Appendix

Pension Fund

Annual Report 2012/13

west sussex county council

CONTENTS

PUBLICATIONS

The Pension Fund is required by the Local Government Pension Scheme (LGPS) Regulations to publish and maintain various documents, covering amongst other things the governance of the scheme, funding strategy, investment principles and communications strategy. The latest copies can be downloaded from the Fund's website and can be made available on request.

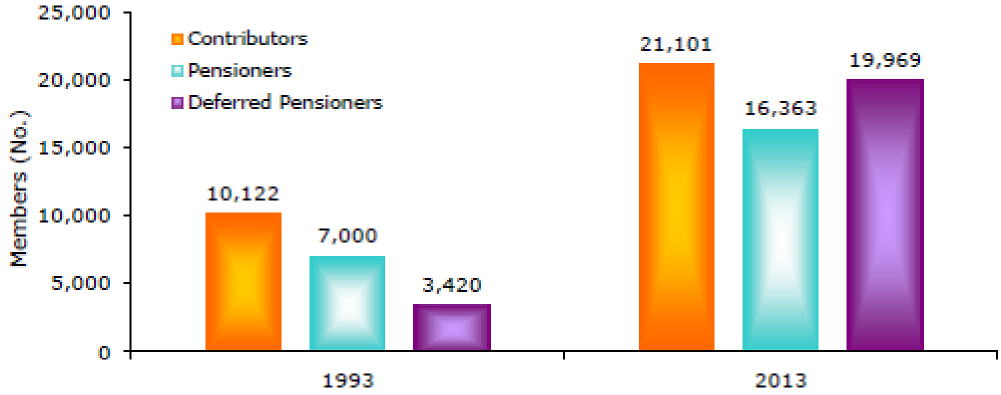
- **Business Plan**: This reviews the Fund's objectives during the year and sets out the future direction. The Pensions Panel review and revise the business plan annually. The current business plan published on the Fund's website was agreed by the Panel in June 2013. The next full review will take place in April 2014.
- **Communications Strategy Statement:** The administering authority prepares, maintains and publishes a communications strategy statement which sets out the policy concerning communications with members, representatives of members, prospective members and employing authorities.
- **Funding Strategy Statement**: The Funding Strategy Statement identifies how employers' pension liabilities are best met going forward (whilst maintaining as near as possible constant employer contribution rates) and sets out how the Fund will take a prudent long term view of funding those liabilities. This statement sets out how the West Sussex Fund has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.
- **Governance Policy & Governance Compliance Statement:** These two statements detail the Fund's governance and stewardship arrangements and report the extent of compliance against a set of best practice governance principles laid down in statutory guidance.
- **Myners Compliance Statement**: In response to the Department for Communities and Local Government (DCLG) adoption of Myners six best practice principles (effective decision making, clear objectives, risk and liabilities, performance assessment, responsible ownership and transparency and reporting), the authority has set out the extent to which the Fund complies with these objectives.
- **Statement of Investment Principles**: The Council has a duty to ensure that scheme funds not immediately required to pay pension benefits are suitably invested and to take proper advice in the execution of this function. It has delegated the decision-making responsibility to the Pensions Panel. This policy outlines how investment decisions are made, the types of investment held, fees paid, risk and corporate governance.

REGULATIONS

Details about The Local Government Pension Scheme (LGPS) regulations and the Local Government Pension Scheme (Management and Investment of Funds) regulations 2009 can be found in Appendix 4.

A 5 point summary

1. Membership: Membership of the LGPS is open to all local government employees who have contracts of employment for more than three months and employees of certain specified employers (such as Colleges, Academies, and those who are providing a service transferred from a local authority). Police officers, teachers and fire-fighters have their own statutory arrangement. Membership comprises contributors (those who are still working and paying money into the Fund), pensioners (former employees, their widows and children, receiving pension benefits) and deferred pensioners (former employees who have deferred pension rights to be paid at some time in the future). This mix has changed significantly over the last 20 years as illustrated below:

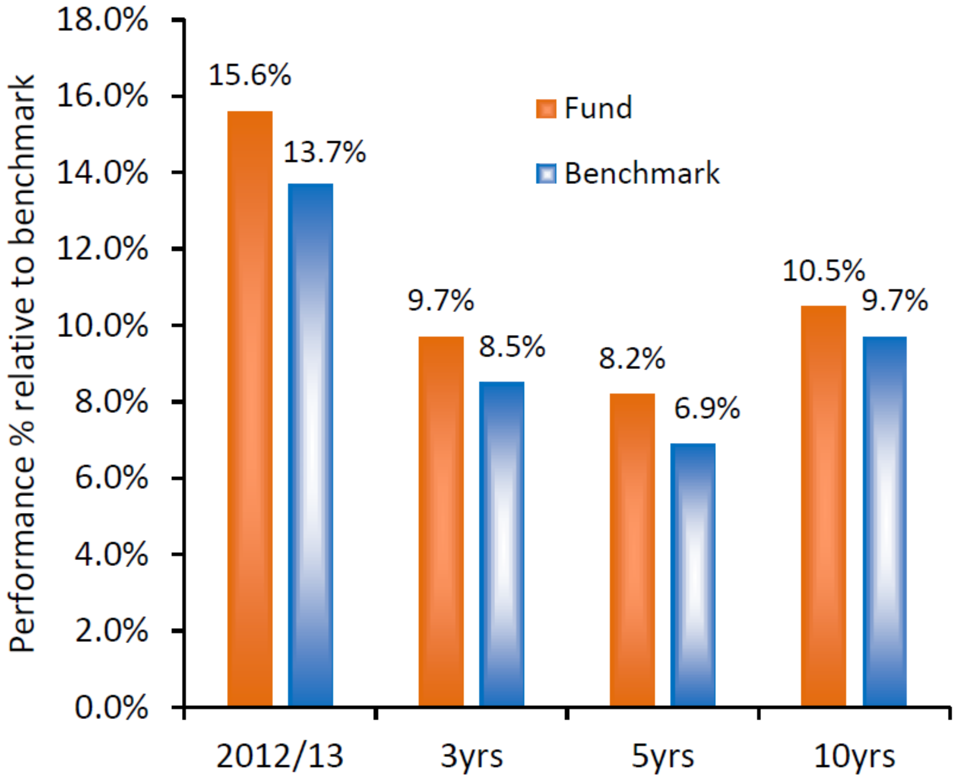


2. Pensions Panel: The Pensions Panel is responsible for the management of the Pension Fund and is supported by the independent adviser and the Director of Finance and Assurance. The Panel comply with best practice covering governance, knowledge and skills, effective decision making, investment objectives, performance assessment and transparency. The Fund is an active shareholder and the Pensions Panel has directed the fund managers to consider, amongst other factors, the effects of social, environmental and ethical issues when investing. During the year, the Fund had votes placed at 100% of domestic (UK) meetings at which they were entitled to vote and 91% of foreign meetings.

3. Investments: The Pension Fund invests in equities, fixed income, property, private equity and cash. At 31 March 2013 the total portfolio was valued at £2,368m, an increase of over £325m compared to 31 March 2012. UK Government bond markets benefited from their perceived status as a safe haven in times of extreme turbulence. Corporate bond returns were more diverse, as were returns from equities as European stocks underperformed relative to US, Asia Pacific and Emerging Markets. The Fund's performance is analysed relative to a customised benchmark and the current weights (effective from 30 September 2011) are detailed below. The total Fund benchmark includes property, whereas the manager benchmarks exclude property.

Asset Class	**Baillie Gifford %**	**UBS %**	**Total Fund Weighting %**	**Benchmark Description**
Global Equities	77.0		32.5	MSCI AC World
UK Equities		41.0	17.5	FTSE All Share
North America		11.0	4.5	FTSE North America
Continental Europe		11.0	4.5	FTSE Developed Europe ex UK
Asia Pacific		11.0	4.5	FTSE Developed Pacific ex Japan
Emerging Markets		3.0	1.5	FTSE All World Emerging Markets
Total Bonds	23.0	23.0	20.0	Market iBoxx GBP Overall
Private Equity			5.0	FTSE World Index
Property			10.0	IPD All Properties Index

During 2012/13, the Fund performance was 15.6%, outperforming the benchmark by 1.7%. The long term relative performance versus the Fund's benchmark is shown below.



4. Funding: The Fund's liabilities are valued every three years and compared to the assets held. The outcome of this exercise sets employer contribution rates. Employee contribution rates are set by central government. The most recent valuation was completed as at 31 March 2010 and showed the Fund to be 86% funded. This means that there was a shortfall of 14%. The Funding Strategy Statement explains how the administering authority intends to meet these liabilities over the longer term.

5. Changes to the LGPS Following the recommendations of the Hutton Report in 2010/11, the Local Government Association (LGA) and trade unions, representing Scheme members, published proposals, on 31 May 2012, for the reform of the Local Government Pension Scheme in England and Wales with the new Scheme coming into force from 1 April 2014. The LGPS reform project was based on the LGA's proposals on new Scheme design, management and governance. The key features of the new Scheme include; moving from a final salary to a Career Average Revalued Earnings (CARE) Scheme, new accrual rate of 1/49th which is higher than the 1/60th currently applied, changing the normal Scheme pension age to reflect each member's State Pension age and revising the employee contribution bandings and rates.

Section 1: Background

Pensions Panel

1. The Pensions Panel was established in 1974 to oversee the Pension Fund's investment programme on behalf of the administering authority and other employing authorities that pay contributions to the Fund. The Pensions Panel comprises seven County Councillors and three non-voting representatives, one from the district councils, one from the other major employers and one from the staff side, nominated by Unison. The Panel is supported by an independent Investment Adviser and the Director of Finance and Assurance and his staff in the execution of its responsibilities. During the year, the Panel members were as follows:

Chairman	Mr. M. Brown
Member of the County Council	Dr. J. Walsh
	Mr. R. Dunn
	Mr. S. Waight
	Mr. M. Hodgson
	Mr. C. Stevens
	Mr. A. Smith
District Council Member	Mr. G. Marples
Scheduled Bodies Member	Mr. A. Price (to October 2012)
Employee Representatives	Mrs. C. Earwaker (to July 2012) Mr. D. Sartin (from July 2012)
Investment Adviser	Miss. C. Burton
Officers	Mr. R. Hornby
	Mr. P. Audu
	Mr. S. Harrison
	Mrs. R. Wood
	Mrs. V. Hampshire
	Mrs. L. Davies

2. Mr Price retired from the Panel during the course of the year as his sponsoring body (Sussex Police Authority) ceased and became the new Sussex Police and Crime Commissioner. An attendance register is attached at Appendix 2. A list of current Panel members can be found on the Fund’s website.

3. The Council has adopted the key recommendations of CIPFA’s Knowledge and Skills code of practice and recognises that effective financial management and decision making can only be achieved where those involved have the requisite knowledge and skills. In addition to the Local Government Employers trustee training, which is offered to all Panel members, training sessions are arranged following Panel meetings covering specific investment or governance issues, as set down in CIPFA’s framework and key issues at the time. All training undertaken and planned is reported annually in the Training Register (Appendix 2).

4. Meetings are attended by investment managers and actuary as required.

Investment Managers	Mr. J. Davies & Mr. I. Barnes (UBS Global Asset Management)
	Mrs S Swindells & Mrs. L Dewar (Baillie Gifford & Co.)
	Mr. P. Balfour & Mr. A. Thomas (Cushman & Wakefield)
	Mr. R. Barr & Mr. R. Wright (Pantheon Ventures)
	Mr. S. Naef, Mr. E. Kass & Mr. G. Waller (Partners Group)
Actuary	Mr. R.S. Bowie, Mr. B. Chalmers, Mr. J. Hastings, Mr S. Law (Hymans Robertson)

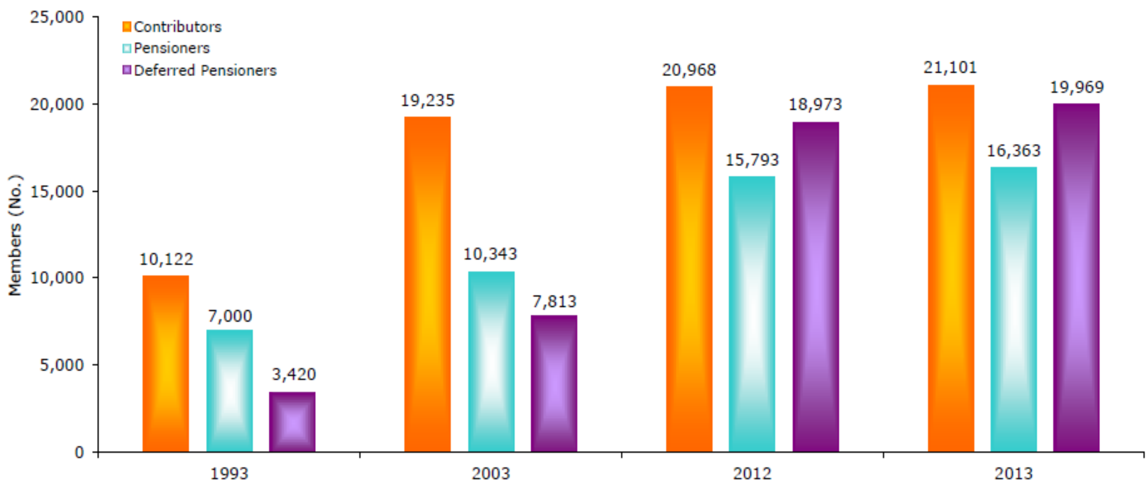
Fund Membership

5. Membership of the LGPS is open to all local government employees who have contracts of employment for more than three months and employees of certain specified employers (such as colleges, academies, and those who are providing a service transferred from a local authority) are eligible.. The Fund's website details all participating employers. There are four main membership groups:

- **County Council employees (54% of active members):** Membership is automatic to all employees who have contracts of employment for more than three months. Employees can, of course, opt not to join the Scheme.
- **District employees (14% of active members):** West Sussex County Council administers the Pension Fund on behalf of the district councils. As with County Council employees, membership is automatic for all employees who have contracts of employment for more than three months.
- **Scheduled bodies (26% of active members):** Regulations allow employees of certain specified bodies to join the Scheme (including non-uniformed personnel of the Police and Crime Commissioner and employees of colleges, academies, town and parish councils)
- **Admitted bodies (6% of active members):** Private sector bodies may also be admitted to benefit staff employed in the provision of services transferred from a local authority, subject to meeting the conditions of the regulations. In addition, the County Council is empowered to admit certain other quasi-governmental organisations to the Fund. Such bodies' liabilities have to be underwritten by a local authority.

Police officers, teachers and fire-fighters have their own unfunded statutory arrangements.

6. Also, membership comprises contributors (those who are still working and paying money into the Fund), pensioners (former employees, their widows and children, receiving pension benefits) and deferred pensioners (former employees who have deferred pension rights to be paid at some time in the future). The bar chart below illustrates the change to the mix of membership comparing year end membership data at 31 March 1993, 2003, 2012 and 2013.



The above graph excludes 567 leavers who have still to decide what to do with the benefits they have built up in the Scheme.

Since March 2012, the number of contributors has increased by 0.6% whilst the number of pensioners and deferred pensioners has risen by 3.6% and 5.3% respectively. Since 1993, total membership has increased by nearly 180%. The ratio of contributors to pensioners (deferred and active) has changed from 51:49 in favour of contributors in 2003 to 37:63 in 2013. Over the decade, the number of contributors has increased by 10%; the number of pensioners in receipt of benefits has increased by 58%. Over the same period, deferred pensioners have increased by nearly 156%. This is due to the change in regulations allowing leavers a deferred benefit entitlement once they had been in the LGPS for more than 3 months and no refunds are payable beyond this point. Previously the deferred entitlement only applied once a member had been in the LGPS for two years or more.

Additional Voluntary Contribution (AVC) Scheme

7. All local government Pension Funds have an AVC arrangement in which employees can invest money deducted directly from pay. This is arranged through an AVC provider, often an insurance company or building society. These schemes provide members with a flexible and tax-efficient way of topping up their retirement benefits. The County Council's current provider is Standard Life, although some members retain paid up plans with Equitable Life, the previous provider. Details of AVCs and the valuation of the schemes can be found in the Accounting Report at Appendix 1.

8. The 1995 Pensions Act imposes a duty of care on the Council in relation to the establishment and monitoring of AVC arrangements. The Council is committed to good governance and ensures that the services and general conduct and financial viability of the provider are kept under review.

Tax Position of the Fund

9. Under Part II of the Finance Act 1970, the Fund is exempt from UK income tax and no capital gains tax is chargeable. However, in the July 1997 Budget, tax credits paid to Pension Funds were abolished. That year, the impact was additional 3.5% of payroll to employer contribution rates due to the reduction of income by around £7m a year to the Fund.

10. In the March 1990 Budget, Pension Funds were exempt from tax on dealings in futures and options. Hitherto, investment in such instruments was classed as taxable activity.

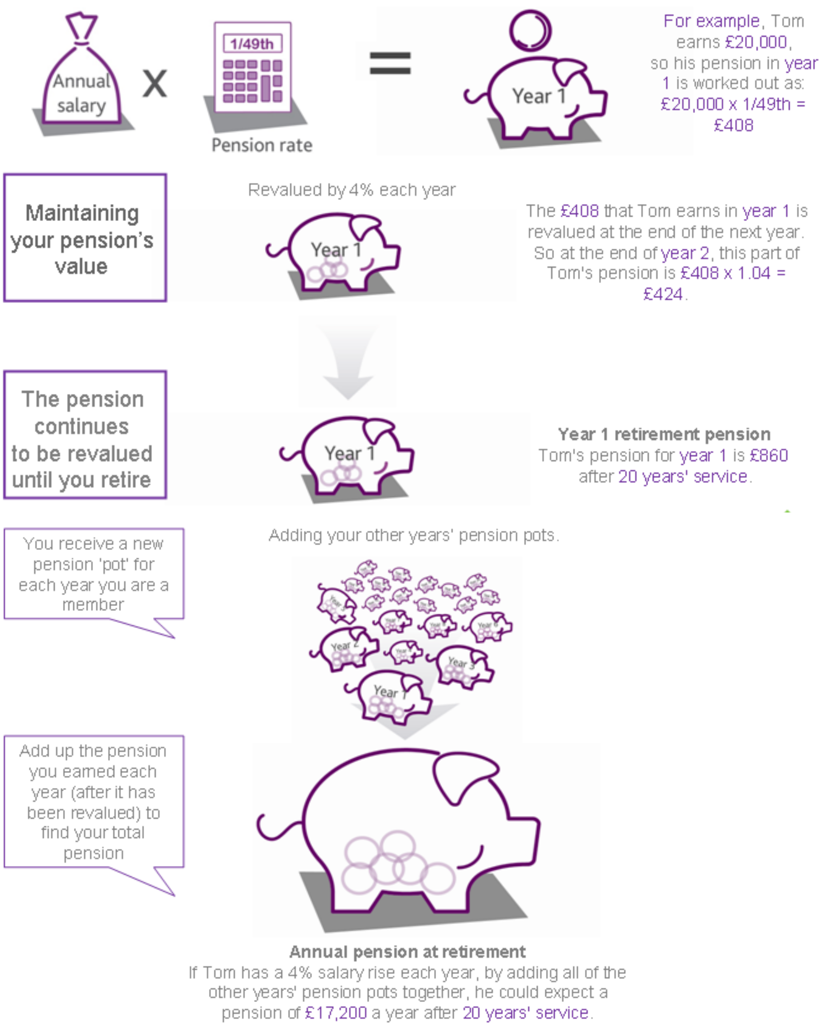
Section 2: Proposed Changes to the LGPS

11. In December 2011, a set of principles were agreed by employers, unions and the government to guide the development of the proposed LGPS 2014 effective from 1st April 2014. Pensions in payment, deferred pensions or benefits accrued prior to 2014 will be fully protected. Also, contributing members' pre-April 2014 pension will continue to be based on final salary at retirement and subject to current Normal Pension Age.

12. Some of the changes to the Scheme, such as the introduction of a Career Average Revalued Earnings (CARE) Scheme and the link to State Pension Age will apply across the public sector. Also, the government has already changed the basis of indexation from Retail Price Index (RPI) to Consumer Price Index (CPI). For clarity, all other benefits remain unchanged in the current (LGPS 2008) Scheme.

13. The key features of the new 2014 Scheme are as follows:

- **Career Average Revalued Earnings (CARE) Scheme** using CPI as the revaluation factor (the current 2008 Scheme is a final salary Scheme). CARE Scheme is a Defined Benefit Scheme like the current Scheme. The below example provided by the Fund's actuary, Hymans Robertson, illustrates how CARE works.



- **Accrual rate to be 1/49th:** (the rate for the current Scheme is 1/60th). A 1/49th means that for each year of membership you will receive 2.04% of your salary. A 1/60th means that for each year of membership you will receive 1.67% of your salary.
- **There would be no normal Scheme pension age;** instead each member's Normal Pension Age (NPA) would be their State Pension Age (the current Scheme has an NPA of 65).

- **Average member contributions to the Scheme would be 6.5%** (same as the current Scheme) with the rate determined on actual pay (the current Scheme determines part-time contribution rates on full time equivalent pay). While there would be no change to average member contributions, the lowest paid would pay the same or less and the highest paid would pay higher contributions on a more progressive scale after tax relief (see the following contributions table).

PROPOSED		
Salary From	To	Contribution Rate (Gross)
	£13,500	5.50%
£13,501	£21,000	5.80%
£21,001	£34,000	6.50%
£34,001	£43,000	6.80%
£43,001	£60,000	8.50%
£60,001	£85,000	9.90%
£85,001	£100,000	10.50%
£100,001	£150,000	11.40%
£150,001		12.50%

CURRENT		
Salary From	To	Contribution Rate (Gross)
	£13,500	5.50%
£13,501	£15,800	5.80%
£15,801	£20,400	5.90%
£20,401	£34,000	6.50%
£34,001	£45,500	6.80%
£45,501	£85,300	7.20%
£85,301		7.50%

- **Flexibility on contribution:** There would be a 50/50 option allowing members, including those who have already or are considering opting out of the Scheme, to pay half contributions for half the pension benefit, whilst still retaining the full value of other benefits (the current Scheme does not offer this option). This 'lower cost' option may have positive impact on auto-enrolment into the Scheme.
- **Death-in-Service Lump Sum:** This would be 3 x pension, instead of 4 x pension.
- **Definition of Pensionable Pay**: Actual pensionable pay would include non-contractual overtime and additional hours for part-time staff. This is excluded in the current Scheme.

14. Further information will be made available on the Fund's website.

Section 3: Investment & Fund Performance

15. The Pension Fund invests contributions and investment income which is not required to pay benefits in stocks and shares, property and private equity.

Fund Structure

16. The Fund has adopted a customised benchmark in line with actuarial advice. A customised benchmark shows the long-term asset mix between asset classes such as equities, bonds and property and is a risk decision relative to the liabilities, rather than an expected return decision. An investment strategy of lowest risk, but not necessarily the most cost effective in the long-term, would be 100% investment in index-linked government bonds. However, the Fund maintains significant exposure to equities in pursuit of potentially higher returns in the longer-term than from index-linked bonds, consistent with its relatively immature liabilities and strength of employers' covenants. The Pensions Panel conducts regular review of asset allocation to ensure an appropriate balance between risk and reward.

17. During the year, the Pensions Panel amended the benchmark for one of the fund managers (UBS). This change is effective from 1st July 2013. At 31 March 2013, the customised benchmark at Fund level is summarised below:

	Allocation	Manager
Equities		
UK	17.5%	In February 2013, UBS Asset Management was re-appointed to manage the (value-biased) global multi-asset balanced portfolio. In February 2007, Baillie Gifford was re-appointed in respect of the global multi-asset balanced portfolio with a growth bias.
Europe	4.5%	
North America	4.5%	
Asia Pacific inc. Japan	4.5%	
Emerging Markets	1.5%	
Global	32.5%	
Bonds		
Unconstrained	20%	
Alternatives		
Private Equity	5%	Pantheon Ventures and Partners Group manage the Fund's private equity portfolio. The former was first appointed in 2001 and re-appointed in 2007 and the latter was appointed in 2007.
Property	10%	The property portfolio has been managed by Cushman & Wakefield Investors, since 1992.

18. The Fund has no allocation to cash, although the fund managers can hold up to 10% in cash with reference to the Benchmark ranges. In addition, working balances are held and managed by the Council. Please see the Statement of Investment Principles on the Fund's website for further information.

19. The customised benchmark is based on a long-term asset allocation. However, in the short-term, the fund managers can aim to add value through tactical decisions, for example, holding more UK equities in the portfolio than the customised benchmark when they are bullish about the UK market, or more bonds than the benchmark, when they are bearish. The table below summarises the total portfolio at 31 March 2013.

	Market Value £000	% of portfolio by value	Benchmark
Equities			
UK	451,548	19.2	17.5
Overseas	1,148,061	48.8	47.5
Bonds			
Total	334,971	14.2	20.0
Property			
Direct	147,180	6.2	10.0
Indirect	37,116	1.6	
Other			
Private equity	157,790	6.6	5.0
Cash at WSCC	13,078	0.6	
Cash with fund managers	20,756	0.9	
TAA	45,007	1.9	
	2,355,507	100.0	100.0

i. Market value is shown at bid price.

ii. The above figures do not include the following investment assets and liabilities or current assets and liabilities which in total amount to £12.2m:

	£000
Investment assets	
Investment income	5,319
Amounts receivable for sales	15,201
Current Assets	
Contributions due	3,608
Other debtors	2,807
Taxation	685
Total assets	27,620
Investment liabilities	
Property rent receipts in advance	(693)
Amounts payable for purchases	(13,202)
Current liabilities	
Contributions	(6)
Other current liabilities	(1,618)
Total liabilities	**(15,519)**
Net	**12,201**

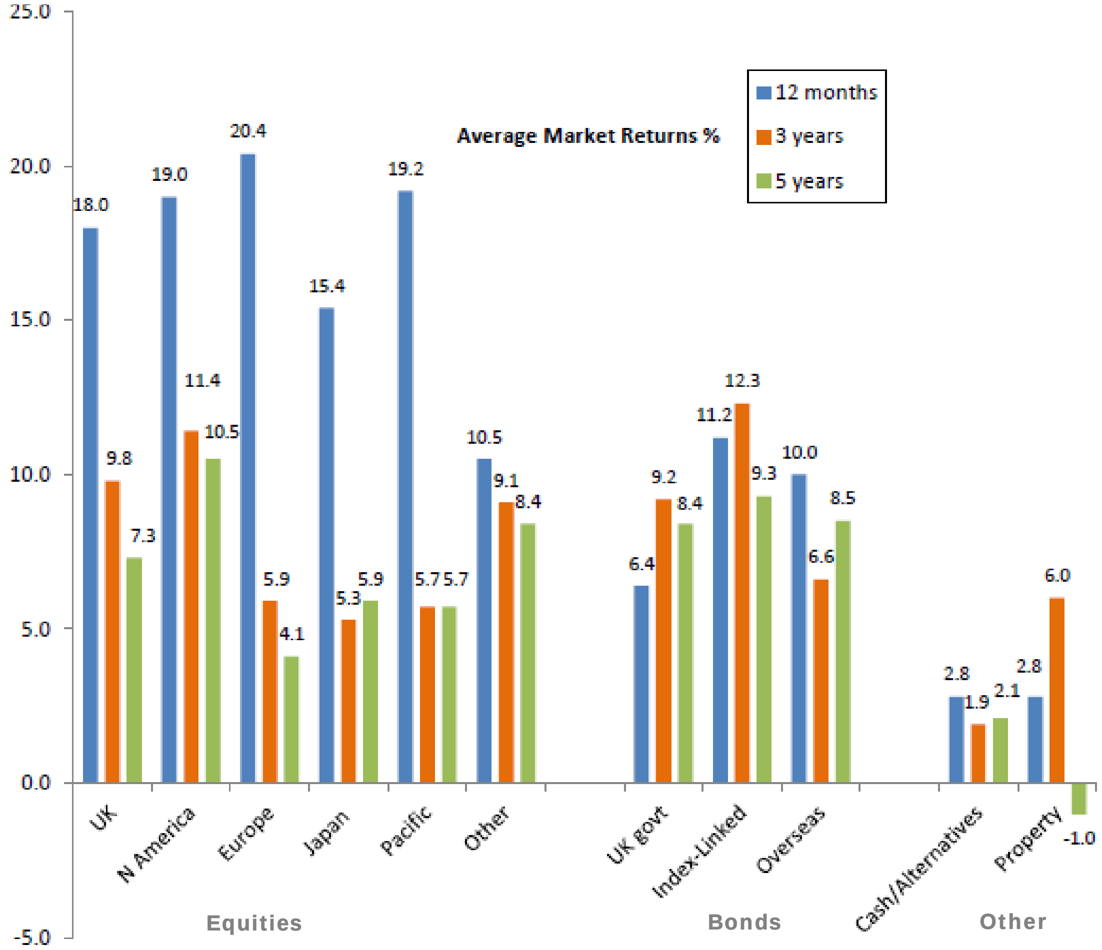
iii. In-house managed funds and unit trusts have been included in the applicable sector allocations.

iv. Private equity valuations are included on an estimated basis; this is because audited information at 31 March 2013 for both Partners Group and Pantheon Ventures were not available at the time of writing this report. Please see the Fund's annual accounts appended to this report for further details about the valuation of the private equity portfolio.

v. Tactical Asset Allocation (TAA) is a method of allocating portfolio assets to take advantage of short-term expected changes in markets, sectors or instruments. . The overlay technique avoids disruption to underlying investments and minimises transaction costs. Please refer to the glossary at the end of this report for further information.

Economic and market background

20. The chart below sets out performance of the major markets during the year which sets the background against which the fund managers have performed. RPI over the year was 3.3%. CPI over the year was 2.8%.

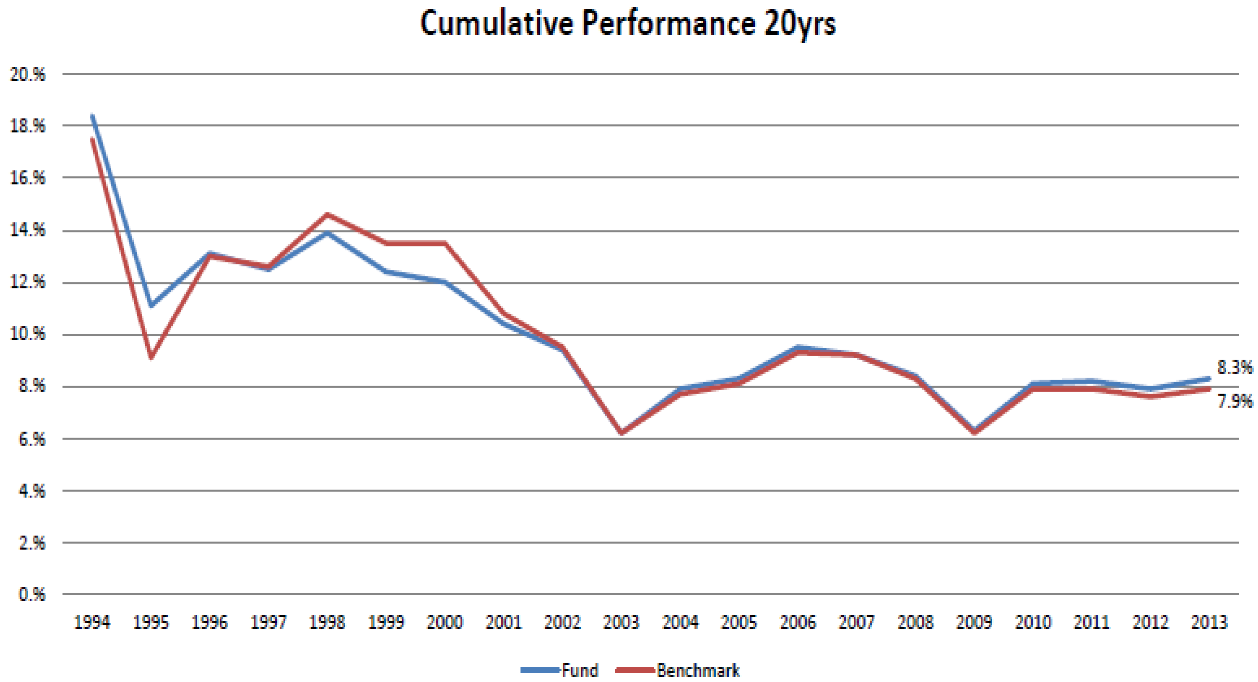


Fund performance

21. The Fund is actively managed. This means that the fund managers aim to outperform their respective benchmark over the long-term.

22. During the year to 31 March 2013, the Fund, achieved a return of 15.6%. It out-performed the customised benchmark by 1.7%.

23. The following chart plots the annualised Fund and benchmark performance over the past 20 years.



24. The table below further analyses Fund performance since 1992 relative to other local authorities. The percentile rank indicates the percentage of Funds in the WM Universe with a return equal to or greater than the return shown. The top ranking is 1 (maximum) and the bottom ranking 100. This enables individual local authority Funds to compare their peer-group rankings across years.

	2012/13 **%**	**3 Yrs Annualised** **%**	**5 Yrs Annualised** **%**	**10 Yrs Annualised** **%**	**20 Yrs Annualised** **%**
Fund	15.6	9.7	8.2	10.5	8.3
Benchmark	13.7	8.5	6.9	9.7	7.9
Relative return	1.7	1.2	1.3	0.8	0.4
Local authority average	13.8	8.1	6.5	9.4	7.8
Percentile position	14	10	13	7	10

% Return per annum rounded to nearest 0.1%.
The Fund's customised benchmark became operational in January 2003. Prior to this, the Fund's performance was measured against the local authority average. i

25. The performance by asset class is discussed in more detail in the following sections.

Section 4: Multi-asset balanced fund managers

Mandate

26. Two external fund managers, UBS Global Asset Management (UBS) and Baillie Gifford, have been appointed to manage the core global balanced portfolios on an active, discretionary basis.

- For the UBS mandate, the objective is to outperform the benchmark by 1% pa over a rolling three year period gross of fees, with the expectation that performance will not fall more than 3% below the benchmark, in any one year, as calculated by the WM Company. However, the manager was reappointed in February 2013, with the performance target of 2% above benchmark over rolling three years net of fees with an upper active risk guideline of 5%, effective from 1 July 2013.
- Baillie Gifford's performance target is to outperform the benchmark by 2% pa over a rolling five year period, which was introduced in 2011/12. In 2011/12, the Pensions Panel amended the manager's mandate to invest in global equities removing regional constraints.
- Both managers have complementary styles: Baillie Gifford is a 'growth' manager whilst UBS has a 'value' bias. The philosophical difference in their approach is critical to the performance of the Fund.

Investment background

27. During the year, equity markets rebounded on a wave in investor sentiment over incremental positive outlook for the US economy and shoots of recovery in some European economies notably Germany. Also, in the US, the fiscal cliff was avoided. Japan performed strongly too. On the currency markets, Sterling weakened against the Dollar and the Euro and this impacted negatively on the returns of Funds that hedge against currency risk.

28. Investors' appetite for risk assets undermined bond performance. Corporate bonds outperformed government bonds (gilts). However, index-linked bonds did better than gilts. Alternative assets, including hedge funds and private equity posted very good results. Emerging markets produced average results and property recorded relatively poor returns, suggesting continued pressure on valuations.

29. Tough austerity measures dominated the minds of policymakers around the world desperate to escape from recession and chart their way to growth. In Greece, a bail-out package was negotiated in exchange for major reforms.

Fund Manager Performance

30. The value of Baillie Gifford's portfolio grew by 18.9% from £925.3m to £1.081bn during the year. UBS saw its portfolio appreciate from £794.4m to £918.9m or 15.6%. Both managers outperformed their respective benchmark during the year. The Fund benefited from the managers' complementary styles. Baillie Gifford outperformed the benchmark by 3.4% (with a return of 18.3% relative to benchmark return of 14.9%). UBS achieved a return of 16.4% and outperformed the benchmark of 14.9% by 1.5%.[1]

31. The fund managers' asset allocation decisions contributed positively to performance. Overweight position in equities versus bonds had a positive impact on performance as investors favoured risk assets during the year.

32. The chart below summarises performance for both mandates over the longer-term. Since 2004, UBS has outperformed the benchmark by 0.1% per annum (10.2% versus

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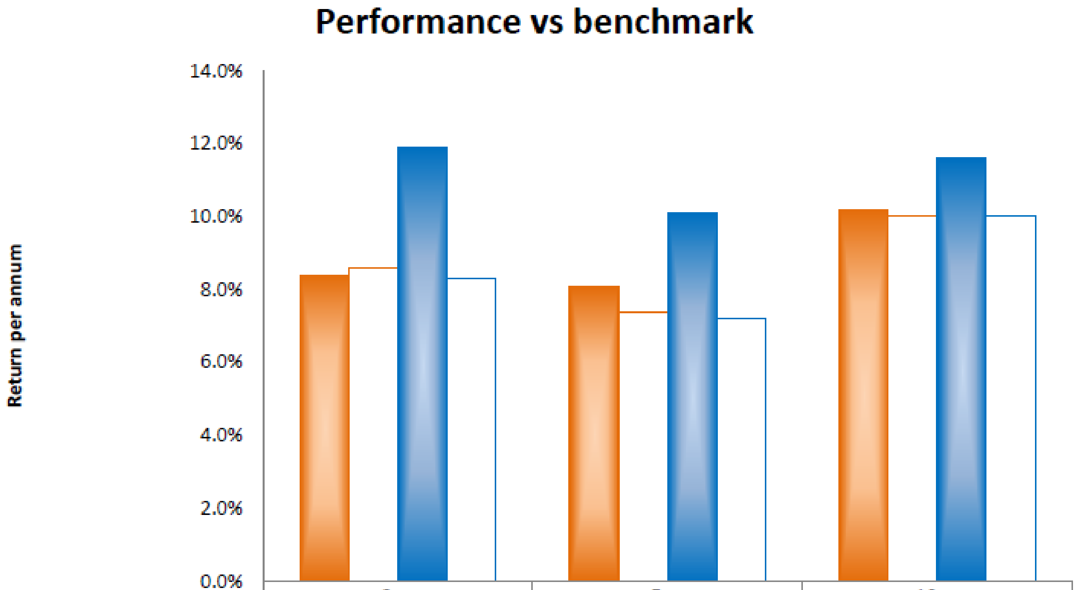
[1] Information relates to relative performance which is the degree by which the portfolio has out or underperformed the benchmark over the period.

benchmark of 10.0%). Over the same period, Baillie Gifford has outperformed the benchmark by 1.5% per annum (11.6% versus benchmark of 10.0%).



	3 yr	5 yr	10 yr
UBS	8.4%	8.1%	10.2%
UBS benchmark	8.6%	7.4%	10.0%
Baillie Gifford	11.9%	10.1%	11.6%
Baillie Gifford benchmark	8.3%	7.2%	10.0%

Portfolio

33. The assets managed by Baillie Gifford and UBS at the beginning and end of the year is shown in the following table, together with the benchmark and comparative figures for the average local authority Fund in the WM Universe.

	31.03.12	31.03.13				
	Total	UBS	Baillie Gifford	Total	B'mark	Local authority average
Equities						
UK	24.0%	39.7%	8.1%	22.6%	30.5%	28.9%
Overseas	55.4%	37.5%	74.3%	57.4%	47.9%	45.8%
Bonds						
Total	17.1%	17.4%	16.2%	16.7%	21.6%	21.7%
Other						
Cash	1.2%	0.6%	1.4%	1.0%	-	3.6%
TAA	2.4%	4.9%	-	2.2%	-	-
Total £'000	1,722,320	918,945	1,081,397	2,000,342		

Market value is shown at Bid price.

34. The top ten companies (by value) held in the portfolio at 31 March 2013 are listed in the following table.

Holding	**Value £000**	**% of total Fund**
BP	35,914	1.5
Royal Dutch Shell	28,858	1.2
Vodafone	27,557	1.2
Prudential	23,994	1.0
Lloyds Bank	23,547	1.0
GlaxoSmithKline	23,208	1.0
HSBC	20,181	0.9
Wolseley	19,298	0.8
Svenska Handelsbkn	18,893	0.8
Amazon	17,962	0.8

35. Within the balanced portfolios, £627.2m is held in the managers' internal pooled funds (£175.2m by Baillie Gifford and £452.0m by UBS), as detailed below. Pooled funds aggregate investors' money and invest in a portfolio of assets such as equities, bonds and property. The type of securities held is governed by the Fund's own investment objective.

Baillie Gifford	**Market value £000**
Sterling Market Cap Bond	175,244
	175,244

UBS	**Market value £000**
Global Optimal Thirds	309,929
UK Corporate Bond	72,179
Tactical Asset Allocation	45,007
Global Emerging Markets	24,838
	451,952

i. Overall, 49% of UBS's portfolio is invested in internally managed pooled funds. As at 31 March 2013, these pooled investments represent 19% of the total West Sussex Pension portfolio, which is in line with the 25% limit imposed by the LGPS regulations for investment in pooled funds run by one firm. There is, however, discretion to go to 35% if there is good reason, Pensions Panel approval and a note to this effect in the Statement of Investment Principles. This will be carefully monitored.

ii. Overall, 16% of Baillie Gifford's portfolio is invested in in-house pooled funds, which represents 7% of the total West Sussex Pension portfolio.

36. Purchases and sales transacted during the year are summarised below.

	Net purchases & sales £000	Profit/loss £000
Equities		
UK	-33,027	71,618
Overseas	35,934	110,694
Bonds		
UK Fixed Income	14,032	1,353
UK Index Linked	-715	(12)
Overseas Index Linked	-1,023	(2)
Other		
Tactical Asset Allocation	-2,864	7,176
Total		
		190,827

Figures exclude accrued income but include corporate actions. Net purchase and sale figures based on book cost of purchases and proceeds of sales including broker commission, third party charges and taxes.

Custodian

37. The Fund uses Northern Trust for global custody services.

38. As global custodian, Northern Trust arrange for the safekeeping of the Fund's assets (excluding property, private equity, pooled investments and some cash), settlement of transactions effected by fund managers, timely collection of income and other administrative actions.

39. During the year, Amaces, an independent custodian monitoring firm, reviewed the service provided by Northern Trust, quarterly, on behalf of the Fund. Overall, there are no issues of concern to the Fund.

40. The Fund is an active shareholder and exercises its voting rights domestically and in foreign markets, if possible, to promote and support good corporate governance. In practice, managers have delegated authority to exercise voting rights on behalf of the Fund in accordance with agreed guidelines. During the year the Fund voted at 100% of domestic and 91% of foreign meetings where it was entitled to. However, late instructions or difficult authorisation processes in some foreign markets can undermine the Fund's ability to exercise its voting rights.

Transaction costs

41. The Myners best practice principles require that the Panel should have a full understanding of the transaction related costs they incur and should seek to include the achievement of value for money and efficiency in its objectives and all aspects of its operations. To this end, since 2003 the Fund has commissioned a trading cost analysis which shows commissions, fees and market impact costs incurred over the year.

42. During the year, April 1, 2012 to March 31, 2013, Elkins McSherry monitored £542.7 million in global equities in fourteen countries. The overall trading cost (commission, fees and market impact) was +12.6 basis points (BP) or £682,983, which is 16.2 basis points lower than the Elkins/McSherry Universe, representing a 'saving' of approximately £878,121.

43. In sterling terms, the Fund made a cost ‘saving’ of £6.3m against the Universe, through efficient trading, over the ten years that the Elkins/McSherry report has been produced.

Section 5: Property

Mandate

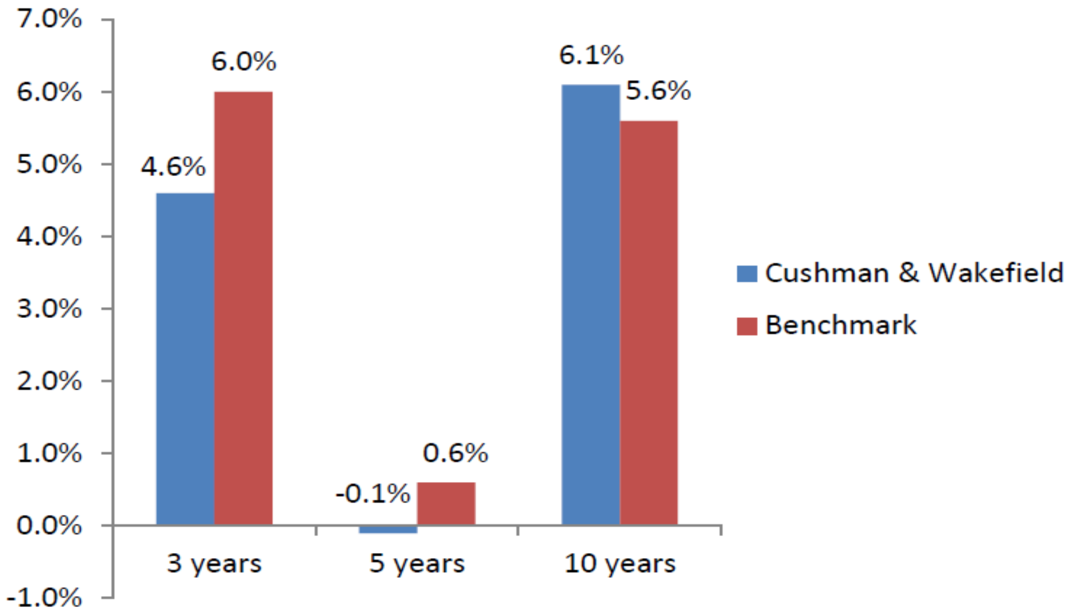
44. The property portfolio, comprising of direct and indirect holdings is managed by Cushman & Wakefield Investors. At 31 March 2013, the portfolio was valued at £184.3m, with the direct holding element valued by Knight Frank, the independent external valuer. The pooled elements of the portfolio are assessed at net asset value (NAV).The portfolio is diversified by geography and property type. The manager seeks to outperform the benchmark (Investment Properties Databank) by 1% pa over rolling 3 years with the expectation that performance does not fall by more than 3% below the benchmark in any one year.

Investment and performance background

45. The portfolio suffered capital decline of 4.5% during the year due to weaker pricing in the secondary market. However, the manager strengthened the portfolio to cushion the weakness in the secondary assets. Also, income return of 5.9% indicates good growth prospects with the benefit of new lettings and index-linked income from some portfolio holdings.

46. The property market was impacted by the uncertain economic situation, shortage of prime stock and stringent financial conditions.

47. During the year, the portfolio return was 1.1% representing 0.5% relative underperformance against the benchmark (1.6%). In addition to weak secondary assets, negative sentiment on vacancies and a decline in the value of some indirect holdings detracted from performance. The chart below summarises performance for the property mandate over the longer-term.



Portfolio

48. Independent valuation of the direct property holdings was carried out by Knight Frank. The portfolio valuation at 31 March 2012 and 31 March 2013 are summarised below. Pooled holdings are valued by independent surveyors to the respective funds.

	2012 £000	2013 £000
Offices	57,605	56,810
High street retail	35,960	48,525
Retail warehouse	12,800	10,095
Industrial	24,550	31,750
Indirect [i]	38,098	37,117
	169,013	184,297

Direct investment in wholly residential property is prohibited. However, the current exposure to residential property is via indirect vehicles. The Unite fund relates to student accommodation and Quercus Healthcare Property Unit Trust, care homes for the elderly. Investors can buy and sell units in these pooled funds.

49. The strategic target allocation to property is 10% of the total Fund. At 31 March 2013, property accounted for 7.8% of the Fund.

50. Cushman & Wakefield have a discretionary mandate. The table below summarises portfolio transactions over the year.

	£000
Sales	
Maidenhead, The Cloisters	595
Altrincham, George Street	855
Bristol, Portbury West	1050
Manchester, Trafford Park	960
Purchases	
Crowborough, Waitrose	15,600
London, Park Royal	10,575
Captiva (indirect holding)	67
	22,782

i. Figures relate to purchase price and have not been adjusted for costs associated with transactions.

51. The Fund receives rental income from direct holdings and distributions from indirect investments. Income over the year is summarised below:

	2011/12 £000	**2012/13 £000**
Rental income	6,947	8,447
Distributions from indirect funds	1,970	1,413
	8,917	9,860

Section 6: Private equity

Mandate

52. Private equity is finance provided over the medium to long-term and management expertise in return for a share of equity in unquoted companies. The attraction of private equity is the potential for good long-term returns.

53. Pantheon Ventures was appointed by the Pensions Panel in October 2001 and it retained its mandate in 2007 following a full procurement exercise, during which Partners Group was also appointed.

54. The Fund has a strategic target allocation of 5% to private equity. However, following a review by the Pensions Panel during the year, it decided to exit this asset class, making no further new investments. The Panel's view is that investment in private equity has not been adequately rewarded and there is better opportunity elsewhere. The decision is not a reflection on the managers' performance. The Fund's commitment schedule is shown below.

Tranche	Firm	Year	Commitment (original) £000
1	Pantheon	2001	41,528
2	Pantheon	2004	40,109
3	Pantheon	2007	49,125
3	Partners	2007	49,027
4	Pantheon	2011	16,983
4	Partners	2011	23,284
			220,055

i. Commitment (original) refers to original commitment in fund currency converted to sterling at prevailing exchange rate on date of commitment. The outstanding commitment at 31 March 2013 is £77.4m, approximately 3.3% of the total Fund.

55. The managers' objective is to outperform the notional benchmark by 5% per annum net-of-fees over rolling five-year periods. The notional benchmark is the FTSE World Equity Index weighted by the initial portfolio cash flows in sterling.

Investment background

56. During the year, there were signs that the US private equity markets were improving as leveraged buyouts (LBOs) and enterprise valuation multiples for private equity reached sustainable levels of around $100b and 8.5x respectively. Also, the IPO market was buoyant both in terms of numbers and value, thus creating good exit opportunity for managers. In addition, with investors beginning to invest their hoards of cash, trade sales looked strong. Global pick-up in fundraising was evident during the year. The European private equity market also showed signs of recovery with fewer deals coming from family offices replaced by upswing in corporate restructuring and disposal of non-core businesses. Improvement in purchase price multiples further reflected easing of distress and stronger balance sheets and greater ratio of trade buyers. Spain and Italy were exceptions due to liquidity fear and loss of confidence. In China, the proliferation of private equity managers was a problem for investors and in Latin America, Chile attracted a lot of interest due to relatively developed institutions, regulatory framework and low taxes conducive to private equity.

Fund manager performance

57. The return on the portfolio was 13.8% over the year, compared to a benchmark return of 17.5%. However, over five years, the private equity portfolios outperformed the benchmark by 0.9% pa (9.5%pa versus 8.5%pa).

Portfolio

58. During the year, £19.3m was invested in private equity and £22.7m was repaid to the Fund. The combined private equity portfolio is well diversified by geography (USA, Europe and Asia), investment stage and vintage (pre-2004 to date) and is therefore diversified across market cycles. Also, risk is spread in terms of strategy (the portfolio includes exposure to venture, buy-out, secondary and direct funds which have different risk, return and cash flows). The portfolio at 31 March 2013 is summarised below:

	Book Cost £000	**Value £000**
Pantheon (Phase I)	20,407	62,190
Pantheon (Phase II)	30,920	42,043
Partners Group	41,025	53,775
	92,352	158,007

Section 7: Corporate governance

59. Corporate governance considers issues relating to the way in which a company ensures that it is attaching maximum importance to the interest of its shareholders and how shareholders can influence management. Constructive relationship between investors and investee companies is vital to creating and sustaining value over the longer term. The Pensions Panel supports the Institutional Shareholders' Committee (ISC) Statement of Principles and has incorporated these into the Fund's Statement of Investment Principles (SIP).

Responsible ownership

60. The Pensions Panel is mindful of its legal duty to obtain the best possible financial return on Pension Fund investments, within an appropriate risk profile. However, good practice in terms of social, environmental and ethical issues is likely to have a favourable effect on companies' financial performance.

61. The Panel has directed fund managers, in acting in the best financial interests of the Fund, to consider, amongst other factors, the effects of social, environmental and ethical issues on the performance of a company when considering the acquisition, retention or realisation of investments. As a result, the Panel has adopted the fund managers' policies and guidelines. These policies are discussed with managers from time to time. UBS and Baillie Gifford report quarterly to the Pensions Panel on corporate governance to ensure that this aspect of engagement is integrated with the managers' investment process.

62. The managers have adopted the ISC Statement of Principles on the responsibilities of shareholders and agents which set out best practice in the course of engagement with investee companies. The ISC code require managers to have explicit policy on how they will discharge their responsibilities, clarify the priorities attached to particular issues and timescale for action, monitor the performance of, and establish, where necessary, regular dialogue with investee companies. Managers should intervene where necessary, evaluate the impact of their engagement and report back to the Fund.

63. The United Nations Environment Programme Finance Initiative (UNEP FI) has published Principles of Responsible Investment (UNPRI) and has encouraged asset owners and asset managers to sign up and commit to the principles and regularly assess themselves against a comply or explain framework, The managers have signed up to these principles.

Voting rights

64. The Pensions Panel wishes to remain an active shareholder and exercise its voting rights to promote and support good corporate governance principles. In practice, managers have delegated authority to exercise the Fund's voting rights according to agreed guidelines. Fund managers report quarterly to the Pensions Panel on voting activity and these reports are published on the Fund's website.

65. The Fund's voting record for the year is discussed above in paragraph 40 of Section 4.

Section 8: Revenue accounts

66. The Fund is financed by contributions from employers and employees and investment income. The surplus of contributions and investment income over benefits paid is reinvested.

67. The revenue accounts of the Fund are summarised below and shown in detail at Appendix 1.

INCOME	2011/2012 £000	2012/2013 £000	Change	Note
Contributions from employers				
Normal	73,457	78,097	6.3%	i.
Additional	-	-		ii.
Contributions from employees	23,788	23,377	-1.7%	iii.
Investment income	48,020	43,420	-9.6%	iv.
Transfers from employers for contributors joining the Fund	4,884	4,835	-1.0%	v.
	150,149	**149,729**		
EXPENDITURE	**2011/2012 £000**	**2012/13 £000**	**Change**	**Note**
Pensions	65,124	72,995	12.1%	vi.
Commutation of pensions and lump sum benefits (including death benefits)	21,894	12,398	-43.4%	vii.
Transfers to employers for contributors leaving the Fund and refunds of contributions	6,639	5,174	-22.1%	v.
Administrative expenses	1,166	1,176	0.9%	viii.
Management expenses	5,797	6,992	20.6%	ix.
Income available for investment	49,529	50,994	3.0%	
	150,149	**149,729**		

i. Normal contributions (including augmentation payments and deficit contributions set by the actuary) from employers have risen by 6.3% year on year although the number of active members in the Fund has increased only very slightly (0.6%). The additional increase in the employer contributions reflects the revised employer contributions agreed at the time of the 2010 valuation. Contribution rates by employer are shown on the Fund's website.

ii. No additional lump sum contributions were received during the year.

iii. Contributions from employees (including additional voluntary contributions) have reduced slightly (-1.7%).

iv. Investment income is analysed on the following page.

	2011/12 £000	2012/13 £000	Change
Equities	34,647	30,695	-11.4%
Bonds	2,583	2,726	5.5%
Managed funds	1,208	5	-99.6%
Private equity	640	386	-39.7%
Cash	216	101	-53.2%
Rent & property distributions	8,917	9,860	10.6%
Class action	61	0	-100.0%
Tax	-252	-353	40.1%
	48,020	43,420	-9.6%

Total income from investments was £43.4m during the year compared to £48.0m in 2011/12. The 9.6% fall was primarily due to structural changes in fund managers' portfolios such as the reduction in managed funds and realignment between equity and bonds.

Distributions from private equity investments amounted to £386k in 2012/13 representing 39.7% reduction on £640k earned in the previous year.

Overall income from cash fell during the year reflecting lower cash balances and anaemic interest rates.

Income from rent and property distributions increased by almost 11% between 2011/12 and 2012/13, largely due to the strong performing Central London offices subsector, which saw average rents increase by 4.5%. Income return for the year was approximately 5.9%.

Net withholding tax increased by 40%, from £252k in 2011/12 to £353k in 2012/13. Both years' figures related to Baillie Gifford's global alpha portfolio with exposure to some markets where there is no reciprocal arrangement for UK pension funds to reclaim withholding tax on investment.

v. Net transfer values are a function of employees joining and leaving the Fund. The net outflow of £1.8m in 2011/12 compares with a net outflow of £0.3m in 2012/13.

vi. Pensions paid increased by £7.9m or 12.1% during the year. LGPS pension payments are increased each April in line with the rise in CPI over the 12 months to the previous September. The pensions increase for 2011 was set at 5.2% with effect from 9 April 2012. In addition the number of pensioners increased by 3.6% over the period. The pensions increase for 2013 has been set at 2.2% and will be applied from 9 April 2013.

vii. The decrease of 43.4% in commutation of pensions and lump sum benefits (including death benefits) is due to the spike in pensioner numbers in the previous year following restructuring that resulted from lower public sector funding during that year. The table below compares the figures across five years. The increase in lump sum payments between 2010/11 and 2011/12 was due to the aforementioned reason. This is broken down below.

	2007/08 £000	2008/09 £000	2009/10 £000	2010/11 £000	2011/12 £000	2012/13 £000
Retirement lump sums	14,825	11,624	17,151	14,789	19,305	10,320
Recoveries for early retirement	-2,892	-4,206	-3,115	-3,813	-5,713	-3,008
Death benefits	1,109	1,517	1,667	1,510	2,564	2,048
Other	102	32	25	12	25	30
Total	13,144	8,967	15,728	12,498	16,181	9,390

viii. Administrative and management expenses are shown below.

	2011/12 £000	2012/13 £000	Change %
Administering authority expenses	928	937	1.0%
External audit fees	33	24	-27.3%
Actuary fees	139	106	-23.7%
Bank charges	4	3	-25.0%
Subscriptions and training	11	16	45.5%
Legal fees	15	80	433.3%
Other admin expenses	35	10	-71.4%
Total administrative expenses	1,165	1,176	0.9%
Fund management fees	5,197	6,236	20.0%
Property management fees	430	562	30.7%
Custody fees	116	121	4.3%
Performance monitoring service	54	73	35.2%
Total management expenses	5,797	6,992	20.6%

The administering authority reviewed its costs during the year resulting in an increase in the amount paid. The increase in legal fees by 433% is due to a number of one off payments for advisors and the legal costs associated with the major procurement undertaken in 2012/13 for the balanced mandate manager, which resulted in the re-appointment of UBS.

The Pension Fund is now subject to a separate audit, rather than being included in the scope of the Council's work. The net fees paid during 2012/13 were lower than 2011/12 because of the change of auditors from the Audit Commission to Ernst & Young.

The Pension Fund maintains a separate bank account. This was made a requirement under the Regulations with effect from 1 April 2011.

Performance monitoring services include fees paid to State Street Investment Analytics who measure the Fund's quarterly performance, Elkins McSherry who provide transaction cost analysis on an annual basis, Amaces, who provide custodian monitoring services to the Fund, fees paid for the independent valuation of the property portfolio by Knight Frank and a charge for analysis provided by the Investment Property Databank. This has been included in the accounts for 2012/13 as an investment management expense.

Section 9: Actuarial valuation

Fund valuation

68. The revenue accounts do not take account of pension and other benefits payable by the Fund in the future. An Actuarial valuation is a valuation carried out by an actuary on a regular basis, in particular, to test future funding or current solvency of the value of the Pension Fund's assets against its liabilities. In the case of the LGPS the Actuary values the Fund's assets and liabilities every three years. Interim valuations are undertaken from time to time to take account of significant factors affecting assumptions made at the time of the last triennial valuation.

69. The underlying principle of the Fund is to ensure that employer contribution rates are set at a level to attain 100% funding, as certified by the Fund's actuary, whilst keeping the employer contribution rate as stable as possible. The purpose of the valuation exercise is to ensure that sums are put aside on a regular and managed basis to meet liabilities in the future.

70. From an employee perspective, members' benefits are currently guaranteed by statute and therefore not directly related to the Fund's assets. In this respect the employer is responsible for making contributions to meet any shortfall.

71. The Fund completed a formal valuation exercise during the year, which was based on figures as at 31 March 2010 and set the employer contribution rates from 1 April 2011 to 31 March 2014. The full valuation report can be downloaded from the Fund's website and is discussed in some detail in the funding strategy statement. The results are summarised below with the 2004 and 2007 results noted as a comparator.

	2004	2007	2010
Fund value	£968m	£1,549m	£1,759m
Liabilities	£1,273m	£1,763m	£2,047m
Shortfall	£305m	£214m	£288m
Funding level	76%	88%	86%

The Fund's liabilities are essentially the benefits promised to fund managers (past and current contributors) and to members' dependent on their death.

72. Since the 2007 valuation, various events have taken place which has had an effect on the estimated cost of the Fund.

- **Assets:** In annual terms, the actual return of the Fund's investments over the three years to 31 March 2010 was 2.8% per annum, whereas the expectation from the previous valuation was that it would be 6.1% per annum. The cumulative underperformance of 10.7% relative to expectation has had a significant negative effect on the funding position.
- **Liabilities:** The discount rate used to value the Fund's future benefit payments based on the return on fixed interest gilts, whilst the benefits themselves are projected to increase in line with both salary and price inflation. Therefore the real return available on gilts (return on fixed interest gilts net of inflation) is a key indicator in the measurement of liabilities. The decrease in real yield since 2007 has increased the value of the Fund's liabilities by around 8.9%.
- **Active membership profile:** The Fund membership is gradually maturing, meaning that the burden on contributing members of meeting the cost of the Fund's liabilities is becoming progressively greater. However, to the Fund's benefit, there have been fewer early leavers than anticipated, fewer ill health retirements than expected and salaries have increased at a slower rate than expected over the period.
- **Post retirement experience:** The level of pension increase was slightly lower than assumed in 2007 (2.9% pa versus 3.2% pa) as was the expected amount of pensions ceasing over the three year period. Both factors have been beneficial to the Fund.

73. In addition the Chancellor of the Exchequer's announcement that the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) will be the basis for

future increases to public sector pensions in payment and the pay freeze for public sector employees has benefited the Fund.

74. The funding level is likely to have worsened since 31 March 2010. The reasons for this are:

- There has been a significant fall in government bond yields (meaning that the nominal discount rate has decreased). This has been partially offset by a decrease in the market's expectation for long term inflation (resulting in a decrease in the pension increase assumption) but overall there has been a decrease in the real discount rate (the nominal discount rate net of inflation). This will have led to an increase in the value placed on the liabilities and a drop in the funding level.
- The fall in funding level will have been partially offset as a result of total investment returns being above the long-term assumption made at the 2010 valuation. The next actuarial valuation as at 31 March 2013 is in progress. The Council's Funding Strategy Statement (FSS) and Statement of Investment Principles (SIP) will also be reviewed at that time.

75. It is important to note that significant valuation shortfalls are rarely funded in one go. The Council's strategy is to phase in its own contribution rate increases over three years, with the view of recovering the deficit over 20 years. The Council produces a FSS which explains how it intends to meet those liabilities over the longer term. This is available on the Fund's website.

Section 10: Business Plan

76. Under the Myners Investment Principles, the Panel is required to have a business plan setting out the future direction of the Fund and regularly evaluate progress. This could cover IT and all other key business activities.

77. Some of the key priorities for 2013/14 are listed below. Further information can be found in the Fund's business plan.

Objective	Priority
Ensure VFM is achieved with Fund resources	Monitor fees paid for Investment services & seek any improvements Benchmark and compare costs and fees where possible
Maximise returns from investments within reasonable risk parameters	Liaise with actuary on the Asset Liability Study and report it to the Panel. Ensure access to global markets are open to the Fund
Ensure VFM is achieved with Fund resources including investment managers and their returns	Ensure competitive procurement process exists for all asset classes. For 2013/14 Property Management procurement process will commence and fees will be a part of the assessment of bidders.
To progress towards assets equal to 100% of liabilities within timeframes in the Funding Strategy Statement	Ensure robust assumptions for Valuation process. Liaise with Actuary to ensure Valuation runs as smoothly as possible, with stakeholder kept informed.
To apply employer contribution requirements recognising the need for maintaining consistent, predictable and non-volatile movement in contributions	Liaise with actuary over updated contribution levels recognising both affordability and stability of contributions. Ensure employers have opportunity to engage with the actuary.
Communications ensure all current and potential scheme members are made aware of the benefits of belonging to the scheme	Ensure the 2014 changes are actively and widely promoted. Involve Communications staff and Capita to spread awareness of the pending changes including Hutton and auto-enrolment

78. In addition the Pensions Panel has a programme of regular procurement exercises for the provision of services to the Fund. Each manager is reviewed every four years and a full procurement exercise carried out if appropriate. The maximum term of a contract without approval otherwise is currently seven years. The procurement exercises for the specific mandates are set out below.

Mandate	Next Review	Contract	Procurement
Transition Manager shortlist		N/A	2014 or 2017
Fund Adviser	2014	No formal expiry date	
Baillie Gifford Balanced Active	2014	31.12.2014	2014
The WM Company Performance Monitoring	2013	No formal expiry date	2013 TBC
Knight Frank External Valuer		07.03.2014	2014
Amaces Custodian Monitoring Services		No formal expiry date	
Cushman & Wakefield Property Management (Direct and Indirect)		24.07.2013	2013
Hymans Robertson Actuarial Services		30.04.2017	2017
UBS Balanced Active	2016	30.06.2017 or up to 30.06.2023	2017 or 2023
Northern Trust Global Custodian	2013	31.12.2013 or 31.12.2016	2013 or 2016
Pantheon Ventures Private Equity Fund of Funds	2013	01.10.2014	2014
Partners Group Private Equity Fund of Funds	2013	01.10.2014	2014

Section 11: Internal Audit

Annual testing of key core financial controls

79. Internal audit have undertaken a review of the Pension Fund as part of their 2012/13 audit plan. This is in addition to the external audit which takes place annually.

Compliance testing of key controls - pensions administration

80. Internal Audit's overall assessment of the extent to which key controls have been applied is that satisfactory assurance could be placed on the effectiveness of the overall control environment.

81. Whilst substantial assurance was found in the majority of areas, some weaknesses were found in the implementation of the new administration system, Hartlink that relate to the pension administration as a whole and not just to admitted and scheduled bodies. These are known issues relating to the implementation of Hartlink and compensating workarounds are in place.

Pension Fund: Scheduled, admitted and employing Bodies

82. The audit focused on pension contributions from employers (checking that they were correctly received to the Pension Fund in a timely manner coded to the correct body in the GL and reflected correctly in AXIS-e/Hartlink and the pension payroll) and pension payments (made at the correct rate only to legitimate beneficiaries).

83. Internal Audit's overall assessment of the extent to which controls and procedures have been applied is that satisfactory assurance could be placed on the effectiveness of the overall control environment.

84. Notwithstanding the issue identified above, the key reasons for this opinion was that the controls present within the systems are sound and procedures are sound and robust and found to be operating effectively.

Pension Fund: Governance and Strategy

85. Internal Audit's overall assessment of the extent to which key controls have been applied is that substantial assurance could be placed on the effectiveness of the overall control environment.

86. Among the key reasons for this opinion were that performance reports are received by the Panel on a regular basis.

Fund manager SAS70/ISAE 3402 Reports

87. Internal audit reviewed the ISAE 3402 as part of their audit plan for 2012/13. The ISAE 3402 provide assurance to user organisation that internal controls over financial reporting are in place. The internal audit report found that 'satisfactory assurance' can be placed on the effectiveness of the overall control environment.

88. Although there were exceptions noted in the Fund Manager's reports, Internal Audit have concluded that Satisfactory Assurance can be placed on the effectiveness of the overall control environment and no further testing is required.

89. It should also be noted that:
    - Pantheon Ventures and Partners Group provide a Type I Report which only gives an assessment of the Description of Controls but controls are not tested for effectiveness.

- Cushman and Wakefield, who manage the property portfolio, do not provide an ISAE 3402 Service Auditor's Report.

- A major fraud had occurred at UBS which was discovered in September 2011 within its Investment Bank in the Global Synthetic Equity business in London, however, the ISAE 3402 Service Auditor's Report and their audit opinion for the period January to December 2011 for UBS Global Asset Management (UK) was not affected.

Appendix 1 - The Local Government Pension Fund Scheme Pension Fund Account

Attached

Appendix 2: Attendance and training register

	Apr-12	Jul-12	Oct-12	Jan-13
PANEL				
Administering authority				
Mr. Michael Brown (Chairman)	✓	✓		✓
Mr. C.H. Stevens	✓	✓	✓	✓
Mr. A. Smith	✓	✓	✓	✓
Mr. M. Hodgson	✓	✓	✓	✓
Mr. R. Dunn	✓	✓		✓
Dr. J. Walsh	✓	✓	✓	✓
Mr. S. Waight		✓	✓	✓
Scheduled bodies				
Mr. A. Price *	✓	✓	✓	
Mr. G. Marples	✓	✓	✓	✓
Employee representative				
Mrs. C. Earwaker **	✓	✓		
Mr. D. Sartin **				
IN ATTENDANCE				
Fund adviser				
Ms. C. Burton	✓	✓	✓	✓
Fund managers				
UBS	∞	∞	∞	∞
Baillie Gifford	∞	∞	∞	∞
Cushman and Wakefield	∞	∞	∞	∞
Pantheon	∞	∞	∞	∞
Partners Group	∞	∞	∞	∞
Hymans Robertson	∞	∞	∞	∞
Officers				
Mr. R. Hornby (Director of Finance & Assurance)	✓	✓		✓
Mr. S. Harrison (Chief Technical Officer)	✓	✓	✓	
Mrs. R. Wood (Pension Fund Investment Strategist)	✓	✓	✓	✓
Mr. P. Audu (Interim Pension Fund Investment Strategist)				
Mrs. V. Hampshire (Principal Accountant)	✓	✓	✓	✓
Mrs. L. Davies (Principal Accountant)				

✓ In attendance
◇ Non-voting
∞ not required

* Mr. Price left the Panel with effect from October 2012 meeting. Another appointment has not yet been made.
** Mrs. Earwaker left the Panel with effect from the July 2012 meeting. Mr. Sartin has been appointed.

Training Register

Local Government Employers (LGE) fundamentals

The Fund uses the Local Government Employers (LGE) three day training course which is recognised by the Department of Communities and Local Government (DCLG). The table below shows which members of the Panel have completed training, which members have training arranged and which members are exempted from the LGE training by previous professional experience.

Member		Day 1		Day 2		Day 3	
Mr. M. Brown (Chairman)	Cabinet Member for Finance and Performance	To be booked during 2013/14					
Mr. M. Hodgson	Member of the County Council	✓	2009	✓	2009	✓	2009
Mr. C. H. Stevens	Member of the County Council	✓	2004	✓	2004	✓	2004
Mr. Robert Dunn	Member of the County Council	To be booked during 2013/14					
Mr. Steve Waight	Member of the County Council	✓		✓		✓	
Mr. James Doyle	Member of the County Council	✓	2010	✓	2010	✓	2010
Mr. A. Smith	Member of the County Council	✓	2007	✓	2007	✓	2007
Dr. J. Walsh	Member of the County Council	✓	2012	✓	2012	✓	2012
Mr. G. Marples	West Sussex District Councils' Representative	✓	2011	✓	2011	✓	2010
Mr. A. Price	Scheduled Bodies Representative	✓	2007	✓	2007	✓	2007
Mrs. C. Earwaker	Employee Representative	✓	2008	✓	2008	✓	2008

Members are encouraged and given opportunities to undertake appropriate additional training. This could be through presentations to the Panel on specific issues or through external courses attended by members.

Specific presentations (from April 1, 2008)

Subject covered	Date
Asset liability study (Hymans Robertson)	Apr-11
Understanding actuarial valuations (Hymans Robertson)	Oct-10
Current trends in local authority investing (WM State Street)	Apr-10
Tactical Asset Allocation (UBS)	Oct-09
Tactical Asset Allocation (UBS)	Apr-09
Risk in investment management	Jan-09
Socially responsible investment (Baillie Gifford and UBS)	Jul-08
An introduction to private equity (Partners Group)	Jul-08

Special papers (from April 1, 2008)

Subject covered	Date
Actuarial valuation	Apr-11
Global equity allocation: Baillie Gifford’s proposals	Jan-11
Private equity investment: Future commitment	Oct-10
Global equity allocation	Oct-10
Global equity investment (C. Burton)	Jul-10
Pension Funds: Investment outside the UK (C. Burton)	Apr-10
Transition management	Sep-08

Knowledge and Skills Framework

As an administering authority of the Local Government Pension Scheme, West Sussex County Council recognises the importance of ensuring that all staff and members charged with the financial management and decision making with regard to the Pension Scheme are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them. It therefore seeks to appoint individuals who are both capable and experienced and it will provide/arrange training for staff and members of the pension decision-making bodies to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. All training undertaken and planned is reported annually in the training register.

Our training plan sets out how we intend the necessary pension finance knowledge and skills to be acquired, developed and maintained. The plan reflects the recommended knowledge and skills level requirements set out in the CIPFA *Pensions Finance Knowledge and Skills Frameworks.*

The Pensions Panel has designated Richard Hornby – Director of Finance & Assurance - to be responsible for ensuring that policies and strategies are implemented.

Appendix 3: Risk and control matrix

Risk Category	Risk Description	Impact	Likelihood	Rating	Direction	Control Measure	Who	Review Date
FINANCE AND RESOURCES	Insufficient funds to meet pension obligations. A funding shortfall would result in higher employer contribution rates.	5	3	15	↓	Review funding strategy (asset liability study) and risks being taken to achieve this (including level of interest and inflation risk, liquidity and collateral and options for managing and mitigation). Working groups have reviewed the Investment Strategy and Mandates. Recommendation that the Fund Managers could be given more discretion about how to generate returns within the Fund's risk parameters. Also, to make no new Private Equity Investment, given the disadvantages associated with a long term investment. Actuary has suggested that the Fund should be cashflow positive well in to the future. These assumptions will need to be refreshed as equity volatility and staff changes may differ to the actuarial assumptions. Preparatory work for the Fund's 2013 valuation has been started, and a work timetable agreed. Prudent assumptions used when setting employer contribution rates. Actuarial valuation process is focused on real returns on assets, net of pay and price increases. Mortality assumptions are bespoke to the Fund's membership profile (such as salary, gender, and location) with some allowance for future increases in life expectancy. However gilt yields, which drive liability assumptions have been lower than used at the 2010 valuation, which has increased liabilities. However there has been some reversion, and improved stock market performance. The Fund's triennial valuation will start from 1 April 2013 with new rates set from 1 April 2014. Specific impact of Hutton reforms yet to be seen, and should be helpful, but Actuary expects an overall rise in liabilities as gilt yield values have fallen.	Actuary Pensions Panel. Independent advisor Director of Finance and Assurance	Annually
FINANCE AND RESOURCES	Employer no longer in the fund but liabilities remain to be covered e.g. if employer goes bust, or employer unable to meet liabilities. This includes risk of declining membership numbers from some employers	5	2	10	→	Risks associated with employers are considered carefully including covenant review at least every three years. The Director of Finance and Assurance has discussed the approach for the 2013 valuation with the actuary Admission Agreements set out the employer obligations clearly and level of a funding guarantee from another scheme employer, external body or government agency. A number of older style admission agreements are being reviewed and amended to bring them in line with current standards. Employers pay for their own salary awards and early retirement costs and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees. Policy under consideration for ill health retirement costs to ensure full recovery from employers if appropriate. The Fund monitors changes in active membership movements on a regular basis, and triggers a reassessment of contribution rates if necessary.	Legal Services Chief Technical Officer Pension Fund Investment Strategist	Monthly
LEGAL	Fund Managers adopt inappropriate strategic investments or has inadequate processes in place to comply with contractual requirements	5	1	5	→	Strategic strategy adopted by the Fund Managers is considered by the Pensions Panel and the fund's independent adviser, with awareness of liquidity requirements. Fund managers' performance is monitored quarterly against the performance of the fund-specific benchmark and the returns assumed in the actuarial valuation. New governance arrangements to hold Investment Managers to account being put in place with effect from the October Pensions Panel meeting – more detailed reporting back to the Panel with written reports in the interim for main equity managers. The Fund's portfolio is diversified by assets and Fund Managers. The Fund adopts a detailed procurement process which clearly outlines the managers obligations. Performance against the Agreement is monitored. Fund managers have strong risk control measures in place which ensure compliance with the Fund's restrictions.	Director of Finance and Assurance Chief Technical Officer Pensions Panel	Monthly

Risk Category	Risk Description	Impact	Likelihood	Rating	Direction	Control Measure	Who	Review Date
LEGAL / GOVERNANCE	Failure to comply with changes to LGPS Regulations and/or Inland Revenue Rules. This could potentially create additional liabilities and administration difficulties for employers and the administering authority	4	3	12	↗	All consultation papers issued by the CLG, Revenue & Customs, and other Bodies are commented on where appropriate. Clear lines of responsibility in place on client v contractor following pension admin outsourcing to Capita in 2012. As part of the new arrangements, SLA's will be put in place for Employers and an Administration Policy document will set out key performance indicators. Performance against these will be reported to the Panel by exception. The Council has worked closely with Capita on the transition to the new pensions administration system to ensure the robustness of information and the system and a new system (called 'HartLink') is now in place. Hymans Robertson were commissioned to produce an audit report on the administration of the West Sussex Fund and key recommendations during the year and these have all been implemented. Reforms to the LGPS will need to be recognised in the pensions administration system. The time delay in the Government issuing consultation papers has meant that this will be a challenging deadline. Details on the impact of Miscellaneous Regulations are being incorporated into the Fund's policy documents and Admission Agreements. Legal advice sought on specific areas for clarity.	Chief Technical officer and Pension Fund Strategist Capita HR	On-going

Risk Category	Risk Description	Impact	Likelihood	Rating	Direction	Control Measure	Who	Review Date
GOVERNANCE FINANCE AND RESOURCES	National Reform of LGPS causes instability/uncertainty. Opt outs may increase as a result of the changes to the Scheme. Admin complexity issues Need to keep both employers and employees informed of changes	2	5	10	↓	Maintain vigilance with Hutton process and changes and resultant Consultation papers, attend relevant training and maintain open dialogue with the Fund actuary. An initial report has been provided by the Actuary on the impact of changes to the LGPS and updating the fund's funding position (based on updated financial assumptions). The outcome has been reported to the Pensions Panel. Scheme design (eg protections, accrual rate and 50:50 option) should reassure members of the value of LGPS benefits. Publicity about Hutton changes taken place via the Council's Communication team to ensure high profile publicity. The Fund will work with Capita to ensure a smooth transfer to the new arrangements, and to develop a communication strategy with employers and employees. To ensure members will hear about the 2014 LGPS Scheme.	Chief Technical officer and Pension Fund Strategist & Capita	ongoing

Appendix 4: Regulations

Administration regulations

90. The Local Government Pension Scheme (LGPS) Regulations, as amended, require the County Council to maintain a Pension Fund for all eligible employees (excluding teachers, police officers and fire-fighters) of both the County Council and other specified bodies e.g. District Councils, Sussex Police and Crime Commissioner (non-uniformed police staff), Colleges, Town and Parish Councils.

91. The Regulations govern the establishment and administration of the Fund, covering such areas as admission, benefits receivable, actuarial valuation, contributions payable by employees and discretions available.

A ‘new look’ LGPS was introduced from April 1 2008. As a general principle, benefit accrued to 31 March 2008 will continue to be calculated in accordance with the Scheme rules at that date. Details of the ‘new look’ Scheme can be found on the Fund’s website.

In June 2007, the LGPS Regulations were amended to require formally the publication of Pension Fund annual reports and prescribing their content in legislation. The first of these new look reports covered the 2007/08 reporting period and required the report to be published on or before December 1, 2008, and annually thereafter.

The authority must publish the Pension Fund Annual Report on or before 1st December following the year end. In preparing and publishing the Pension Fund Annual Report, the authority must have regard to guidance given by the Secretary of State.

The report should contain:

A	A report about the management and financial performance during the year of each of the Pension Funds maintained by the authority	✓
B	A report explaining the authority’s investment policy for each of those Funds and reviewing the performance during the year of the investments of each Fund	✓
C	A report of the arrangements made during the year for the administration of each of those Funds	✓
D	For each of those Funds, a statement by the actuary who carried out the most recent valuation of the assets and liabilities of the Fund in accordance with regulation 36 (actuarial valuations and certificates) of the level of funding disclosed by the valuation	✓
E	The current version of the statement under regulation 31 (governance compliance statement)	✓
F	For each of those Funds, the fund account and net asset statement with supporting notes and disclosures prepared in accordance with proper practices.	✓
G	An annual report dealing with • the extent to which the authority and the employing authority in relation to which it is the administering authority have achieved any levels of performance set out in the pension administration strategy in accordance with regulation 65(2)(b) • such other matters arising from its pension administration strategy as it considers appropriate	N/A (see below*)
H	The current version of the statement referred to in regulation 35 (funding strategy statement)	✓

I	The current version of the statement under regulation 9A of the Local Government Pension Scheme (Management and Investment of Funds) regulation 1998 (statement of investment principles)	✓
J	The current version of the statement under regulation 67 (statement of policy concerning communications with members and employing authorities) and	✓
K	Any other material which the authority consider appropriate	✓

* Preparation of a Pension administration strategy document is a discretionary requirement.

Investment regulations

92. The Local Government Pension Scheme (Management and Investment of Funds) regulations 2009 came into force on 1 January 2010 and replace the Local Government Pension Scheme (Management and Investment of Funds) regulations 1998. During 2009/10, the Council put in place a separate bank account, in time for the 1 April 2011 deadline stipulated by the regulations. The regulations also stipulate specific ranges for certain investments, which fund managers must comply with. Further details can be found in the Fund's Statement of Investment Principles which can be found on the Fund's website