive fees; and the balanced funds (c5% of total assets) relate to two long standing mandates which would unlikely be a starting point for any further collaboration activity.

***Active bond strategies***

The make-up of individual Funds’ bond portfolios are wide ranging. Broadly, we can categorise the eight Funds’ aggregate allocation as follows:

| | |
|---|---|
| UK Government Bonds: | 27% (including Liability Driven Investment – LDI) 3 mandates. |
| UK Corporate Bonds: | 49% (including absolute return mandates) 6 mandates. |
| Global Bonds: | 24% (two global bonds and a Multi-Asset Credit mandate). |
| *Total:* | *100%* |

UK Government bonds consist of a mix of 2 government bond mandates with one provider, but very different objectives (one is passive index linked gilts, the other an actively managed Core Plus strategy). The remaining LDI mandate is not an area we would collaboration to be best utilised - as portfolios are driven by a Fund’s own liability profile; of which there will be different challenges at a local level.

The UK corporate bond holdings relate to 6 mandates with 3 managers. There is however no commonality at the underlying fund level to leverage any efficiencies in their current form. We do note that from a strategic perspective the case for holding UK corporate bonds is changing. Therefore to the extent to which these mandates are up for review may provide potential for collaboration – for example, within a joint procurement, if this was to be considered an appropriate approach.

There are no consistencies to leverage within global bonds.

## Other expenses

Investment manager fees aren't the only way to levy cost efficiencies under the current arrangements. Over £1.6m of other expenses were disclosed across the eight funds over the last year and a summary of these are outlined below.

| Custody (£000) | Reporting (£000) | Consulting advice (£000) | Audit and legal (£000) | Other expenses (£000) | Total (£000) |
|---|---|---|---|---|---|
| 647 | 99 | 648 | 105 | 115 | 1614 |

The remainder of this section provides comment on any potential cost efficiencies that we believe could realistically be achieved.

### *Custody*

An area where the LGPS is already benefiting from improved collaboration is in respect of custodian services.

A summary of the custodian fees currently incurred are outlined below:

| | Fund A (£000) | Fund B (£000) | Fund C (£000) | Fund D (£000) | Fund E (£000) | Fund F (£000) | Fund G (£000) | Fund H (£000) | Total (£000) |
|---|---|---|---|---|---|---|---|---|---|
| Custody Fees | 51 | N/A – pooled funds only | 50 | None disclosed | 157 | 134 | 138 | 117 | 647 |

From the data provided, there are at least 3 named custodians (HSBC, BNY Mellon and Northern Trust) between the Funds who disclosed custodian fee information.

By looking to procure a single custodian we would expect there to be significant fee savings to be made, and are aware of incredibly aggressive pricing in recent custodian reviews.

To give an idea of the order of magnitude; when Norfolk, Hackney and Suffolk went through a joint process under the National Custodian Services Framework; the three funds, with combined assets of £5.2bn, disclosed that they are expecting to save a total of £1.25m over the lifetime of the contracts. A reported £250,000 was also saved in procurement costs by using the framework.

There are clearly fee savings to be achieved here; but should a decision be made to build or rent a collective model for Wales we would suggest this forms part of those considerations as opposed to being considered as a standalone decision.

### *Other expenses*

Other significant expenses relate to consulting, reporting and audit and legal costs.

However, the nature of the costs being incurred are specific to work carried out at a particular Fund level, and we have therefore not considered the cost savings any further.

# Appendix B

## Outline questionnaire for providers

**At this stage we have simply provided headline suggestions of areas for initial questioning. If required, we would be pleased to forward a draft RFP.**

**Background**

The eight Welsh LGSP Funds have assets under management of £X and collectively have Y investment manager mandates.

The Welsh Funds are keen to explore collaborative solutions for investing and have the following goals:

- Improved governance
- Best in class investments
- Cost reduction and transparency
- Robust risk management

Specifically, in the first instance we are looking for a provider who can aggregate our equity assets under a single structure, whilst fulfilling our 4 stated goals set out above.

**Current Mandates**

[To add a description of mandates at the time of tender]

**Requirements**

The investment services provider must be able to document experience in the management of the above or similar solutions.

(IF THE WELSH FUNDS DECIDE TO OPT FOR OPTION 3, WE WOULD SUGGEST THE FOLLOWING IS ADDED)

The provider must be able to meet the following minimum criteria at the time of submission:

- Independent Investment Research – Global investment manager research team which advises clients of a similar size to Client
- No in-house management of individual securities
- Independent Operational Research Team – A dedicated global operational research team which advises client of a similar size to Client
- On-line access to investment manager research and operational risk reviews
- Global operational infrastructure with portfolios that have been implemented
- Demonstrable experience in implementing multi-manager multi asset portfolios
- UK presence with a minimum of two investment relationships with institutional

investors

- Currently running a fully integrated solution including manager research, advice, operational risk review, portfolio risk management (based on security level data), implementation and oversight of all third parties and integration with in-house risk systems
- Proven success in reducing explicit costs from third service provider (including but not limited to asset managers, custodians etc)

Further information can be obtained from: [TO INSERT}

**SUGGESTED HEADINGS FOR QUESTIONS**

- BACKGROUND INFORMATION ON YOUR ORGANISATION
- MANAGER RESEARCH AND ADVICE
- RISK MANAGEMENT SERVICES
- IMPLEMENTATION AND TRANSITION SERVICES
- OPERATIONAL AND COMPLIANCE DUE DILIGENCE
- THIRD PARTY RELATIONSHIPS
- COMPLIANCE & CONFLICTS OF INTEREST
- COSTS, FEES & COMPENSATION
- ADDITIONAL INFORMATION

Mercer Limited
Belvedere, 12 Booth Street
Manchester M2 4AW
+44 (0)161 832 5688

**APPENDIX 2**

**Society of Welsh Treasurers Pension Sub Group**

## 1.00 PURPOSE OF REPORT

1.01 To ask Members to approve the participation by the Fund in a joint procurement exercise with the other 7 pension funds in Wales for the appointment of a single provider for passive investments.

## 2.00 BACKGROUND

2.01 The Society of Welsh Treasurers (SWT) Pensions Sub Group commissioned Mercer to develop a business case for the establishment of a governance structure and investment framework that will allow the eight Welsh LGPS funds to invest collaboratively.

2.02 Mercer completed this report in May 2015 and one of the recommendations was to consider the appointment of a single provider for passive investments across the eight Welsh funds. Further, that this could be done in advance of any further work on a 'collective investment vehicle' and that significant savings could be achieved.

2.03 It was agreed at the SWT Pensions Sub Group meeting on 26 June 2015 that a sub group of investment officers from all eight funds would meet and provide advice on this recommendation to the September meeting and a briefing paper for all funds to present to their panels/committees.

2.04 The investment officers met on 31 July 2015 at which there was a consensus for a potential way forward following detailed discussion.

## 3.00 CONSIDERATIONS

### Passive Mandates

3.01 To remind Committee Members, managers of passive investments simply follow the index and hence the fees are low compared with active mandates where manager skill is required to pick stocks. Therefore, the choice of manager is of relatively less importance and fees are the main driver for the procurement.

3.02 However, there are some more subtle differences between providers relating 'bid offer spreads', stock lending, currency hedging and the range of funds available which have a marginal impact on investment performance and need to be considered alongside fees. Hence it was concluded that appointing a third party to assist with the procurement would add value to the process.

3.03 In Wales, we have circa £3bn passive equity and bond exposure across the eight funds with **three managers** across **eighteen mandates**. Analysis showed there is a disparity of fees between managers and mandates leading to the assumption that immediate savings could be made if one provider was appointed which agreed with the Mercer report.

3.04 There are differing approaches to passive exposures across the funds, for example, some preferring a global rather than regional approach but the aim of the procurement would be to appoint a provider for passive investments who could meet both current and future needs of all eight funds. Hence certain agreed principles are recommended to be adopted:

- Individual investment strategies (geographical requirements) would be accommodated.
- Each fund would retain investment autonomy and independence and ownership of assets.
- The passive mandate would be either pooled or segregated (if no fee impact).
- ESG considerations and currency hedging to be accommodated if required.

3.05 Based on these principles the investment officers agreed to recommend:

- The appointment of one provider for passive investments on behalf of the eight Welsh Pension Funds.
- A joint procurement exercise to deliver fee savings to all eight funds by jointly appointing the same provider.
- The appointment of a third party to facilitate the procurement and provide expert advice, the costs to be split equally, which will be sourced via the Clwyd Fund's consultant framework.

3.06 Once approved by Committees/Panels delegation for the appointment should be given to relevant officers.

**Timetable**

3.07 If approval is received for the procurement and relevant delegations given the new provider could be appointed and in place by April 2016. This assumes the Clwyd Fund launches the search for a consultant early October which enables the OJEU search to commence for the provider by the end November 2015.

.

**4.00 <u>RECOMMENDATION</u>**

4.01 That Members agree to the participation of the Fund in the joint procurement exercise as outlined in the report.

**Report of the Section 151 Officer**

**Pension Fund Committee – 24 September 2015**

**RENEWAL OF 'ADMITTED BODY' STATUS OF CELTIC COMMUNITY LEISURE (BY NEATH PORT TALBOT COUNTY BOROUGH COUNCIL) TO THE CITY & COUNTY OF SWANSEA PENSION FUND**

| | |
|---|---|
| **Purpose:** | The report requests approval to renew Celtic Community Leisure as an Admitted Body in the City & County of Swansea Pension Fund. |
| **Reason for Decision:** | To ensure compliance with the Local Government Pension Scheme Regulations 2013 (as amended). |
| **Consultation:** | Legal, Finance and Access to Services. |
| **Recommendation(s):** | It is recommended that: |
| 1) The Pension Committee approve the application of Neath Port Talbot CBC to renew the Admitted Body status of Celtic Community Leisure subject to completing an agreed Admission Agreement | |
| **Report Author:** | Lynne Miller – Pensions Manager |
| **Finance Officer:** | Jeff Dong – Chief Treasury & Technical Officer |
| **Legal Officer:** | Stephanie Williams |
| **Access to Services Officer:** | N/A |

**1.0 Introduction**

1.1 In 2003, the City & County of Swansea Pension Fund, Neath Port Talbot CBC and Celtic Community Leisure (formerly referred to as Neath Port Talbot Leisure Ltd.) entered into a 10 year Pensions Admission Agreement under regulation 5(3)(a)(i) of the Local Government Pension Regulations 1997 (as amended).

1.2 The original contract expired in March 2013 as did the associated Pensions Admission Agreement.

1.3 The Admission Agreement has been extended by the Committee while a new contract between Neath Port Talbot CBC and Celtic Community Leisure was negotiated.

1.4 Neath Port Talbot CBC have now resolved to continue the contract with Celtic Community Leisure and therefore the Pension Admission Agreement also needs to be resolved.

**2.0 Main Body of Report**

2.1 At a Cabinet meeting on 25 March 2015, Neath Port Talbot CBC approved that the Director of Education, Leisure and Lifelong Learning discuss the terms of a contract with Celtic Community Leisure.

2.2 Negotiations have now been finalised with a new 10 year contract due to commence with effect from 1 October 2015 with the option to extend for a further 5 years.

2.3 Neath Port Talbot CBC therefore request that the Admitted Body status be renewed for 10 years from the commencement of the contract, with the option to extend for a further 5 years subject tocompletion of an admission agreement

2.4 Celtic Community Leisure intend to close the scheme to new members

**3.0 General Issues**

3.1 There are no other variations proposed.

**4.0 Equality and Engagement Implications**

None.

**5.0 Financial Implications**

5.1 The admission shall be subject to sponsor guarantee by Neath Port Talbot CBC or financial bond or guarantee by Celtic Community Leisure to secure potential future unfunded liabilities which shall be determined by all parties

**6.0 Legal Implications**

6.1 There are no legal implications associated with this report.

**Background Papers:** None

**Appendices:** None

**Report of the Section 151 Officer**

**Pension Fund Committee – 24 September 2015**

# APPLICATION FOR 'ADMITTED BODY' STATUS OF RATHBONE TRAINING LTD. TO THE CITY & COUNTY OF SWANSEA PENSION FUND

| | |
|---|---|
| **Purpose:** | The report requests approval, in principle to admit Rathbone Training Ltd. as an Admitted Body in the City & County of Swansea Pension Fund. |
| **Reason for Decision:** | To ensure compliance with the Local Government Pension Scheme Regulations 2013 (as amended). |
| **Consultation:** | Legal, Finance and Access to Services. |
| **Recommendation(s):** | It is recommended that: |
| 1) The Pension Committee approve, in principle, the application of Rathbone Training Ltd., as an admitted body to the City and County of Swansea Pension Fund, subject to Actuarial risk assessment and completion of admission agreement | |
| **Report Author:** | Lynne Miller – Pensions Manager |
| **Finance Officer:** | Jeff Dong – Chief Treasury & Technical Officer |
| **Legal Officer:** | Tracey Meredith |
| **Access to Services Officer:** | N/A |

## 1.0 Introduction

1.1 The Local Government Pension Regulations 2013 permit an Administering Authority to make an admission agreement with

> "a body which provides a public service in the United Kingdom which operates otherwise than for the purposes of gain and has sufficient links with a Scheme employer for the body and the Scheme employer to be regarded as having a community of interest"

1.2 Rathbone Training Ltd was awarded a contract for the Government's Work Based Learning 4 in Wales from Gower College on 1st April 2015, resulting in 8 staff TUPE transferring to Rathbone Training Ltd with effect from 1st April 2015.

1.3 Rathbone Training Ltd. has subsequently applied for admitted body status as a closed scheme employer in the City and County of Swansea Pension Fund.

## 2.0 Main Body of Report

2.1 Rathbone Training Ltd. is a UK-wide youth charity that provides access to training and qualifications to young people.

2.2 They form part of the Newcastle College Group (NCG), one of the largest education, training and employability groups in the UK and report directly to the Chief Executive of NCG. The NCG Board of Governors has the ultimate responsibility for decision-making.

2.3 Rathbone Training Ltd was awarded a contract for the Government's Work Based Learning 4 in Wales from Gower College on 1st April 2015, resulting in staff TUPE transferring to Rathbone Training Ltd with effect from 1st April 2015.

2.4 Assumptions had been made by Rathbone Training Ltd. and Gower College that the staff transferring from Gower College to the employment of Rathbone Training, would be transferred to the Admission Agreement already established between Rathbone Training Ltd. and the London Pension Fund Authority (LPFA); however, the LGPS regulations specify that each contract must have a separate admission agreement and therefore the City and County of Swansea has been approached as the Pension Fund the staff contributed to while they were employed directly by Gower College.

2.5 If it is agreed in principle for Rathbone Training Ltd. to become an admitted body in the Fund, the Fund's Actuary will be approached to carry out a risk assessment to assess the liability that would be transferred.

2.6 Rathbone's would also be required to enter into a bond in order to protect the Fund against any level of risk arising on premature termination of the provision of service or assets by reason of insolvency, winding up, or liquidation of the admission body and any future unfunded liabilities arising

## 3.0 General Issues

3.1 There are no other variations proposed.

## 4.0 Equality and Engagement Implications

None.

## 5.0 Financial Implications

5.1 There are no financial implications associated with this report.

## 6.0 Legal Implications

6.1 There are no legal implications associated with this report.

**Background Papers:** None

**Appendices:** None

# Agenda Item 6

**Report of the Head of Legal, Democratic Services & Procurement**

**Pension Fund Committee – 24 September 2015**

**EXCLUSION OF THE PUBLIC**

<table>
<tr><td colspan="3">Purpose:</td><td>To consider whether the Public should be excluded from the following items of business.</td></tr>
<tr><td colspan="3">Policy Framework:</td><td>None.</td></tr>
<tr><td colspan="3">Reason for Decision:</td><td>To comply with legislation.</td></tr>
<tr><td colspan="3">Consultation:</td><td>Legal.</td></tr>
<tr><td colspan="3">Recommendation(s):</td><td>It is recommended that:</td></tr>
<tr><td>1)</td><td colspan="3">The public be excluded from the meeting during consideration of the following item(s) of business on the grounds that it / they involve(s) the likely disclosure of exempt information as set out in the Paragraphs listed below of Schedule 12A of the Local Government Act 1972 as amended by the Local Government (Access to Information) (Variation) (Wales) Order 2007 subject to the Public Interest Test (where appropriate) being applied.</td></tr>
<tr><td></td><td>Item No’s.</td><td colspan="2">Relevant Paragraphs in Schedule 12A</td></tr>
<tr><td></td><td>7-10</td><td colspan="2">14</td></tr>
<tr><td colspan="3">Report Author:</td><td>Democratic Services</td></tr>
<tr><td colspan="3">Finance Officer:</td><td>Not Applicable</td></tr>
<tr><td colspan="3">Legal Officer:</td><td>Patrick Arran – Head of Legal, Democratic Services and Procurement (Monitoring Officer)</td></tr>
</table>

## 1. Introduction

1.1 Section 100A (4) of the Local Government Act 1972 as amended by the Local Government (Access to Information) (Variation) (Wales) Order 2007, allows a Principal Council to pass a resolution excluding the public from a meeting during an item of business.

1.2 Such a resolution is dependant on whether it is likely, in view of the nature of the business to be transacted or the nature of the proceedings that if members of the public were present during that item there would be disclosure to them of exempt information, as defined in section 100I of the Local Government Act 1972.

## 2. Exclusion of the Public / Public Interest Test

2.1 In order to comply with the above mentioned legislation, Cabinet will be requested to exclude the public from the meeting during consideration of the item(s) of business identified in the recommendation(s) to the report on the grounds that it / they involve(s) the likely disclosure of exempt information as set out in the Exclusion Paragraphs of Schedule 12A of the Local Government

Act 1972 as amended by the Local Government (Access to Information) (Variation) (Wales) Order 2007.

2.2 Information which falls within paragraphs 12 to 15, 17 and 18 of Schedule 12A of the Local Government Act 1972 as amended is exempt information if and so long as in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

2.3 The specific Exclusion Paragraphs and the Public Interest Tests to be applied are listed in **Appendix A**.

2.4 Where paragraph 16 of the Schedule 12A applies there is no public interest test. Councillors are able to consider whether they wish to waive their legal privilege in the information, however, given that this may place the Council in a position of risk, it is not something that should be done as a matter of routine.

## 3. Financial Implications

3.1 There are no financial implications associated with this report.

## 4. Legal Implications

4.1 The legislative provisions are set out in the report.

4.2 Councillors must consider with regard to each item of business set out in paragraph 2 of this report the following matters:

4.2.1 Whether in relation to that item of business the information is capable of being exempt information, because it falls into one of the paragraphs set out in Schedule 12A of the Local Government Act 1972 as amended and reproduced in Appendix A to this report.

4.2.2 If the information does fall within one or more of paragraphs 12 to 15, 17 and 18 of Schedule 12A of the Local Government Act 1972 as amended, the public interest test as set out in paragraph 2.2 of this report.

4.2.3 If the information falls within paragraph 16 of Schedule 12A of the Local Government Act 1972 in considering whether to exclude the public members are not required to apply the public interest test but must consider whether they wish to waive their privilege in relation to that item for any reason.

**Background Papers:** None.
**Appendices:** Appendix A – Public Interest Test.

**Appendix A**

## Public Interest Test

| No. | Relevant Paragraphs in Schedule 12A |
|---|---|
| | |
| **12** | **Information relating to a particular individual.** |
| | The Proper Officer (Monitoring Officer) has determined in preparing this report that paragraph 12 should apply. His view on the public interest test was that to make this information public would disclose personal data relating to an individual in contravention of the principles of the Data Protection Act. Because of this and since there did not appear to be an overwhelming public interest in requiring the disclosure of personal data he felt that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. Members are asked to consider this factor when determining the public interest test, which they must decide when considering excluding the public from this part of the meeting. |
| | |
| **13** | **Information which is likely to reveal the identity of an individual.** |
| | The Proper Officer (Monitoring Officer) has determined in preparing this report that paragraph 13 should apply. His view on the public interest test was that the individual involved was entitled to privacy and that there was no overriding public interest which required the disclosure of the individual's identity. On that basis he felt that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. Members are asked to consider this factor when determining the public interest test, which they must decide when considering excluding the public from this part of the meeting. |
| | |
| **14** | **Information relating to the financial or business affairs of any particular person (including the authority holding that information).** |
| | The Proper Officer (Monitoring Officer) has determined in preparing this report that paragraph 14 should apply. His view on the public interest test was that:<br><br>**a)** Whilst he was mindful of the need to ensure the transparency and accountability of public authority for decisions taken by them in relation to the spending of public money, the right of a third party to the privacy of their financial / business affairs outweighed the need for that information to be made public; or<br><br>**b)** Disclosure of the information would give an unfair advantage to tenderers for commercial contracts.<br><br>This information is not affected by any other statutory provision which requires the information to be publicly registered.<br><br>On that basis he felt that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. Members are asked to consider this factor when determining the public interest test, which they must decide when considering excluding the public from this part of the meeting. |
| | |

| No. | Relevant Paragraphs in Schedule 12A |
|---|---|
| | |
| **15** | **Information relating to any consultations or negotiations, or contemplated consultations or negotiations, in connection with any labour relations matter arising between the authority or a Minister of the Crown and employees of, or office holders under, the authority.** |
| | The Proper Officer (Monitoring Officer) has determined in preparing this report that paragraph 15 should apply. His view on the public interest test was that whilst he is mindful of the need to ensure that transparency and accountability of public authority for decisions taken by them he was satisfied that in this case disclosure of the information would prejudice the discussion in relation to labour relations to the disadvantage of the authority and inhabitants of its area. On that basis he felt that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. Members are asked to consider this factor when determining the public interest test, which they must decide when considering excluding the public from this part of the meeting. |
| | |
| **16** | **Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings.** |
| | No public interest test. |
| | |
| **17** | **Information which reveals that the authority proposes:**<br>**(a) To give under any enactment a notice under or by virtue of which requirements are imposed on a person; or**<br>**(b) To make an order or direction under any enactment.** |
| | The Proper Officer (Monitoring Officer) has determined in preparing this report that paragraph 17 should apply. His view on the public interest test was that the authority's statutory powers could be rendered ineffective or less effective were there to be advanced knowledge of its intention/the proper exercise of the Council's statutory power could be prejudiced by the public discussion or speculation on the matter to the detriment of the authority and the inhabitants of its area. On that basis he felt that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. Members are asked to consider this factor when determining the public interest test, which they must decide when considering excluding the public from this part of the meeting. |
| | |
| **18** | **Information relating to any action taken or to be taken in connection with the prevention, investigation or prosecution of crime** |
| | The Proper Officer (Monitoring Officer) has determined in preparing this report that paragraph 18 should apply. His view on the public interest test was that the authority's statutory powers could be rendered ineffective or less effective were there to be advanced knowledge of its intention/the proper exercise of the Council's statutory power could be prejudiced by public discussion or speculation on the matter to the detriment of the authority and the inhabitants of its area. On that basis he felt that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. Members are asked to consider this factor when determining the public interest test, which they must decide when considering excluding the public from this part of the meeting. |

# Agenda Item 7a

By virtue of paragraph(s) 14 of Schedule 12A
of the Local Government Act 1972
as amended by the Local Government (Access to
Information) (Variation) (Wales) Order 2007.

Document is Restricted

By virtue of paragraph(s) 14 of Schedule 12A
of the Local Government Act 1972
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Information) (Variation) (Wales) Order 2007.

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By virtue of paragraph(s) 14 of Schedule 12A
of the Local Government Act 1972
as amended by the Local Government (Access to
Information) (Variation) (Wales) Order 2007.

# Agenda Item 8

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Information) (Variation) (Wales) Order 2007.

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