Lancashire County Council

Pension Fund Committee

Friday, 6th September, 2013 at 10.45 am in The Duke of Lancaster Room (Formerly Cabinet Room 'C'), County Hall, Preston

Agenda

Part 1 (Open to Press and Public)

No. Item

1. Apologies

2. Disclosure of Pecuniary and Non-Pecuniary Interests

Members are asked to consider any Pecuniary and Non-Pecuniary Interests they may have to disclose to the meeting in relation to matters under consideration on the Agenda.

3. Minutes of the Meeting held on 7 June 2013 (Pages 1 - 6)

To be confirmed, and signed by the chair.

4. Exclusion of Press and Public

The Committee is asked to consider whether, under Section 100A(4) of the Local Government Act, 1972, it considers that the public should be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the appropriate paragraph of Part 1 of Schedule 12A to the Local Government Act, 1972, as indicated against the heading to the item.

Part II (Not open to Press and Public)

5. Investment Performance Report (Pages 7 - 18)

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

Lancashire County Council

6. **Investment Panel Report** (Pages 19 - 48)

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

Part I (Open to Press and Public)

7. **Private Equity Strategy** (Pages 49 - 60)

8. **Property Investment Strategy** (Pages 61 - 76)

9. **Consultation on the Future Structure of the Local Government Pension Scheme** (Pages 77 - 94)

10. **Annual Report and Accounts of the Fund - 2012/13** (Pages 95 - 170)

11. **UK Stewardship Code compliance** (Pages 171 - 190)

12. **Fund Shareholder Voting and Engagement Report** (Pages 191 - 246)

13. **Urgent Business**

An item of urgent business may only be considered under this heading where, by reason of special circumstances to be recorded in the Minutes, the Chair of the meeting is of the opinion that the item should be considered at the meeting as a matter of urgency. Wherever possible, the Chief Executive should be given advance warning of any Member's intention to raise a matter under this heading.

14. **Date of Next Meeting**

The next meeting of the Committee will be held on Friday 29 November 2013 at 10.00am at County Hall, Preston.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Lancashire County Council

Pension Fund Committee

Minutes of the Meeting held on Friday, 7th June, 2013 at 11.15 am in The Duke of Lancaster Room (Formerly Cabinet Room 'C') - County Hall, Preston

Present:

County Councillor Terry Burns (Chair)

County Councillors

L Beavers	M Parkinson
D Borrow	A Schofield
M Brindle	K Sedgewick
G Dowding	D Stansfield
J Gibson	D Westley
J Lawrenson	B Yates
R Newman-Thompson	

Co-opted members

Bob Harvey, (Trade Union representative)
Councillor Paul Leadbetter, (Lancashire Leaders' Group representative)
Councillor Mark Smith, (Blackpool Council representative)
Councillor Dorothy Walsh, (Blackburn with Darwen Borough Council representative)

County Councillors G Dowding, R Newman-Thompson, A Schofield and D Stansfield replaced County Councillors S Perkins, J Oakes, K Iddon and P White respectively at this meeting.

Eric Lambert and Noel Mills, Independent Advisers to the Pension Fund were also present.

1. Constitution: Chair and Deputy Chair; Membership; Terms of Reference

Resolved:

That,

i. the appointment of County Councillors T Burns and M Parkinson as Chair and Deputy Chair respectively of the Pension Fund Committee for the 2013/14 municipal year be noted.

ii. the appointment of County Councillors M Parkinson and T Burns as Chair and Deputy Chair respectively of the Pension Fund Administration Sub-Committee for the 2013/14 municipal year be noted.

iii. the membership of the Pension Fund Committee and the Pension Fund Administration Sub-Committee be noted.

iv. the Terms of Reference of the Pension Fund Committee and the Pension Fund Administration Sub-Committee be noted.

2. Apologies

Apologies for absence were received from Councillor Ian Grant and Ron Whittle.

3. Disclosure of Pecuniary and Non-Pecuniary Interests

None.

4. Minutes of the Meeting held on 22 March 2013

The Minutes of the meeting held on 22 March 2013 were presented.

Resolved: That the Minutes of the meeting held on 22 March 2013 be confirmed and signed by the chair.

5. Exclusion of Press and Public

Resolved: That the press and members of the public be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the paragraph of Part 1 of schedule 12A to the Local Government Act, 1972, indicated against the heading to the item. It was considered that in all the circumstances the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

6. Investment Performance Report

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee considered a report on the performance of the Fund as at 31 March 2013, focussing on the key areas of:

- the funding position;
- cash flow;
- investment performance and allocation; and

- risk management of the Fund, including credit, liquidity, investment and operational risks.

It was reported that the Pension Fund had been nominated for the European Innovation (Public Pension Scheme – below £15billion) Award. Officers were congratulated on the nomination.

Resolved: That the report be noted.

7. Investment Panel Report

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee received a report from the Investment Panel setting out the work of the Panel at its meeting held on 1 May 2013. The Committee's attention was specifically drawn to the following key areas:

- The investment context in which the Fund was currently operating particularly in the context of the US economy;
- Investment decisions in respect of credit and fixed income investment strategy, and European property funds;
- Further allocation work i.e. Regulatory Driven and Long Dated Secured Investments, and Infrastructure opportunities; and
- The work being undertaken to develop a Liability and Risk Management Strategy for the Fund.

Resolved:

i. That the report be noted.

ii. That a members' briefing be held on the development of a Liability and Risk Management Strategy prior to the submission of the Strategy for approval by the Committee.

The Committee then returned to the remaining Part I agenda items.

8. Pension Service - Annual Administration Report

The Committee received the 2012/13 Administration Report which set out the Service's performance against the standards and targets contained within the Service Level Agreement (SLA).

It was reported that performance continued to meet, and in some areas exceed, the SLA targets. The Committee welcomed the report and the £0.300m one-off rebate which had been given to the Fund by the County Treasurer following an exceptional underspend in the delivery of Your Pension Fund Service in 2012/13.

Officers were asked to consider the inclusion of a State (personal) benefit statement in Annual Benefit Statements issued by Your Pensions Service. It was noted that information would need to be provided by The Department for Works and Pensions and officers agreed to look into this suggestion.

Resolved: That the 2012/13 Administration Report be noted.

9. Knowledge and Skills Framework

The Committee considered a report on the establishment of an appropriate training programme to ensure that the Committee was able to meet its commitments under CIPFA's Knowledge and Skills Framework which had been adopted on 3 February 2012.

Members and officers of the Fund already possessed some of the required knowledge and skills set out in the framework. However, it was likely that some areas could be strengthened, and it was recommended that a self assessment tool which had been developed by Hymans Robertson in conjunction with the CIPFA Pensions Network be used to identify any knowledge and skills gaps. It was agreed that the process would run as follows:

- access to the web-based training tool to be provided to relevant officers and members for them to engage with the training materials;
- training needs assessment submitted to and returned from officers and members;
- analysis of potential training needs and development identified.

This would be done over the next few months and a training programme for both members and officers would then be developed, incorporating the training materials available in the toolkit, relevant seminars, conferences and internal training days.

Resolved:

i. That the proposed approach to establishing an appropriate member and officer training programme, as set out in the report, be agreed.

ii. That appropriate tools be used to identify areas where the knowledge and skills of both officers and members require strengthening, and that following this, a programme of activity to address any identified development areas be developed and undertaken.

10. Strategy for the Procurement of UK and Local Property Investment Managers and Independent Valuers

The Committee considered a proposed procurement strategy for the appointment of the UK and Local property investment management mandate and independent valuation contracts.

The Committee was informed that whilst aspects of the contracts for the management and independent valuation of the Fund's UK property portfolio had been renegotiated to the advantage of the Fund and a temporary arrangement had been entered into for the Local portfolio, the contracts had not been fully tendered for many years. It was now proposed to fully market test the UK portfolio investment management contract and the contract for the Independent Valuer. This would be undertaken at the same time as seeking an investment manager for the Local portfolio. The new contracts implementation date would be 1 April 2014, or earlier, if practicable.

It was noted that the Local property investment management mandate would look to maximise opportunities from projects such as the City Deal.

Resolved:

i. That the procurement strategy for the appointment of the UK and Local property investment management mandate, and independent valuation contracts, as set out in the report, be approved.

ii. That a report on the results of the procurement exercise be presented to the Committee prior to the appointment of the property investment manager and the establishment of the advisory board.

11. Fund Shareholder Voting and Engagement Report

The Committee considered a comprehensive report on the Fund's shareholder voting arrangements and activity, and engagement activity for the period 1 January to 31 March 2013.

It was noted that the Fund had voted on 421 occasions during this period and had opposed or abstained in 26% of votes.

Resolved: That the report be noted.

12. Internal audit annual report 2012 13 including the audit plan 2013 14

The Committee considered the internal audit annual report for the Fund 2012/13.

Based on the internal audit work undertaken during the year, the internal audit service was able to provide substantial assurance over the internal control environment for the Fund and pension administration.

The Committee also received details of the internal audit plan of work for 2013/14 which amounted to 85 days.

Resolved:

i. That the internal audit annual report 2012/13 be noted.

ii. That the internal audit plan for 2013/14 be approved.

13. External Audit
Lancashire County Pension Fund Annual Audit Plans 2012/13

The Committee considered the External Audit plan and fees for the audit of the County Pension Fund for 2012/13.

Resolved: That External Audit plan and fees for the audit of the County Pension Fund for 2012/13 be noted.

14. Urgent Business

None.

15. Date of Next Meeting

It was noted that the next meeting of the Committee would be held on Friday 6 September 2013 at 10.00 am at County Hall, Preston.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

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Document is Restricted

Pension Fund Committee
Meeting to be held on 6 September 2013

Electoral Division affected: All

Private Equity Strategy
(Appendix 'A' refers)

Contact for further information:
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Executive Summary

The Fund has a long standing private equity programme and as part of its programme of work to review the investment strategy in relation to each asset class the Investment Panel has reviewed the Fund's strategy in relation to private equity, which encompasses a wide range of investments from start ups and venture capital to large scale buy outs.

The report at Appendix 'A' reviews the private equity portfolio, the current strategy and proposes a new private equity strategy, including authorisations required for its implementation.

Recommendation

The Committee is asked to approve the new private equity strategy and the authorisations required to implement it.

Background and Advice

Appendix 'A' is a review of the private equity (PE) strategy, highlighting the nature of its investments, the portfolio's construction and risk management. A new strategy is proposed, which the Investment Panel believes will enhance returns without taking materially greater risk.

Key characteristics of the current private equity portfolio and strategy include:

1. The portfolio is highly diversified, possibly overly diversified;
2. The portfolio has allocated to some products that require less active involvement from the pension fund, but which are more expensive;
3. The portfolio has some allocation to strategies that have historically been more volatile than others, without sufficient compensation for this risk;
4. The portfolio has re-invested a majority of capital with the same fund managers;
5. The fund has committed unevenly on an annual basis;
6. The nature of the relationship between the pension fund and its external fund manager has been passive.

The recommendation for a new private equity strategy requires the following approvals:

1. Confirmation of the PE allocation at 7.5% Net Asset Value (NAV) (not commitments) as a percentage of the pension fund;
2. Formally target PE net Internal Rate of Return (IRR) of FTSE All Share + 3% (with informal use of additional or alternative benchmarks where appropriate, as stated in section 2.2) (the internal rate of return equates to an annualised return on the capital invested);
3. Confirmation of the PE Strategy Limits (set out in section 2.4A);
4. Confirmation of the Concentration Limits (set out in section 2.4B);
5. Authority to purchase individual funds in the secondary market, subject to external advice;
6. Authority to invest in co-investment funds, subject to external advice;
7. Authority to invest in secondary funds, subject to external advice;
8. Authority to make co-investments that replicate those made by co-investment funds that LCPF has committed to;
9. Authority to make co-investments offered by LCPF's primary or secondary PE funds, without external advice, but subject to due diligence from the PE manager offering the co-investment.

Consultations

This strategy has been developed in consultation between officers and the Fund's Independent Advisers.

Implications:

This item has the following implications, as indicated:

Risk management

Private equity is illiquid and increasing the allocation from 5% of assets under management (AUM) to 7.5% reduces liquidity on these additional assets. This is compensated by the potential for superior returns (i.e. an illiquidity premium).

The new strategy proposes allocating more capital to fewer funds, thereby reducing diversification. However, these investments may be shared across a wider range of managers. It is the opinion of the Investment Panel that the portfolio risk will not be materially higher.

Co-investing in individual deals alongside a fund manager risks negative selection bias, whereby the fund managers offer co-investments in the less attractive opportunities. This risk appears modest and is offset by the fee reduction.

Changes in the strategy are expected to be gradual over a number of years, such that there will be no sudden changes in the portfolio.

Financial

The proposed increase in the allocation to private equity will be financed by a reduction in the allocation to public (listed) equities.

Any identification of investment opportunities without the assistance of the external fund manager/adviser is likely to result in lower fees.

Any co-investments are likely to be undertaken without paying significant fees to the fund manager or consultants.

A more active management of relationships with external advisers has the potential to reduce fees and/ or improve returns on investments, and is likely to provide access to a range of better opportunities and this is already becoming apparent as a range of opportunities for investments with different managers, or managers with whom LCPF has only previously dealt through a fund of funds route are now being brought forward for the Fund's consideration.

Local Government (Access to Information) Act 1985
List of Background Papers

None

Reason for inclusion in Part II, if appropriate

N/A

Private Equity Strategy

1. Overview of the Current Private Equity Portfolio and how it is Managed

1.1 Overview of Current Portfolio

The LCPF private equity (PE) fund has NAV (net asset value) of approximately £250m, which equates to 5% of the total £5bn pension fund, as at June 2013. This is invested across 28 different managers, in 69 funds and gives exposure to over 1000 underlying companies. The capital has been committed with the support of Capital Dynamics:

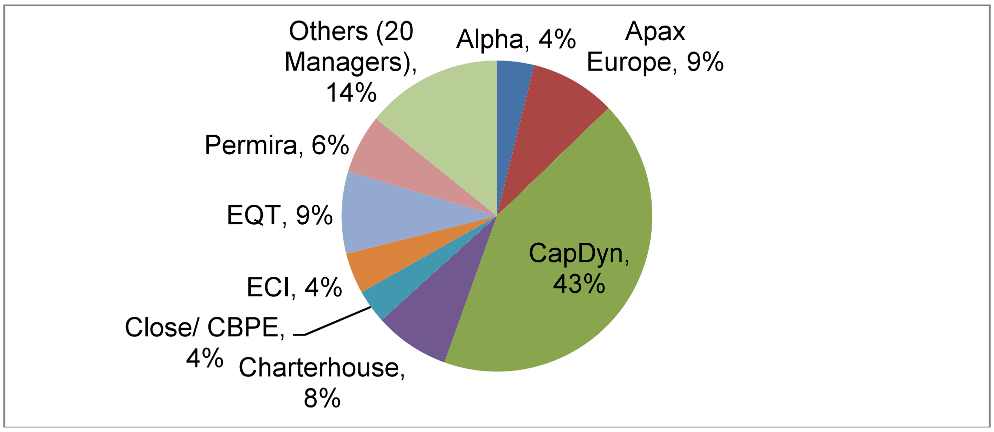
How LCPF Has Invested its Assets

NAV (at 31 August 2013)	**No. of Managers**	**No. of Funds**	**Comments**
Primary Funds New funds with no investments at the time of being committed to	27	57	Funds Identified by Capital Dynamics
Primary Funds of Funds FoF manager identifies new funds with no investments at the time of being committed to	1	9	Funds Managed by Capital Dynamics
Co-Investment Fund Manager invests alongside PE managers	1	1	Managed by Capital Dynamics
Secondary Fund Manager buys older Primary funds, from current investors, which are >50% already invested	1	1	Managed by Capital Dynamics
Direct Investment Red Rose		1	Identified by Capital Dynamics
Total	**28**	**69**	

The vast majority of LCPF's exposure is to buyouts of companies located in developed western markets. This is the main arena for global private equity. It also has some exposure to venture capital, to Asian funds and to non-primary funds.

85% of the current NAV exposure is concentrated in 25% of the managers, though this does not fully consider the diversification from funds of funds (see chart, below):

LCPF Exposure by PE Manager (Net Asset Value, 31 Aug 2013)



The chart above classifies all Capital Dynamics funds together. This includes CD funds of funds, which are diversified across many underlying managers. The risk relating to Capital Dynamics is diversified across more managers than it might initially appear.

1.2 Fund Types in the PE Portfolio

Individual Primary Funds
LCPF's individual primary funds are identified by Capital Dynamics, with a one-off finder's fee paid. Fees are also paid to the primary fund managers, typically 2% p.a. and 20% of profits ('carry'). The finder's fee is relatively inexpensive, compared to funds of funds and allows LCPF to leverage off Capital Dynamics' research.

Primary Funds of Funds
LCPF has committed to 8 primary funds of funds (FoF), covering USA, Asia and Europe; in buyouts and venture capital. The FoF manager then commits to around 15 primary PE funds. The advantage is greater diversification and also devolution of investment decisions to a third party. The main risks are an additional layer of fees (approximately 1% p.a. mgt/ 0%-10% carry) in addition to primary manager fees.

Co-Investment Fund
LCPF has committed to one co-investment fund, managed by Capital Dynamics. This invests in around 15 companies, alongside private equity managers. An attraction for LCPF is lower fees than a primary fund (approximately 1% p.a./ 12.5% carry). Return potential appears broadly comparable to a primary fund. Risks include reduced access to the many investments that PE managers choose not to co-invest; and a risk of negative selection bias (PE funds offering co-investments in companies that they perceive as less attractive)

Secondary Fund
LCPF has committed to one secondary fund, managed by Capital Dynamics. This invests in PE funds that are at least 50% already invested. Attractions of a secondary fund for LCPF include the greater certainty of the funds' final performance; diversification; secondary funds are often bought at a discount to NAV; and avoidance of early years' annual management fees. The negatives are a double fee layer (approximately 2% p.a./ 20% to the PE manager and 1% p.a./ 10% to the secondary manager). The net result is expected to be moderately lower risk and (sometimes) lower return when compared to primary fund investing, with an attractive risk-adjusted return.

Direct Investment
LCPF has invested in one company directly, Red Rose. This was originated by Capital Dynamics. Red Rose is lower risk quasi-infrastructure, without the gearing typical in PE.

A summary of the typical industry fees paid for different fund types is below. Actual fund fees vary by provider and date (sometimes at half these official rates):

LCPF Current PE Portfolio Exposure by Investment Structure

Data at 31 August 2013	One-Off Fees	Annual Fees		Carry		Funds Held	Underlying Cos Invested In	% of NAV + Undrawn Commitments	Comments
		PE Mgr	FoF Mgr	PE Mgr	FoF Mgr	est.	est.		
Primary Funds	0.50%	2%		20%		1	15	66%	
Primary Fund of Fund		2%	1%	20%	0% to 5%	10 to 20	150	18%	
Co-Investment Fund		1%		12%		1	10 to 20	4%	
Secondary Fund		2%	1%	20%	10%	10 to 20	150	5%	Shorter life, less mgt fees
Direct Investment		n/a		n/a		n/a	Red Rose	7%	

Fees are approximation of industry averages, not actual fees paid by LCPF

1.3 The Nature of LCPF's Relationship with Capital Dynamics

LCPF established a private equity business relationship with Crossroads Ltd in September 1998. The relationship was governed by a broadly worded contract that defined Crossroads similarly to a discretionary fund manager, setting strategy and managing daily operations.

When Crossroads was acquired by Capital Dynamics, in 2004, the relationship was maintained, with the original contract not revised.

In practice, Capital Dynamics recommends funds for LCPF to invest in, with LCPF investing in all funds recommended to date.

1.4 PE Portfolio Performance

The benchmark used to evaluate the PE portfolio is FTSE All Share (Total Return). In addition, an informal comparison is made to the British Venture Capital Association (BVCA) PE benchmark top quartile fund average return.

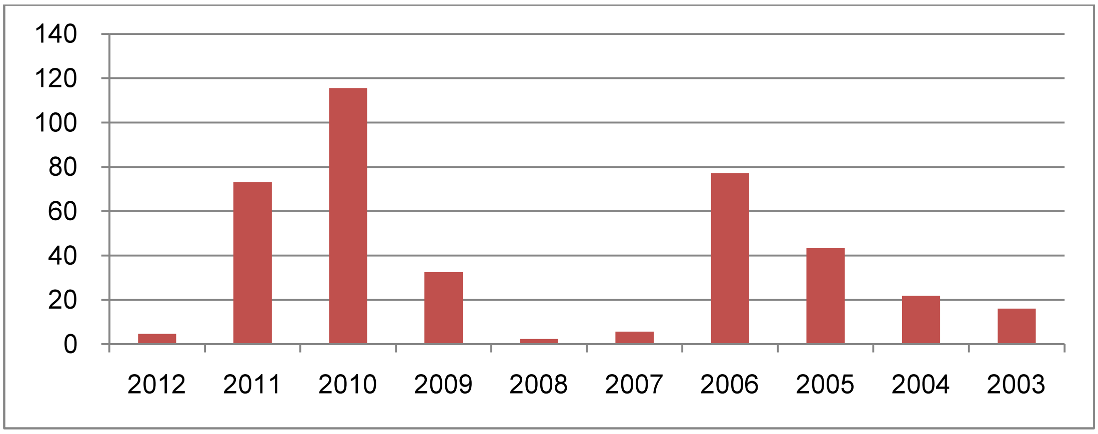
Since inception the reported PE portfolio net IRR is approximately 13%, which represents a 3% premium to the FTSE All Share. For comparison, this equates to an average return of 1.5x capital invested (i.e. a 150% return achieved over a 10-13 year fund life).

Asset Allocation and Risk Management

Since 1998, LCPF has committed to 54 funds through 18 managers. However, a small number of these managers are disproportionately large. 80% of capital was committed to half the managers; 35% to one (Capital Dynamics; though this includes funds of funds that are then invested in many fund managers).

In addition, capital was not committed in equal amounts every year. The largest committed in any year was £115m and the smallest £3m. This might imply some manager specific risk and market timing risk.

Annual Commitments to Private Equity by LCPF (£m)



1.5 <u>External Consultant's Opinion</u>

LCPF commissioned a review of its portfolio at June 2011 by consultant BFinance. Key conclusions included:

- LCPF is overdiversified. 30 funds is sufficient;
- There is a large number of recent fund of funds, which leads to higher fees and a delay in return generation. This is regarded as unusual as investors often use FoFs as a first step before investing directly. LCPF has 'regressed' in the opposite direction;
- Reliance on a few well known brand name PE managers, possibly missing out on less well known names;
- A focus on European buyouts, possibly missing opportunities elsewhere;
- More resources should be used to find better funds and negotiate better terms;
- LCPF could find ways to lower fees, such as through direct co-investments.

2. Future Private Equity Strategy

2.1 <u>Target PE fund Size</u>

NAV as % of Pension Fund	7.50%

It is recommended that LCPF targets a private equity portfolio NAV equal to 7.5% of the pension fund, up from 5%. Long term PE investing is well suited to a long term pension fund that can accept the illiquidity.

Due to time delays between capital being committed (by LCPF) and invested (by the PE manager) of up to 5 years, commitments have to be around 2x to 2.5x the target NAV. There is a risk that commitments will be drawn by PE managers faster than forecast, or current investments will be exited slower than forecast. In both situations, cash flow will be negative and the fund NAV will rise more than forecast.

Capital Dynamics has suggested annual commitments of between £100-120m p.a., of which around two-thirds will sustain the historic 5% commitment and a further third to grow this to 7.5% of the Pension Fund.

2.2 Target Return

LCPF expects a private equity return in excess of the U.K. stock market, as compensation for the greater illiquidity and potential volatility.

- Formally target annualised return ('Net IRR') of FTSE All Share + 3%
    - 3% is a minimum risk premium, with 6%-8% an achievable 'stretch' target;
    - This is expected to equate to a net IRR of 10% to 15%;
    - A PE fund is considered successful if it is rated in the top quartile of funds with a similar vintage and strategy;
    - Use alternative fund benchmarks, as appropriate, for funds that can be shown to warrant this.

2.3 Risk Management

Key risk drivers have been identified in the table below. These were considered in setting the Strategy Limits.

Risk Driver	Importance	Risk Management Solution	Return Consideration
Market direction	High	Invest equally on a three year rolling basis, to avoid market timing	Avoids buying at the top and selling at the bottom
Fund strategy risk	High	Focusing on lower risk/ higher return developed market buyouts. Limit exposure to higher risk/ (sometimes) lower return venture capital	Risk and return are aligned, but good funds can still be found in strategies with poor average returns. No strategy is off-limits.
Company specific risk	High	Diversify across 40-80 funds, resulting in exposure to c.400-1200 underlying companies. Implies 5-10 new funds per year.	Need to avoid over diversification reducing returns. Marginal risk/return benefit falls as diversification increases (is your tenth choice fund as good as your first?)
Manager risk	High	High Risk: Favour managers with strong records, as evidence of persistence. Medium Risk: Be wary of relying too much on a single manager, especially for primary funds.	Risk and return is aligned. LCPF manager also has autonomy to commit to younger managers if returns warrant additional risk
Sector risk	Medium	Diversification across multiple generalist funds creates a sector diversified portfolio. Exposures should be monitored	Sector diversification helps reduce volatility. Do not expect this to reduce returns.
Country or region risk	Medium/ Low	Focus on developed markets, where returns are less variable than emerging markets. Prefer U.K. liabilities to be matched by U.K. assets if returns are equal.	Good companies in a weak or volatile region should still perform strongly. No region or country is off-limits to fund manager.

2.4 PE Strategy Limits

We set strategy limits that reflect the market and also give LCPF the opportunity to be over/ under weight the market (see table, below). In addition to formal limits, informal guidance is given, to aid risk management.

A. PE Strategy Limits (by Fund Type and Geography)

	Assume Pension Fund Value (£m) 5,000	% of PE Allocation		% of Pension Fund		Example for £5bn Pension Fund (£m)	
		Min	Max	Min	Max	Min	Max
	Fund Type		100%		7.5%		375
1	**Buyouts (LBOs)**	70%	100%	5.25%	7.50%	263	375
2	**Venture Capital (VC)**	0%	10%	0%	0.8%	0	38
3	**Other PE Sub-Classes**	0%	20%	0%	1.5%	0	75
3.1	Max in Any Single Sub-Class	0%	10%	0%	0.8%	0	38
	Geography						
	Europe (incl. U.K.)	50%	75%	3.8%	5.6%	188	281
	Non-Europe	25%	50%	1.9%	3.8%	94	188
	Developed Markets	90%	100%	6.8%	7.5%	84	188
	Emerging Markets	0%	10%	0%	0.8%	0	38

"Emerging Markets" are as defined by MSCI or FTSE listed indices

Primarily, the best and most consistent returns have been in developed market buyouts. There are periods when this has not been the case and the allocation limits enable the LCPF to adapt to market changes.

The central expectation is to commit the vast majority of capital between Europe and North America, with a bias to buyouts.

Supporting Guidance on Private Equity Strategy Limits

- Venture capital is expected to be not more than 10% of the PE fund
    - Average returns are mostly poor and volatile, but there are periods of strong performance, as well as individually strong managers.
- Emerging market funds are expected to be not more than 10% of the PE fund
    - Emerging market returns in this area have not been sufficient to warrant the risks, though this may change.

B. Concentration Limits (by Fund Structure)

Limits on the concentration by fund structure are proposed (see table, below), with the aim of ensuring a minimum level of diversification, but discouraging over diversification. These limits reflect the different risk profiles of the different forms of investment and are set in two dimensions, the first in relation to limits on the new commitment that can be made each year (thus the maximum that could be committed to new primary funds in a year is 25% of the total new commitments). The second dimension is limits within the total PE portfolio where for example no more than 50% of the total portfolio should be in secondary funds.

Concentration Limits by PE Fund Structure

Commitment Limits per individual PE Fund (as a % of annual PE commitment target)	Target	Min.	Max.	Total PE Portfolio Limit (% of NAV)
Primary Fund	15%	7%	25%	100%
Co-Investment Fund	15%	7%	25%	40% incl Direct
Primary Fund of Fund	20%	10%	30%	50%
Secondary Fund	20%	10%	40%	50%

Direct Co-Investments by LCPF in individual companies (as % of the original fund's investment)		20%	100%	40% incl Co-Investment Funds

The central expectation is to commit to 4-6 funds per year, mostly primary, allowing for larger commitments to more diversified funds of funds. In addition to initial commitments to funds, direct co-investments are allowed in individual companies that are held by LCPF's funds.

3. Transition from Current Private Equity Portfolio to Future Portfolio

The transition to the new strategy will take place gradually by investing future commitments in line with the proposed new strategy.

It is not intended to make a single bulk commitment to increase PE exposure from 5% of pension fund NAV to 7.5% but instead increase annual commitments to achieve an equal exposure to all future vintages.

We may support this by purchasing funds in the secondary market to gain greater exposure to past vintages ('back filling'). This enables a faster move from 5% NAV to 7.5%. This will depend upon both the price and performance of the relevant funds.

Commitments will be made with the aim of improving returns or lowering costs. This may include:

- Avoid primary funds of funds and instead commit directly
    - This confirms the way most capital is already invested;
    - A fund of fund might be acceptable as a way to gain access to a fund manager's research, or in a niche that LCPF can not easily access through direct primary funds;
- Conviction investing rather than a diversified market proxy
    - More actively engage with all LCPF's advisers to source best ideas;
    - Moving to a more concentrated portfolio will be gradual;
    - Decision on size of individual fund commitments is with the LCPF.
- Source investments from a broader range of fund managers and advisers
    - Reduces concentration risk of current limited relationships;
    - Investments not originated by Capital Dynamics are unlikely to be monitored by them and will therefore require closer monitoring by LCPF.
- Increase exposure to co-investment funds
    - This is a continuation of the existing co-investment strategy;

    - Can offer a similar return to primary funds, at a lower cost.
- Make co-investments directly alongside LCPF's external co-investment funds
    - Where available, LCPF may directly invest in the same co-investments as its external co-investment fund. The timeliness of co-investing does not allow for external consultant advice, so reliance is placed in the co-investment manager.
- Make co-investments directly in existing LCPF primary or secondary funds, without an adviser;
    - The underlying fund would have already been evaluated by an adviser.
- Increase investments in secondary funds, where appropriate
    - This is a continuation of the existing secondary strategy;
    - Where available, LCPF may directly invest in the same underlying funds as its external secondary manager, without seeking external consultant advice placing reliance on the manager's research.
- Make direct investments in companies, where available (longer term goal).

Request for Authorisation

To achieve the stated aims, the following is requested:

- Confirmation of the PE allocation at 7.5% NAV (not commitments) as a percentage of the pension fund;
- Formally target PE net IRR of FTSE All Share + 3% (with informal use of additional or alternative benchmarks where appropriate, as stated in section 2.2);
- Confirmation of the PE Strategy Limits (set out in section 2.4A);
- Confirmation of the Concentration Limits (set out in section 2.4B);
- Authority to purchase individual funds in the secondary market, subject to external advice;
- Authority to invest in co-investment funds, subject to external advice;
- Authority to invest in secondary funds, subject to external advice;
- Authority to make co-investments that replicate those made by co-investment funds that LCPF has committed to;
- Authority to make co-investments offered by LCPF's primary or secondary PE funds, without external advice, but subject to due diligence from the PE manager offering the co-investment.

Pension Fund Committee
Meeting to be held on 6 September 2013

Electoral Division affected: None

Property Investment Strategy
(Appendix 'A' refers)

Contact for further information:
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Executive Summary

The Fund has a long standing property portfolio and as part of its programme of work to review the investment strategy in relation to each asset class the Investment Panel has reviewed the Fund's strategy in relation to property in the context of the Fund's overall investment strategy and the report at Appendix 'A' sets out the strategy which the Panel recommend is adopted going forward.

Recommendation

The Committee is recommended to approve the strategy for property investment as set out at Appendix 'A' and in particular:

a) The target long term absolute return target of 8% per annum.
b) The split of the total property allocation between a diversified core portfolio representing 70%-80% of the allocation and a specialist / opportunity portfolio representing 20%-30% of the total allocation.
c) A limit on the gearing in funds in which the allocation can be invested of 50%.

Background and Advice

As part of the ongoing programme of developing specific investment strategies for each asset class the Investment Panel has considered a revised strategy for property investment which is set out in Appendix 'A'.

This strategy brings the investment approach for this asset class in line with the investment strategy for the fund as a whole in seeking to look more globally, to look to achieve longer term stable returns and to seek out "best ideas".

The most significant changes to the current approach are in terms of the proposal to split the portfolio between what is in essence the current diversified core approach and a new specialist / opportunity allocation. The diversified core allocation will use fund investments to gain geographic diversification, while the specialist / opportunity

Lancashire County Council

allocation will use fund investments to take advantage of the expertise of particular firms in delivering return in these areas.

Increasing investment in property through the Fund route will expose the Fund to the effect of leverage (that is borrowing by the manager of the fund in order to support their programme of activity). While this is not something the Pension Fund would look to engage with in other investment settings it is common in property funds and a limit on the level of gearing to which the Pension Fund might be exposed in any individual investment is proposed.

The other significant change is to set an absolute target for longer term performance rather than solely use an index relative target, although this will be maintained for short term measurement purposes. The 8% net return per annum used for the infrastructure portfolio is recommended as the appropriate level for this longer term target.

Consultations

This strategy has been developed through a process of consultation between the Investment Team and the Fund's existing property manager, and the Fund's Independent Advisers, prior to it being endorsed by the investment panel.

Implications:

This item has the following implications, as indicated:

Risk management

The proposed strategy seeks to address the key risks that exist in the current property investment approach which derive from geographic concentration and sectoral concentration, that is properties in the same place of the same type, through creating opportunities for both geographic diversification and investment in a wider range of different types of property, building on the existing core of direct property holdings.

Local Government (Access to Information) Act 1985
List of Background Papers

None

Reason for inclusion in Part II, if appropriate

N/A

Appendix A

PROPERTY INVESTMENT STRATEGY

1. Introduction

1.1 This report presents an investment strategy for the main property portfolio of the Fund discussing the broad categories of investment to be targeted by the Fund.

1.2 This property investment strategy is built on the Fund's overall investment policy for property:

"Property is a good diversifying asset. However, by restricting itself to UK property the Fund limits its ability to access the benefits of growth in the world economy. While UK property investment is likely to continue to be direct it is likely that it will be easier to gain the relevant exposure to appropriate overseas property through buying unitised products." (Investment Allocation Strategy approved by Pension Committee Dec 2010).

1.3 At its simplest property is an investment in a piece of land or a building giving the investor a return as rental income and/or capital value growth. Capital growth may come through time holding the asset and/or be driven by asset management initiatives and development.

1.4 Property investment returns are attractive to pension funds in that they provide a combination of a bond-like rental income return (modest risk-return) and an equity-like capital growth component (higher risk-return). The IPD UK Monthly Index over 20+ years has recorded an overall return of 9.3% per annum, of which 7.2% is income return and 2.1% capital return. The rental income component of the return has typically been stable while the capital growth element has proved to be volatile.

1.5 Risks and returns in property investment come both at a market level and from individual asset choice. The choice of country and region and the choice of property sector influence the risks and returns being run. High growth economies offer the potential of property values increasing in line with higher rates of growth in GDP, but they may also represent higher risk with anticipated future growth already factored in prices being paid. At an individual asset level, there are asset specific risks and opportunities. The property manager has the opportunity to add value through initiatives to improve buildings and manage the tenant roster. Asset specific events, such as the loss of an important tenant, illustrate the risks at an asset level.

2. The Fund's Property Investment Strategy by category

2.1 The Fund's investment strategy envisages 10% to 20% of the value of the Fund being invested in diversified property, being UK and overseas, and using both direct and indirect routes.

2.2 This paper does not propose what overall property allocation should be put in place. This is a role for the Investment Panel after reviewing the risk and return profiles of all investment classes.

But the following considerations are relevant:

- With bond coupons historically very low, the property rental return of over 5% per annum is an attractive return, especially if based on leases with some inflation linkage.
- Having gone through the boom and bust of 2005 to 2009, property values now appear to have stabilised and returned to their long-term trend values.

With the current investment climate generally supportive of property investment, a mid-range allocation of 15% has been assumed for this paper.

Return characteristics of property investments

2.3 The two components of property investment returns (rental income and capital growth) are very different.

2.4 The bond-like rental income return is stable and reliable showing little volatility. Over 25 years the rental component of the IPD UK monthly index it has never exceeded 10% per year nor dropped below 5% per year.

2.5 Rental income also has a linkage with inflation. In some leases, this may be expressed contractually with rents increasing with inflation, albeit with caps and collars to the increases. With others, the triennial rent reviews will tend to follow inflation, but this is not always the case. In difficult economic times, rents tend to fall on re-letting. It is also expensive to hold property empty. For example, in the UK business rates are payable by the landlord on vacant properties. This drives landlords of properties typically in secondary locations with little tenant demand, to let them at whatever price they can just to avoid business rates. This fulfils the objective of releasing as much property as possible for occupation, but means that rental income and consequent capital values become much more volatile in secondary locations.

2.6 The equity-like capital growth component of property returns is very variable and volatile. Real property prices do not show the rapid price fluctuations of quoted equities, but on a longer time scale, price movements can be just as severe. The 2.1% per annum long term UK capital growth component quoted in the introduction hides years of boom and bust. Extraordinary growth of 20% to 30% per year was recorded on 1987, 1988, 1994 and 2005 to 2007. These periods were followed by busts with years of falling prices. In 2008 and 2009 values fell -20% to -30% each year.

2.7 Asset management and development activity can drive property returns in a manner less correlated with general property market/index returns, but such activity also involves an acceptance of the risks attached to such activities.

2.8 Capital values of commercial property fluctuate significantly depending on the security of the rental income. Like bonds, prices depend on the covenant strength of the issuer and the length of the lease contract. Unlike bonds, the rental income can be turned on and off as leases are issued and terminate.

The value of an office block in a secondary location, for example, can fall as much as 30% if a tenant decides not to renew a lease. Correspondingly it will rise again if a new long-term tenant is signed up. A typical private equity property strategy is to seek out buildings that are vacant or with short leases, then refurbish some parts, re-let and re-gear the leases, then sell realising the capital appreciation embedded in the new longer leases.

2.9 In practice, property investment can be structured to create a range of different risk/reward profiles from stable bond-like annuity income performance to volatile equity-like development returns.

Country property risks and returns

2.10 Different countries display very different property returns. This may be part timing in that volatility in capital values tends to move in cycles between optimism and pessimism, so the starting point of the measure can influence the return.

2.11 There is also a linkage with the economic prosperity of the country. Property prices are affected by macro-economic factors such as GDP and the availability of credit and investment as well as country-specific factors. Among the various macroeconomic factors, GDP is important with research by the Bank of International Settlements suggesting it is "a dominant influence on commercial property prices".

2.12 Property Total Returns by country have been tracked by IPD indices (in local currency) for some time, for example as follows:

Country	Total Return pa	Over
	% p.a.	
South Korea	11.0%	7 years
France	6.28%	10 years
UK	5.52%	10 years
Japan	4.98%	8 years to 2010
US	4.56%	10 years
Germany	2.87%	10 years

The figures are presented to illustrate the variability of country returns between countries. Figures are presented for South Korea as a proxy for developing economies with faster growing GDPs as it is the only emerging country for which an IPD index is available.

2.13 UK Property returns have been comparable with returns in all the major developed economies, but in recent years have lagged property returns seen in faster developing economies, as illustrated by the example of South Korea. It does not follow that buying properties in countries with higher GDPs will necessarily produce higher property returns. For example, the faster growth in rental income expected in a higher growth country may already be factored in the property valuations there. If that growth rate is not sustained, then property values might well suffer disproportionately. The variability of returns emphasises the need to create a diversified portfolio of country returns with the opportunity to be over-weight in regions where property values are expected to grow the fastest.

2.14 In terms of price volatility, the UK Property market has shown the most volatility of any of the markets in terms of prices rising during the credit-fuelled boom of 2005 to 2007. Other markets show less of a valuation bubble, with the German market not showing any bubble effect at all.

2.15 Property or Real Estate usually involves owning physical property directly or indirectly in the countries concerned. Political and administrative stability and the rule of law are therefore also important considerations and unlike traded stocks, markets and pricing in the market can be very opaque.

2.16 Jones Lang Lasalle publish a detailed scoring of countries' transparency of their property markets based on ratings for performance measurement, market fundamental data, governance of listed vehicles, regulatory and legal processes, and transaction process. Countries are banded as highly transparent, transparent, semi-transparent, low and opaque (See Annex 1).

2.17 If a manager is looking to invest in property internationally, transparency scoring is a tool that may be used to determine a universe of investible countries with acceptable political and administrative risk.

2.18 When considering property investment overseas, the tax position also needs to be taken into account as it may be very different from the UK. Property taxes differ between countries for all investors, for example, rates of stamp duty taxes. With foreign ownership of property being a sensitive political issue, some countries impose irrecoverable withholding taxes and other levies on property income going to foreign investors (e.g. the US FIRPTA tax rules and Australian capital gains tax on property). These taxes would not be incurred on an equivalent investment in the UK, so a balance must be struck between the benefits of diversification and additional costs involved.

2.19 Investing outside the UK in property just as for all other investment classes involves taking currency risk as the assets will be denominated in local currencies. This paper assumes that currency risks will be appraised and managed on a Fund-wide basis, not separately for the property portfolio.

<u>Property investment structures</u>

2.20 Property investment and divestment is expensive. Acquisition costs are typically up to 5% of the cost of a property and selling costs can be 2%, so it is not an investment class to be traded into and out of in the short term.

2.21 As with quoted equities, property can be held directly or indirectly. Unlike equities, given the size of the individual lot, direct ownership of property is only really open to larger investors, such as the Fund.

2.22 Indirect exposure to property can be through private funds or listed vehicles. Private funds can be open-ended or closed with a pre-determined life span and are valued according to the net asset value (NAV) of their properties. The value of listed vehicles is determined by the market so while correlated with the net asset value, it is subject to another level of volatility reflecting investor sentiment at the time to the market, to property in general and to the company particular.

2.23 Direct and indirect investment routes both have a place in a portfolio of property assets depending on circumstances. The following table sets out some of the factors to take into account when deciding on the route to follow:

Direct investment	
Advantages	**Disadvantages**
Control, over acquisitions, disposals, management initiatives, risk profile, gearing. Cost effective and tax efficient (management costs less than 0.5% per year)	Requires more in-house management Requires scale to achieve acceptable diversification. Need to source and appoint professional advisers directly. May require establishing own foreign holding company structures.
Indirect investment	
Advantages	**Disadvantages**
Buying into existing portfolio (open ended or secondary acquisition of closed fund). Brings quick allocation to countries/markets selected, diversification of buildings and tenant covenants, possible acquired at a discount to net asset value. Expertise and professional resources of fund manager. Greater diversification of buildings and tenants. Little in-house management burden Can commit smaller sums	Existing portfolios may have legacy issues, e.g. potentially onerous covenants agreed when competing to purchase. Lack of liquidity, closed end funds are illiquid for life of fund (upto 10 yrs) except as a secondary sale (often only possible at a discount to NAV. Open ended funds can be locked up, redemptions can take years. Lack of control. Possible lack of alignment of interests of different investors. Funds flows drive timing of acquisitions and disposals. Pressure from investors to get commitments invested. Most saleable (i.e. attractive) assets may be sold to meet redemptions. Closed end funds need to dispose of

	properties in a fixed window in time. Costs, higher management costs and less tax efficient (management costs in range 1% to 2.5% per annum). Funds may also have significant performance fees or carry of structured as private equity. Exposure to gearing without control except broad range permitted in fund regulations.

2.24 The use of listed investment companies for indirect investment may remove the issues of illiquidity but brings in significant volatility in returns dependent on market sentiment. In the long term, listed company returns are comparable to private fund returns, but actual returns may be greatly influenced by the timing of the investment.

The Investment Strategy

2.25 The aim of the Property Investment Strategy is to deliver solid, reliable property returns to the Fund through a diversified portfolio of investments. It aims not only to reduce volatility by seeking exposures across property sectors and geographies but also offer the prospect of higher returns through appropriate diversification and specialist/opportunity investment.

2.26 It is proposed that the aim of the property portfolio should be to deliver an absolute return to the Fund rather than track a particular property benchmark. Such an approach promotes long term value decision-making over shorter term drivers to meet a particular index benchmark performance. However, the volatility of returns means that evaluation of performance against an absolute return benchmark is most meaningful when undertaken over longer periods of time.

2.27 For performance reporting purposes, it is proposed that an absolute benchmark of 8% per year is used, the same as for the infra-structure investment allocation. In judging the results of individual constituents of the property portfolio, especially in the shorter term, then specialist property benchmarks may be used.

2.28 As the absolute benchmark reporting will only become meaningful after a number of years, it is proposed the performance of the property portfolio is also measured against the existing broad IPD UK property index. This performance measure will also measure the value of adding diversity into the property portfolio beyond the existing direct UK portfolio.

2.29 The portfolio construction will be influenced not only by the net returns available, but also by the correlation and volatility of returns across sectors and geographies. The value leakage between gross and net returns needs to be taken into account because it varies significantly depending on the investment route chosen

Proposed property allocations

2.30 It is proposed that the mainstay of the property allocation should be to a core property portfolio with additional investments seeking some diversification and higher returns. Where core strategies might have an IRR of 6-8% per annum, the specialist income/opportunity strategies would be expected to return IRRs of 8-12% per annum:

	Banded ranges		Example £m
Value of Fund			5000
Percentage allocation to property			15%
Total Property Allocation			750
Diversified Core Portfolio	Range	70% to 80%	525 to 600
Specialist / Opportunity Portfolio	Range	20% to 30%	150 to 225

This combination of core and specialist holdings offers the prospect of at least achieving the 8% per annum absolute return benchmark proposed if not exceeding it.

3. The Diversified Core Portfolio

3.1 The Diversified Core Portfolio is proposed to be between 70% and 80% of the property allocation.

Definition of Core Property

3.2 Property professionals place property in bands in terms of its risk and return characteristics as Core, Core +, Value Added and Opportunity. This describes the quality of construction, the location, the length of lease and quality of the tenant. For the Fund's portfolio Core is taken to be Core and Core + property.

3.3 Core property is the very best property in leading locations typically with tenants with high quality covenants holding long leases. Core + properties are similar properties but in slightly less favourable locations, slightly shorter leases and weaker tenant covenants.

3.4 Rental yields are lowest with Core properties, but they may be considered as being the safest stores of value and offering the prospects of both steady rental and capital growth, making them appropriate mainstream investment assets for a pension fund seeking long term secure growth. Some long leases have explicit inflation linkage.

3.5 Even with core property, the property investment manager needs to be active and pursue asset management opportunities within the portfolio to maximise the value of the properties.

Existing Core Portfolio

3.6 The Fund currently has a £434m direct UK property portfolio comprising 44 properties managed by Knight Frank under an advisory mandate. It is invested in Core and Core + property and represents around 9% of the Fund. With projects underway and under late-stage consideration the portfolio will increase to £460m. Since inception in 1988, it has performed to its IPD benchmark.

3.7 In addition the Investment Panel has approved £125m for investment in two European core property funds, Invesco £50m and M&G £75m. To date £40m has been invested/committed to M&G, £25m through secondary purchases (reducing the entry cost) and £15m committed to new units (as yet uncalled). A commitment to Invesco has yet to made.

Proposed Core Portfolio

3.8 The proposed core portfolio represents 70% to 80% of the Fund. Taking the mid-range at present, this represents a portfolio of £563m.

3.9 To create a diversified core portfolio, the Fund needs to seek diversification both across geographies and across property sectors. Management of the portfolio involves targeting geographies and sectors most likely to produce the consistent long-term absolute returns required by the Fund. Given the high cost of property acquisition and disposal, investments are anticipated to be for the long term.

3.10 In seeking returns across geographies, the Fund needs to look to country core property returns that show little correlation between themselves and the prospects of returns in excess of the UK. M&G, for example, run their European Property Fund and an Asian core property fund. The Asian fund is marketed on the basis that it provides core property returns that show little correlation with the core property returns of UK and Europe.

3.11 Diversification may also be gained by looking across property sectors. The present portfolio is based on a mix of commercial property (offices, industrial premises, retail, retail parks, logistics and hotels). Other property sectors, for example, residential and agricultural, offer the prospect of stable returns not so correlated with commercial property. Residential property investment returns have been particularly stable compared with the volatility of commercial property values through the global financial crisis. Residential property investment has long been a significant part of overseas core property funds and the present return to longer term renting in the UK is opening up this sector to institutional investment again.

3.12 A possible route to achieving diversification across property sectors and geographies is through the use of derivatives rather than acquiring actual property. There are a number of brokers offering or looking to offer derivatives that pay property index returns. At the moment there are some total UK market instruments and proposals to launch property sector specific instruments. The difficulty with property derivatives is that they tend to be traded in very low volumes so can suffer illiquidity, though this is less of concern if held to maturity. While there may not be an immediate role for property derivatives in the Fund, it is an area that should be kept under review, particularly if country property return derivatives became available.

3.13 The total value leakage between gross and net returns is also an important factor that needs to be taken into account when building a diversified core portfolio. It gives UK investment and direct investment, in particular, an intrinsic advantage over indirect funds, which suffer higher management costs and tax charges. Taking recent results, the UK Direct portfolio produced a gross return of 5.6% per annum and a net return of 5.00% per annum. Based on recent accounts from the Invesco and M&G European Property Funds, in order for the Fund to receive the same net annual return of 5.00%, the Invesco European Property Fund would have to have to achieve an annual gross return of 7.33% and the M&G European Fund a 6.8% annual gross return (Annex 2). With core returns expected in the 6% to 8% per annum range, the 1% to 1.5% annual gross return differential that an indirect overseas fund must achieve just to match the direct UK portfolio is a significant challenge to the fund manager.

3.14 One way that a manager may boost returns is through the use of gearing. If you can buy a quality real estate asset with a long lease and a good tenant covenant at a rental yield of 7% per annum, then if you can fund a part of the acquisition with debt paying say 4% per annum then gearing of this sort appears attractive provided volatility of returns stays within acceptable bounds.

3.15 Gearing is commonplace in property funds to boost returns:

Fund	Gearing Loan to Value (LTV)	Annual return on gross asset value	Annual return on net asset value
M&G European	23%	6.1%	6.6%
Invesco European	37%	3.9%	4.5%
M&G Asian	17%	7.5%	7.8%
Invesco Core US	10%	5.6%	5.8%

The above table shows that property fund managers' use of gearing recovers about half the intrinsic cost disadvantage of fund structures compared with direct investment discussed above.

3.16 If investing in indirect funds, exposure to some gearing is inevitable. To minimise the risks involved, the Fund should only invest in property funds with limited gearing (to a proposed maximum of 50%).

3.17 The risk (and opportunity) in gearing is that movements in capital values are magnified. For example, if the property market moves by 10%, while an ungeared investment will increase or decrease in value by 10%, a fund with 50% gearing will rise or fall by 20%. In view of the increased volatility brought by gearing, the Fund currently does not have any leverage in its direct UK portfolio. However, such gearing does offer experienced managers a way of achieving out-performance against property benchmarks.

3.18 The Fund's current property holdings, being around £450m in its direct UK portfolio and £125m approved for investment in two core European property funds represents the full proposed allocation to core property. The 80:20 split between direct UK investment and indirect overseas investment is appropriate given the intrinsic advantage of UK direct. The diversification to only core Northern European property means that the Fund is unable to benefit from diversification into markets less correlated with the UK and those developing countries with higher forecast GDPs or from diversification into other property sectors such as an exposure to residential property.

3.19 It is proposed that the Fund build a diversified core property portfolio based on the existing UK direct core account surrounded by fund investments offering exposure to core property returns in other sectors and overseas countries favouring those with less correlation with the UK and those with prospects of returns higher than expected in the UK. A property manager able to adjust fund weightings between regions and countries may be appropriate to take account of changing circumstances. CBRE, for example, run a global multimanager core property product, presently returning 9% per annum net to investors. The existing approved European core funds could have a place in the portfolio, but the scale of the allocation would need to be reduced in order to include other funds offering some alternative geographical diversification and exposure.

3.20 The investment mandate of the existing direct UK portfolio will need to be set as an absolute return mandate to be achieved from continuing investment in a wide range of UK property. The UK property investment mandate procurement process currently in its planning stage will incorporate the overall property strategy as well as prudential limits as to the level of risk that the UK portfolio may take in terms of lot size, single tenant exposure, construction risk, development and acquisition of vacant properties. The new UK direct investment mandate is planned to be a discretionary mandate with an advisory-board style consultation mechanism as used by many indirect property funds.

3.21 It is proposed that investment due diligence be commissioned to assist the Fund is designing its core property portfolio with a view to creating a diversified portfolio minimising correlation of returns between components where possible and constructing a portfolio able to deliver the 6% to 8% annual absolute returns required.

4. Specialist / Opportunity Portfolio

4.1 The proposed investment strategy sees between 20% and 30% of the property investment allocation being invested in specialist or opportunity funds or other similar vehicles seeking a higher return overall than core property in the range 8% to 12% per annum. Taking the mid-range and current Fund value this represents an amount of around £187m.

4.2 The higher returns flow from investments in properties perceived as riskier or from asset management and development initiatives. A number of investment groups have achieved these higher returns consistently over many years. For example, the Blackstone Group has run opportunistic property funds since 1991. Eight funds over 20 years, typically over $1bn invested in each have returned a net IRR to investors of 16% per annum. Returns for different vintages range from 9% to 40%.

4.3 Blackstone and similar specialist managers may invest in value add, opportunity or distressed property. For example, a run-down office block may be bought, refurbished, remarketed and re-let with better quality tenants on longer leases, thereby achieving a significant valuation uplift. This type of investment opportunity needs specialist knowledge and experience and is best accessed through private equity-style funds or listed property development companies

4.4 Investors may also look at very specialist sector investments, for example, hotels, student accommodation, health-care facilities, and care-home facilities. These types of investments typically generate higher income distributions but perhaps at the cost of a depreciating specialist infra-structure. The specialist knowledge and management required means that these types of investments are again best accessed through indirect routes.

4.5 Specialist hotel funds, for example, search out key quality hotels in the best locations. The lease terms are typically geared to the hotel's performance and include covenants regarding levels of refurbishment expressed as a percentage of turnover. For example, Invesco has two funds with nearly €800m invested. It concentrates on hotels in key locations, such as airports, which are focused on the business traveller. Revenues from such locations are likely to be reliable. In 2011, Invesco's hotel fund returned a net 11.3% (income 7% and capital growth 4.3%) while the core portfolio returned 9.3% in the same period.

4.6 The illiquid nature of indirect property investment funds does mean that there can be distressed fund opportunities. Where an investor wishes to redeem its holding, but is either in a closed end fund of a fixed life or in an open end fund which has a significant redemption queue, then opportunities do arise to acquire units at a significant discount to net asset value. Provided that the Pension Fund is confident in the underlying property holdings of the distressed fund, the discount to net assets on acquisition can provide a significant boost to performance and more than offset the intrinsic cost disadvantage of funds generally. Investment groups such as Partners have used this strategy very successfully to produce some impressive results.

4.7 Many investment managers are currently marketing property debt funds to replace the loans previously sourced with banks. These funds have not been considered here as they have been covered in the Fund's credit investment allocation.

4.8 It is proposed that investment due diligence be commissioned to assist the Fund in building out a portfolio of specialist/opportunity property investments with a view to achieving an absolute return in the range 8% to 12% per annum, with some funds expected to exceed the 12% return. The type of structure envisaged would be:

25%	Global value-add property	e.g. Blackstone
25%	UK value-add	e.g. Moorfield
25%	Global opportunity property	e.g. Partners Group
25%	Specialist income	e.g. Invesco Hotel fund

As many of the funds available are closed end private-equity style funds, consideration will also need to be given to spreading investment across fund vintages. The investment due diligence is expected to define the composition of the specialist/opportunity allocation and propose a short-list of possible funds for approval by the Investment Panel, on which fund-specific due diligence would then be commissioned.

Annex 1

LCPF Property Strategy

Property Market Transparency Index

Country Property Market Transparency Ratings 2012 (Jones Lang Lasalle)

Ranking		Transparency Score
Highly Transparent Markets		
1	United States	1.26
2	United Kingdom	1.33
3	Australia	1.36
4	Netherlands	1.38
5	New Zealand	1.48
6	Canada	1.56
7	France	1.57
8	Finland	1.57
9	Sweden	1.66
10	Switzerland	1.67
Transparent Markets		
11	Hong Kong	1.76
12	Germany	1.8
13	Singapore	1.86
14	Denmark	1.86
15	Ireland	1.96
16	Spain	2.06
17	Belgium	2.07
18	Norway	2.08
19	Poland	2.11
20	Italy	2.16
21	South Africa	2.18
22	Austria	2.22
23	Malaysia	2.32
24	Czech Republic	2.34
25	Japan	2.39
26	Hungary	2.53
27	Brazil - Tier 1	2.54
28	Portugal	2.54

Ranking		Transparency Score
Semi Transparent Markets		
29	Taiwan	2.6
30	Brazil - Tier 2	2.75
31	Turkey	2.76
32	China - Tier 1	2.83
33	Greece	2.84
34	Israel	2.85
35	Philippines	2.86
36	Slovakia	2.9
37	Russia - Tier 1	2.9
38	Indonesia	2.92
39	Thailand	2.94
40	Romania	2.96
41	South Korea	2.96
42	Puerto Rico	2.96
43	Mexico	2.97
44	Russia - Tier 2	2.98
45	Chile	3.01
46	China - Tier 2	3.04
47	UAE - Dubai	3.05
48	India - Tier 1	3.07
49	India - Tier 2	3.08
50	India - Tier 3	3.15

Annex 2

LCPF Property Strategy

Comparison of fund cost structures

	Invesco Year ended 30-Sep-12		M&G Year ended 31-Jul-12	Internal Portfolio 31-Mar-12
Income Return	5.04%		4.57%	4.70%
Capital Return	1.28%		-0.14%	0.30%
Net Return to investors	6.32%		4.43%	5.00%
Analysed as:				
Property Valuation increase/(decrease)	5.14%		-1.00%	0.30%
Rental income return	5.60%		7.02%	5.30%
Gross return	10.74%		6.02%	5.60%
Amortisation of acquisition costs	1.00%	*	n/a	n/a
Return leakage/cost	3.42%		1.59%	0.60%
Net return to investors	6.32%		4.43%	5.00%
Total cost as a percentage of gross return	31.84%		26.41%	10.71%
Gross return required to match UK net return	7.33%		6.80%	5.60%

*: Invesco amortises its acquisition costs over 5 years through NAV, others charge acquisition costs

Pension Fund Committee
Meeting to be held on 6 September 2013

Electoral Division affected: None

Consultation on the Future Structure of the Local Government Pension Scheme
(Appendices 'A' and 'B' refer)

Contact for further information:
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Executive Summary

The Minister responsible for the Local Government Pension Scheme (LGPS) together with the Local Government Association have launched a consultation process aiming to identify options for changes in the way the LGPS is run which could have the potential to reduce the costs of running the scheme and therefore contribute to the longer term sustainability of LGPS.

Central to this consultation, is the belief set out in a number of speeches by the minister that there are currently too many LGPS funds and that fewer larger funds will be more efficient and effective in a range of ways.

Set out at Appendix 'B' is a proposed response to the consultation on behalf of the Fund.

Recommendation

The Committee is asked to approve the draft response to the consultation on structural reform of the LGPS set out in Appendix 'B'.

Background and Advice

In May this year Brandon Lewis MP the minister responsible for the Local Government Pension scheme made a speech setting out his view that in addition to the various reforms being made to the scheme itself there is a need to undertake structural reforms to change the way in which the LGPS is run.

The Minister is coming at this very strongly from the view that there are too many small funds within LGPS which therefore creates an unnecessarily high cost base with insufficient skill and critical mass. This is a debate which has been alive in London for some considerable time as each London Borough has its own fund and there is a view that some form of merger would create the opportunity to both reduce costs and improve returns.

Lancashire County Council

Following this speech during July the Government and LGA have launched a consultation seeking views on how the structure of LGPS might be reformed. A copy of the consultation document is attached at Appendix 'A'.

Appendix 'B' sets out a draft response to this consultation on behalf of the Fund. The basic line taken is in favour of increasing collaboration, an area where the Lancashire fund already has strong credentials and against forced mergers. There are a number of reasons for this. Firstly forcing mergers is likely to create some significant issues around accountability to stakeholders in the new much larger funds. Secondly a belief that while funds can be too small the converse is also true and funds can be too big and that therefore LGPS should be aiming for the right size funds, although there is no evidence to indicate that larger funds necessarily perform better than smaller ones.

The key factor which is emphasised in the draft response is that all moves which aim to professionalise the way in which LGPS funds are run are supported as this in itself has the potential to drive both performance and bring out areas where costs can be reduced. Again this is an area where the Fund has significant and useful recent experience.

The consultation closes around the end of September and it is expected that the Government's proposals, if any, will be announced around the beginning of the new calendar year. Depending upon the nature of these proposals primary legislation may be required which would mean that any implementation could be a reasonable time in the future.

Consultations

No specific consultations have been undertaken, although discussions about the issues raised in this consultation, although a informal discussions have taken place between North West LGPS funds whose responses are along similar lines to the proposed Lancashire County Pension Fund response.

Implications:

This item has the following implications, as indicated:

Risk management

As referred to in the draft response any structural changes to LGPS funds would create a range of new risks which will need to be managed, the principal one being a loss of focus during the period of change. The consultation process itself and the uncertainty which it causes also creates risks, for example in some cases around staff recruitment and retention which funds will need to address over the coming months.

Local Government (Access to Information) Act 1985
List of Background Papers

None

Reason for inclusion in Part II, if appropriate

N/A

Department for Communities and Local Government

Local Government Association

Call for evidence on the future structure of the Local Government Pension Scheme

Background

In 2010, the Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission. The purpose of the Commission was to review public service pensions and to make recommendations on how they could be made sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers. Lord Hutton's final report was published on 10 March 2011. Among its recommendations, the report made clear that the benefits of co-operative working between local government pension scheme funds and achieving administration efficiencies more generally should investigated further. The Local Government Pension Scheme currently costs local taxpayers £6billion a year in employer contributions.

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

Lord Hutton went on to comment about the need for change and improved scheme data. At paragraph 6.1 he said:

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

On 16 May 2013, the LGA and DCLG held a roundtable event on the potential for increased co-operation within the Local Government Pension Scheme, including the possibility of structural change to the current 89 funds. 25 attendees represented administering authorities, employers, trade unions, the actuarial profession and academia.

The roundtable aimed to bring objectivity and transparency to the subject through open debate. There was a full discussion of the possible aims of reform and the potential benefits of structural change, together with the further work needed to provide robust evidence to support emerging options. The meeting focused on the issues to be addressed by reform rather than the detailed arguments for any of the potential ways forward that have been proposed.

The roundtable heard about the projects being undertaken to look at the options for structural reform of the Scheme in London and Wales and considered the range and relative priorities of the desired outcomes of reform, the data requirements for determining a start point and target and the next steps for delivering those outcomes.

On 22 May at the National Association of Pension Funds' local authority conference, the Local Government Minister Brandon Lewis said:

I am determined that we make progress and make it as quickly as reasonably possible. I can therefore announce this morning, that we will consult later in the year on a number of broad principles for change. This will be your opportunity to tell us what reforms could be made to both help improve your investment performance and reduce your fund management costs.

The consultation will not set out some pre-determined solution to what is undoubtedly a complex and contentious issue. I am neither ruling anything in nor ruling anything out at this stage. However, the clear message from me this morning is that I am not wedded to the existing number of 89 funds in England and Wales. If it takes a smaller number of funds to improve the efficiency and cost-effectiveness of the scheme, I shall not shy away from pursuing that goal.

I have talked a fair amount about the need for robust data to inform decisions. I am therefore working with the LGA and others to launch a call for evidence, which will both inform our consultation and help all involved formulate their views in response to the consultation.

You will be aware that work is well underway to establish a shadow national pensions board for the Scheme. I have met with the LGA and local government trades unions on several occasions to discuss the sort of work that I would like the board to undertake.

This document sets out the call for evidence from DCLG and the LGA, working with the Shadow Scheme Advisory Board, and explains how it will feed into the forthcoming consultation.

The call for evidence

At the roundtable, the following high level and secondary objectives for structural reform were proposed:

<u>High level objectives</u>

1. Dealing with deficits
2. Improving investment returns

<u>Secondary objectives</u>

1. To reduce investment fees
2. To improve the flexibility of investment strategies

3. To provide for greater investment in infrastructure
4. To improve the cost effectiveness of administration
5. To provide access to higher quality staffing resources
6. To provide more in-house investment resource

The roundtable also agreed that, although there is a wide range of data available on Local Government Pension Scheme funds, it is currently widely dispersed and would benefit from enhancement, collation and further analysis. It also considered how best to achieve a high level of accountability to local taxpayers, particularly if services are to be shared or funds merged.

In your response to this call for evidence, it would be helpful if you could have particular (although not exclusive) regard to the following questions and provide evidence in the form of annexes to support your answers.

Question 1 – How can the Local Government Pension Scheme best achieve a high level of accountability to local taxpayers and other interested parties - including through the availability of transparent and comparable data on costs and income - while adapting to become more efficient and to promote stronger investment performance.

Question 2 – Are the high level objectives listed above those we should be focussing on and why? If not, what objectives should be the focus of reform and why? How should success against these objectives be measured?

Question 3 – What options for reform would best meet the high level objectives and why?

Question 4 – To what extent would the options you have proposed under question 3 meet any or all of the secondary objectives? Are there any other secondary objectives that should be included and why?

Question 5 – What data is required in order to better assess the current position of the Local Government Pension Scheme, the individual Scheme fund authorities and the options proposed under this call for evidence? How could such data be best produced, collated and analysed?

Timetable

Responses to this call for evidence should be submitted in electronic form to Victoria Edwards at: LGPSReform@communities.gsi.gov.uk

The closing date for submissions is 27 September 2013.

The submissions will then be analysed by DCLG and the LGA, working with the Shadow Scheme Advisory Board. You may be asked to provide further clarification and/or evidence to support your answers during that process.

The analysis of submissions will then inform a formal consultation on the options for change to be published by DCLG in the early autumn.

Call for evidence on the future structure of the Local Government Pension Scheme – Response on behalf of the Lancashire County Pension Fund

The Lancashire County Pension Fund provides the Local Government Pension Scheme (LGPS) in the County of Lancashire providing a means of pension saving for nearly 144,000 scheme members and 253 employers ranging from local authorities to multi-national companies and small local charities. The Fund had assets at the end of March 2013 of just over £5bn and is one of the top ten LGPS funds by this measure.

The Fund has a successful record of collaboration and successfully provides pensions administration services on a shared service basis to Cumbria County Council and the Lancashire Police and Fire-fighter's schemes. The Fund has also jointly procured a range of services including actuarial services with neighbouring funds.

The Fund welcomes the opportunity to respond to the call for evidence on the future structure of the LGPS and looks forward to the process of reform continuing in the positive and constructive manner that has been evident in most of the country to date.

In answering the questions posed in the call for evidence we start from, the proposition that there is no inherent logic that says that larger funds perform better than smaller funds, or that small is beautiful. In investment terms the LPFA Fund one of the larger funds has tended to underperform while the Orkney Fund one of the smallest has tended to perform very well. Equally the very large Greater Manchester Fund has performed well and Shetland performs poorly. Thus we can read nothing into the size of funds and a disruptive top down driven series of fund mergers to create a small number of regional "super-funds" would be likely to be costly and detract from performance in the medium term as funds focus on the merger process.

The thinking behind the call for evidence seems to be that a smaller number of larger funds will inevitably pay less and perform better. There is no evidence to support this. The Lancashire fund already pays managers' lowest tier of fees due to the size of mandate which it awards and is able to negotiate "most favoured nation" terms which mean that it will always pay the manager's lowest fee, While it is accepted that this is not the case for smaller funds the scale of savings which might be achieved through squeezing managers are insignificant in the context of the real issue which faces LGPS funds which is the scale of funds' liabilities and hence the size of the deficit which needs to be addressed, through the delivery of successful investment and liability management strategies.

A central theme in the Minister's speech at the NAPF Local Government Conference launching the call for evidence was the need to professionalise the running of LGPS. We would support this and in the running of the Lancashire County Pension Fund we have already taken steps to move away from the traditional model of most funds which sees the running of the Pension Fund as something undertaken by certain key staff effectively in their spare time. In most cases the financial scale of local authority pension funds is much greater than that of their host authorities and we do a disservice to scheme members if we do not place sufficient management focus and skill into the way in which we exercise our responsibilities for these funds.

Dealing with the questions in the Call for Evidence in turn

Question 1 – How can the Local Government Pension Scheme best achieve a high level of accountability to local taxpayers and other interested parties – including through the availability of transparent and comparable data on costs and income – while adapting to become more efficient and to promote stronger investment performance.

The first question to deal with here is to whom should funds be accountable? There is a strong argument that as pensions are deferred pay funds should be accountable to beneficiaries, equally given that the deferred pay is funded by the taxpayer there should be accountability to the employer who represents the taxpayer. Both are valid cases and while the focus has understandably been on employers and taxpayers the importance of accountability to beneficiaries must not be underestimated and we welcome the proposals in the consultation on governance arrangements to strengthen the voice of beneficiaries in the oversight of schemes.

Accountability might be thought to mean any combination of the following:

- The ability to influence the level of contribution rates;
- The ability to influence investment strategy and risk appetite;
- The ability to challenge performance in the fields of both investment and administration

So how is accountability best exercised? Certainly the publication of information in an accessible and understandable form is central to this and there are already requirements on funds to publish a great deal of information and to formally consult on the production of a range of key policies and strategies.

Our view would be that the current range of requirements on Funds in relation to what has to be published and consulted on and the degree of prescription on the content of particular documents encourages a tick box mentality which actually stifles the process of engagement with stakeholders that would result in enhanced accountability. Somewhat more freedom within an overall regime which encourages openness and dialogue seems likely to encourage innovation in terms of engagement with various different groups of stakeholders.

Generally neither employers nor employees are able to "shop around" between pension funds and therefore while comparative information on fund performance may be interesting the "killer" pieces of information are the absolute return achieved by the Fund and the funding level. If a relative performance benchmark is required the best one that we have identified is performance relative to the assumptions made by the actuary in setting contribution rates. Out performance against this measure means that any deficit is being eroded quicker than planned, thus it is meaningful in the fund specific context.

There is potentially a degree of conflict between the overall objectives of the Fund which are to ensure that resources are available to ensure benefits can be paid and the desire or employers and taxpayers for reduced contribution rates. The Fund must have regard to the affordability and sustainability of contribution rates, but we cannot reach a situation where employers are given some form of veto mirroring the council tax referendum process. This could result in funds being run in an imprudent manner and would be acting entirely counter to the best interests of scheme beneficiaries. Thus we need to be clear how far accountability to stakeholders should go and the tension highlighted above may become greater with the increased involvement of the Pensions Regulator and the greater read across that seems to be intended from the governance arrangements that apply in private sector funds where accountability to key stakeholders such as sponsors seems relatively weak and the interests of beneficiaries predominate. This is likely to be appropriate in the private sector where schemes are trust based. The situation in the public sector is different and this must be understood and reflected in the arrangements that are arrived at.

Question 2 – Are the high level objectives listed above those we should be focussing on and why? If not, what should be the focus of reform and why? How should success against these objectives be measured?

While the sentiment of these two objectives is right the focus is wrong. We would suggest that the objectives should be framed in terms of:

- Ensuring that funds are available to meet pension promises when due (i.e. the management of fund cash flows)
- Achieving a fully funded and sustainable scheme within the timescale set by the actuaries. (i.e. the elimination of the deficit)

The delivery of increased investment returns is simply one tool to achieve these objectives and in some cases may not be the appropriate tool to use if it fundamentally changes the investment risk balance in a way that is inappropriate to the overall liability profile.

Reform of any sort needs to make the achievement of these objectives more likely in the medium term than the maintenance of the status quo.

The way in which we have framed the two objectives makes them susceptible to simple and easily understandable measurement.

- In terms of fund cash flows this is the net flow of cash (i.e. excluding unrealised gains and losses on investments) into the fund from all sources, further sophistication could be added by splitting the measure between dealings with members and investment income.
- In terms of funding level each triennial valuation will create a "glide path" that shows the funding level improving over time. The simple measure is for actual funding to be measured against this glide path. The actuarial firms now provide funds with tools using rolled forward data which allow a reasonable estimate of the funding position to be made at any point in time.
- To reinforce the funding level investment performance should also be measured against the actuarial assumption the reason for this being that in many cases it is the movement in liabilities rather than poor investment performance that has caused deficits not to reduce in line with the glide path, therefore there is some merit in looking at investment performance as an independent secondary measure associated with the funding level.

Using two primary measures and one secondary measure in this way provides a relatively easily understandable way of gauging success by looking at outcomes rather than at inputs.

Question 3 – What options for reform would best meet the high level objectives and why?

Our clear preference is to create a climate where greater collaboration between funds is encouraged on the grounds that this creates the opportunity to achieve at least some of the secondary objectives outlined within the call for evidence without diluting the current level of accountability to scheme employers and beneficiaries.

As stated above we do not accept the argument that larger funds are necessarily better than smaller funds. What is important is whether the strategy is right and its implementation is managed properly and that those overseeing the Fund have access to the appropriate levels of advice, knowledge and skill to be able to deliver a strategy that is right for a fund of any particular size.

It is clear that in order to deliver the sorts of strategy that will help LGPS deliver improved funding levels and address the issue of liabilities there is a need to build on the various concentrations of intellectual capital which exist across LGPS but which are not necessarily available to all funds. There are means of doing this which do not need to involve the structural upheaval which the merging of funds would necessitate.

These might include the creation of investment management teams shared between funds, and thus provide all funds with access to a level of in house resource able to challenge the easy nostrums sold by many of the investment consulting firms who operate as the de facto overall managers of some LGPS funds.

There is, perhaps, the opportunity for some smaller funds to achieve the same or better returns with lower fees by the creation of some form of pooled investment vehicle, e.g. five or six small funds pooling their active equity mandates as one mandate in order to achieve a critical mass for investment. Equally there are things larger funds could do, in the form of market led solutions, which could offer assistance to smaller funds and some benefit to the larger fund. For example as a way of achieving some turnover in a private equity portfolio the larger fund could parcel some of its investments into its own fund of funds and sell interests to smaller funds. This would allow the smaller funds to achieve access to a valuable form of investment that they might otherwise not be able to achieve and allow the larger fund both to turn over a portfolio which can be desirable to achieve better balance for example in terms of exposure to different vintages and achieve an income stream from management fees although this is unlikely to be as much as the 1 and 10 (plus the 2 and 20 in the underlying funds) that exist in a more commercial fund of funds.

Our feeling is that means of encouraging greater sharing and, importantly, joint funding of expertise between funds is desirable, This can be achieved without impinging on the sovereignty that exists in the individual fund and Pension Committee which would result in reduced accountability.

It may be the case that there should be a minimum size for funds either in terms of membership or assets, but given that funds outside London cover County areas (whether Shire or Metropolitan) these would seem unlikely to fall below any logical minimum based on the current range of sizes of funds. London is, we would suggest, a different issue, but one which London funds should sort out amongst themselves.

The key question for the proponents of fund mergers is how accountability to the employers and tax payers is to be retained in a situation where a fund covers say two counties and the administering authority is one of them. The logic would be that there would have to be some sort of movement to the model in South Yorkshire where there is in effect a separate joint authority. However, this ignores the complexity local government in the shire areas, Thus South Yorkshire can easily achieve representation of all the individual constituent districts within a manageable committee. If we were to posit the merger of the Lancashire and Cumbria funds as an illustration to achieve one representative per local authority ignoring other employers and beneficiaries the Committee would be 22 as a minimum, This sort of arrangement would be unmanageable but as direct representation is reduced in a structure that is more separate from a single administering authority with which employers have a much wider relationship and engagement they will begin to feel that the Fund is unaccountable and remote to a greater degree than is the case at present. Clearly any sensible arrangements for managing such a Fund would seek to counteract this, but it is an almost inevitable effect.

It is also, though equally the case that the single fund in Northern Ireland operates through the appointment of its equivalent of the Pensions Committee through the formal public appointments process and currently has no councillors on the committee. Clearly Northern Ireland does represent a unique set of circumstances, but this move to a sort of "professional trustee" model analogous to the private sector is more likely to address the sorts of conflict of interest issue which the Pension Regulator will see in the current arrangements. It does, however, make achieving direct accountability to the various stakeholders directly affected by the decisions of the Pensions Committee much more difficult to achieve.

Thus it would seem that if we are to maintain some form of direct accountability some form of enhanced collaboration will result in the greater professionalisation of the operation of the scheme that the Minister wants to see.

Question 4 – To what extent would the options you have proposed under question 3 meet any or all of the secondary objectives? Are there any other secondary objectives that should be included and why?

In general terms the secondary objectives while logical in their own right do not flow, as might have been expected from the primary objectives. With one exception they represent sensible objectives which it is difficult not to support. To take each of them in turn:

Reduced Investment Fees

Collective investment vehicles and the development of concentrations of in house expertise to both run money directly and negotiate with external managers clearly give the opportunity to do this. The scale of reductions achievable will be limited to those which already achieved by the larger funds which have secured "most favoured nation" status in their fee agreements.

To improve the flexibility of investment strategies

The greatest opportunity here is not related to structural reform of the LGPS but the application of the EU Public Procurement rules to the appointment of managers for segregated accounts. This significantly hampers the flexibility and speed with which funds can act if they need to. A situation which makes available greater levels of in house resource particularly with skill and expertise in the techniques which allow liability risks to be managed will certainly increase flexibility. However, funds will need to be prepared to make the upfront investment in their in house teams in order to maximise the potential benefits.

To provide greater investment in infrastructure

This is not an appropriate objective for inclusion here. Pension Funds exist to secure the resources necessary to meet the pension promises made to beneficiaries. Funds will invest in infrastructure if appropriate opportunities with the correct risk and return characteristics are presented to them. We are not currently being overwhelmed with a rush of such opportunities. A greater level of in house expertise which we would seek to promote through collaboration will, however, provide the opportunity to investigate and fully examine proposals more effectively as they come forward.

To improve the cost effectiveness of administration

The Lancashire and Cumbria funds provide a strong case study in the financial and other benefits that can be achieved through collaboration in the area of administration. The administration service in Lancashire took on work previously delivered by a poorly performing private sector contractor and has both improved the quality of service delivered to scheme members and the fund as a whole. This has delivered considerable savings for Cumbria as well as upfront investment in new technology which provides the bedrock for improved customer service. This demonstrates what can be achieved by willing partners without the unnecessary distraction of mergers.

To provide access to higher quality staffing resources

To provide more in house investment resource

Certainly the ability to create stronger in house teams should deliver this, but we would argue that this does not in itself require either collaboration or the creation of larger funds. It is a matter for administering authorities to decide how they want to run their funds. Traditionally many have chosen to see the running of the pension fund as an add on to the work of one or more members of staff within the finance department. Having reflected on this we have taken a different view and recruited a strong in house team with backgrounds in the financial services world, a decision that has paid dividends both in terms of improved performance and reduced fees as well as the identification of strategies which reduce the exposure of the fund to equity volatility while maintaining returns. While the benefits achieved by the team have justified the investment there is a danger in creating small pockets of expertise and sharing a resource such as we and some other funds have developed is a simple, and relatively low cost, method of delivering these benefits across the whole of LGPS. If any message should come through clearly in our response it would be that if we professionalise the running of LGPS structure is irrelevant. The running of pension funds is a big business in its own right, most are many times larger in financial terms than the budgets of their administering authorities and we should not treat it as a part time adjunct to other work.

Question 5 – What data is required to better understand the position of the Local Government Pension Scheme, the individual Scheme fund authorities and the options proposed under this call for evidence? How could such data be best produced, collated and analysed?

We are somewhat perplexed by the fact that the data available within the LGPS is suddenly inadequate. If data has been as poor is portrayed for so long it has been within CLG's gift, as the regulator for the sector to remedy the situation.

We outlined our suggested measures of success in answer to question 2 and we feel that these should be central to any revised collection of data. However, we would accept that there is a benefit in collecting other cost and volume data for funds in order to promote the process of continuous improvement across LGPS. However, to be of real use these data must be comparable.

At the heart of achieving comparable data are clear and easily understood definitions of the data items to be reported, which should preferably avoid funds having to apply judgements to source data in order to allocate items to the correct headings. Anecdotal evidence would indicate that there are differences of understanding of the current definitions across LGPS funds.

There are a range of concerns expressed around the way in which charges between host councils and funds are calculated, which are leading some to call for more prescription in this area. Given the professional obligations on the section 151 officers of administering authorities we do not feel more prescription is justified. However, it is entirely right that Pension Committees should periodically review and if necessary challenge the levels of cost charged to Funds by the administering authority. There are ways of making these charges more transparent, for example in the case of Pensions Administration the Lancashire Fund has a clear service level agreement with the County Council which sets a cap on the per member charge of the lower quartile of shire county funds in the SF3 return. A per member charge is the way in which an external provider would charge and this provides a clear comparison in terms both of performance and value for money. The promotion of similar quasi-contractual arrangements for other elements of the costs charged to funds would promote greater transparency and understanding.

There are significant issues with the reporting of investment management fees as depending upon the way in which investments are made the fees may be transparent or as in fund of funds type investments somewhat more opaque. It would perhaps be helpful for such fees, including in house investment costs to be compared using the standard measure of bps relative to assets under management. However, it needs to be accepted that different investment strategies will lead to different fee levels and the data should not be used to reinforce a drive towards a common low cost investment strategy. The costs of delivering a strategy must be seen in the context of whether or not it has delivered its objectives. Almost all funds participate in the WM local authority universe which measures investment performance although there are felt to be some limitations with this and simply looking at a local authority universe and the understandable focus on the performance of funds within the local authority league table means that these data are not as useful as they might be.

Given that the data collection machinery for the SF3 return already exists within CLG it would seem sensible to maintain this as the means of data gathering, although there might be merit in transferring these responsibilities and the associated resources to the new Scheme Advisory Board. This will give greater ownership of the product by Funds and provide a forum which can encourage discussion of the results across the scheme which is not the case at present.

Pension Fund Committee
Meeting to be held on 6 September 2013

Electoral Division affected: None

Annual Report and Accounts of the Fund – 2012/13
(Appendix 'A' refers)

Contact for further information:
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Executive Summary

This reports sets out the Lancashire County Pension Fund Annual Report 2012/13

Recommendation

The Committee is asked to agree the Lancashire County Pension Fund Annual Report 2012/13, as set out at Appendix 'A', for submission to the Full Council.

Background and Advice

The Local Government Pension Scheme (Administration) Regulations 2008 (No. 239) requires each administering authority to prepare an annual report for the pension fund and publish it before 1 December following the year end. The regulations prescribe that the following should be included in the annual report:

- a report on the management and financial performance of the fund during the year;
- an explanation of the investment policy;
- a report on the administrative arrangements for the fund;
- a statement from the actuary on the latest funding level;
- the current version of the governance compliance statement;
- the fund account and net asset statement with supporting notes and disclosures;
- the extent to which the fund has achieved its required performance levels; and
- the current version of the funding strategy statement, the statement of Investment principles and communications policy and any other information the authority considers appropriate.

The terms of reference of the Pension Fund Committee require it to approve the annual report for submission to Full Council.

Lancashire County Council

A copy of the Lancashire County Pension Fund Annual Report 2012/13 is attached at Appendix ‘A’. The Annual Report includes the following sections:

An overview of the management and financial performance of the fund

This highlights the major issues considered by the Investment Panel and Committee during the year, a summary of market conditions and a summary of the performance of the fund.

The Governance Compliance Statement

This highlights compliance or otherwise with the guidance given by the Secretary of State.

Administration of the Fund

An update on issues arising from the administration of the fund during the year, including any changes to the administration regulations.

Knowledge and Skills Framework

A summary of the framework used to ensure that the right knowledge and skills mix exists to meet the financial management needs of the pension fund.

Investments of the Fund

A summary of the investment activity during the year and an analysis of performance of the investments.

The accounts and financial statements

The draft accounts and financial statements of the pension fund approved by the County Treasurer on 28 June 2013 are shown in the County Council’s Statement of Accounts and also in the Pension Fund Annual Report. The accounts are currently being audited by the external auditor and the auditor’s opinion, together with any changes required as a result of the audit process will be included inthe published Annual Report, when this is complete.

An up to date list of all the scheduled and admitted bodies within the fund is included within the notes to the financial statements.

Actuarial Valuation

A summary of the latest actuarial valuation carried out at March 2010 and applicable for the three years commencing 1 April 2011.

The following standing policy statements are referred to in the Annual Report as available from the Pension Fund and from its web-site at www.yourpensionservice.org.uk:

The Governance Policy Statement

The Governance Policy Statement approved by the Committee in April 2008 has been updated to include changes agreed by the Committee in July 2011.

The Communication Policy Statement

There are no changes to this document, which was revised in April 2007.

The Funding Strategy Statement

The Funding Strategy Statement which was approved by committee in February 2011.

The Statement of Investment Principles

The Statement of Investment Principles was approved by committee in November 2012.

Consultations

The Investment Panel are consulted on all investment policy issues.

Implications:

This item has the following implications, as indicated:

Risk management

The policy on risk is outlined in the Funding Strategy Statement and the Statement of Investment Principles.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
Investment Manager reports, Investment Panel Agendas and Minutes	Quarterly throughout the year	Mike Jensen – Resources – 01772 534742

Reason for inclusion in Part II, if appropriate

N/A

Lancashire County Pension Fund

Annual Report

2012 / 2013

Lancashire County Pension Fund

Annual Report 2012/13

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A. Management Structure

Management Structure as at 31 March 2013

Pension Fund Committee *
2012/2013 (as at March 2013)

Lancashire County Council
D A Westley (Chair)
M J Welsh (Deputy Chair)
T Aldridge
M Brindle
M Devaney
P Evans
K Iddon
J Lawrenson
F De Molfetta
M Parkinson
T Pimblett
S Riches
G Roper
K Young

Blackburn with Darwen Borough Council
D Walsh

Blackpool Borough Council
M Smith

Lancashire District Councils
P Leadbetter
I Grant

Co-opted Members representing Trade Unions
R P Harvey
R Whittle

Co-opted Member representing HE/FE Establishments
J McCann

Administering Authority
Lancashire County Council

Fund Managers
Legal & General Investment Management
Knight Frank
Capital Dynamics
Baillie Gifford & Co
MFS International (UK) Ltd
Robeco Institutional Asset Management
Morgan Stanley Investment Management
NGAM UK Ltd
Mellon Transition Management

Custodian
Northern Trust

Independent Investment Advisers
E Lambert
N Mills

Treasurer to the Lancashire County Pension Fund
G Kilpatrick CPFA

Actuary
Mercer

Auditor
Grant Thornton

Property Solicitors
Pinsent Curtis Biddle
DWF

Independent Property Valuer
Cushman & Wakefield

Corporate Governance Adviser
PIRC

Performance Measurement
Northern Trust

AVC Providers
Prudential
Equitable Life

Legal Advisors (other than property)
In House
MacFarlanes
Eversheds
Clifford Chance
Allen and Overy
Taylor Wessing
Addleshaw Goddard

Bankers
National Westminster

*Membership of the Pension Fund Committee changed following the Lancashire County Council elections in May 2013. The new chair of the committee is County Councillor T Burns.

B. Overview of Management and Financial Performance

The investment performance of the Lancashire County Pension Fund during 2012/13 has been driven primarily by the substantial asset allocation and manager changes made from late 2011 onwards.

Markets benefited from perceived reduction in risks, in particular those emanating from the Eurozone which had produced a highly volatile backdrop to global investment activity during the previous year. The actions of Mario Draghi, the head of the European Central Bank, in particular can be credited with reducing market volatility.

The continued efforts by many of the world's central banks in adding liquidity to global markets also helped reduce financial anxiety, helping to create a general improvement in asset prices. The economy of the United States has been the principal beneficiary of this stability as consumer confidence has returned, particularly to the housing market. Late in the year the new Japanese government announced its own aggressive version of Quantitative Easing (QE) adding yet more liquidity to the system.

There are still many strong cross currents to be negotiated in world markets, in particular a slow down in emerging market growth, the potential for developed world deflation and residual risks in European sovereign and bank debt markets.

The strong rally in world Equity markets in the final quarter of the year produced a 9.1% rise in the FTSE100, whilst with the additional benefit of the fall in the value of Sterling produced a rise in the MSCI all world of 14.2%. Credit markets continued to perform positively as the perception of risk fell, the IBOX non Gilt Sterling index (a published index based on a broad range of high quality corporate bonds of varying maturity) rose 7.0%.

Government bond markets in the US, UK and core Europe performed well over the 12 month period, the IBOX 15yr+ Gilt index rose 8.9% buoyed by the addition of liquidity by monetary authorities.

2012/13 was a period of implementation of revised investment allocations for the Fund. The early steps into lower volatility investment made late in the previous year were augmented by radical changes to the Funds approach to equity investing, shifting focus away from the UK to a global bias and the use of more active investing styles. Whilst the Fund should always view performance over the medium rather than short term it has been pleasing to see changes having immediate effects, both in terms of absolute and relative performance but also of total Fund volatility.

The overall return achieved by the Fund during 2012/13 was 14.9% compared to the benchmark return of 13.5% and the actuarial liability benchmark of Gilts +2.5% (7.9%) and average local authority return of 13.8%. This ranked in the 24th percentile of the WM Local Authority Universe, the majority of out performance coming from the new active equity mandates, property and the internally managed funds. The major drag on performance came from the funds fixed income mandates, which have been reallocated after the end of the reported period.

During the year the Fund was cash flow positive, with income from contributions and investments exceeding expenditure on benefits and expenses by £98.3m but excluding investment income, and accounting for transfers in, it should be noted that the Fund was cash flow negative (£15.8m).

The on going implementation of the Fund's investment strategy together with improvements in governance, place the Fund in a strong position to deal with developments in global risk, the international regulatory framework and the future of structure pensions in general.

Capital for long term investment remains scarce in light of the effects of forthcoming regulation for the banking (Basle 3) and insurance (Solvency 2) sectors, leaving open defined benefit Pension Funds in a strong position to positively address the goals of full funding and sustainable cost. The challenges for the future remain risk management and judicial diversified asset allocation.

The Fund was nominated for the CIO "European Public Sector Fund of the Year" award and received the "Renewable Energy Association Pioneer Award" for its activity in Solar energy financing.

County Councillor T Burns
Chair of the Pension Fund Committee

G Kilpatrick CPFA
County Treasurer and Treasurer to the
Lancashire County Pension Fund

C. Governance of the Fund

The Pension Fund Committee has considered the governance arrangements relating to the administration and investments of the Fund in the light of guidance issued by the Department for Communities and Local Government (DCLG) regarding the requirement to complete a Governance Compliance Statement, established for all areas of governance of pension fund activities.

Comprehensive terms of reference have been established for all areas of governance of pension fund activities including the Pension Fund Committee, the Investment Panel, the Administration Panel and issues delegated to the Treasurer to the Fund. These can be found in the Fund's Governance Policy Statement. Governance Policy Statement

The Fund's Governance Compliance Statement is shown below reporting compliance with guidance given by the Secretary of State.

LANCASHIRE COUNTY PENSION FUND GOVERNANCE COMPLIANCE STATEMENT:

Principle		**Full Compliance**
A. Structure	*(a) the Management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing Council*	✓
	(b) that representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee(1)	**Partial** See note 1 below
	(c) that where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	✓
	(d) that where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	✓

B. Representation	*(a) that all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. (1)* *These include:* *(i) employing authorities (including non-scheme employers, e.g. admitted bodies)* *(ii) scheme members (including deferred and pensioner scheme members)* *(iii) independent professional observers (2)* *(iv) expert advisers (on an ad hoc basis)*	**Partial** (see notes 1& 2 below)

Reasons for Partial Compliance

Note 1: Although District Councils, Scheduled Bodies and employees are represented, Admitted bodies are not. Admitted bodies only represent 7% of contributors to the fund and are therefore not represented. However, all employers receive a full annual report and are alerted to important events. Although employee representatives, i.e. Trade Unions, do not formally represent deferred and pensioner scheme members, it is accepted that representation is available to deferred and pensioners members via this route where necessary and/or appropriate.

Note 2: Guidance envisaged that an independent professional observer could be invited to participate in governance arrangements to enhance the experience, continuity, knowledge, impartiality and performance of committees or panels which would improve the public perception that high standards of governance are a reality and not just an aspiration. This role is currently performed by the Fund's independent advisers and officers and it is not apparent what added value such an appointment would bring.

C. **Selection and Role of Lay Members**	*(a) that committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.* *(It is the role of the administering authority to make places available for lay members and for the groups to nominate the representatives. The lay members are not there to represent their own local, political or private interest but owe a duty of care to their beneficiaries and are required to act in their best interests at all time.)*	✓
D. **Voting**	*(a) the policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.*	✓
E. **Training/ Facility Time/ Expenses**	*(a) that in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.* *(b) that where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.*	✓ ✓
F. **Meetings – Frequency**	*(a) that an administering authority's main committee or committees meet at least quarterly.* *(b) that an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.* *(c) that administering authorities who do not include lay members in their formal governance arrangements, provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.*	✓ ✓ ✓

G. Access	*(a) that subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.*	✓
H. Scope	*(a) that administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.*	✓
I. Publicity	*(a) that administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed can express an interest in wanting to be part of those arrangements.*	✓

Lancashire County Council's Annual Governance Statement

The County Council has produced its Annual Governance Statement for 2012/13. This statement sets out assurances on the County Council's governance arrangements, internal control and the way the County Council manages its affairs.

As the County Council is responsible for the administration of the Pension Fund, including the provision of systems, controls and governance, this statement embraces the activities of the Pension Fund.

D. Administration of the Pension Fund

Overview

The Local Government Pension Scheme is a statutory public sector pension scheme which operates on a “defined benefit basis”. Lancashire County Council as 'Administering Authority' is required by law to administer the Scheme within the geographical area of Lancashire.

The County Council administers the Scheme for over 150 employers. These employers include organisations such as local authorities, further and higher education colleges and voluntary and charitable organisations. This includes a number of “Admitted Bodies”. These are organisations that have entered into an agreement with the County Council to participate in the Fund.

The Pension Fund Committee is required to receive regular reports from the Treasurer to the Fund on the administration of the Fund ensuring that best practice standards are satisfied and met and to satisfy itself and justify to all stakeholders, including Fund Employers, that the Fund is being run on an efficient and effective basis. A Service Level Agreement (SLA) exists between the Pension Fund and the service provider. The SLA contains specific service level standards and corresponding service level targets and an Annual Administration Report is presented to the Pension Fund Committee.

Review of the Year

2012 has been a year of change within the Pension Service. The biggest development was the launch of a member self service function “my pension online”. This development allows scheme members to access their pension records online and this service will become the primary method of communication with scheme members in the future.

Overall performance continues to meet the targets set. At the beginning of 2013 the service was restructured and as a result dedicated client teams were created to deliver more efficient customer focussed services. A Performance Manager was appointed to ensure that standards and targets are met. The overall achievement against service level targets over the year was 96%.

The Service also continues to be cost effective with the cost of administration remaining below the Government’s key indicator as reported in national benchmarking returns.

Public Sector Pension Reform

A Statutory Consultation started on 21December 2012 on new benefit regulations for the Local Government Pension Scheme (LGPS) from 1 April 2014. A number of further consultations have followed with the intention of having a new LGPS in place by 1 April 2014. This new Scheme will reflect the provisions of the Public Service Pensions Bill which having worked its way through Parliament reached Royal Assent on 25 April 2013.

The main provisions of the new LGPS 2014 are:

- The Scheme will be a Career Average Re-valued Earnings (CARE) Scheme with an accrual rate of 1/49th and will be re-valued in line with the Consumer Price Index (CPI)
- Normal Pension Age will be the same as the individuals State Retirement Age (minimum 65)

The next step of the statutory consultation process will ensure that the regulations covering protections for current scheme members (known as the transitional regulations) are set. These regulations will describe how the move from current to new rules will take place and set the foundation for protections. In particular, protections will include a final salary link and protected retirement age for benefits built up to March 2014.

More details can be found at (www.lgps.org.uk) and within the full Annual Administration Report

Other information

Further statements relating to the administration of the Scheme include the Communication Policy Statement and the Pensions Administration Strategy Statement.

Your Pension Service can be contacted at:

PO Box 100
County Hall
Preston
PR1 0LD

Telephone: 01772 530530

E-mail: connect2pensions@oneconnectlimited.co.uk
http://www.yourpensionservice.org.uk

E. Knowledge & Skills Framework

CIPFA Pensions Finance Knowledge and Skills Framework

The Chartered Institute of Public Finance and Accountancy (CIPFA) published its code of Practice on public sector pensions finance knowledge and skills in October 2011. The Code has been devised in response to Lord Hutton's recommendation that every public sector pension scheme (and individual LGPS fund) should have a properly constituted, trained and competent "Pensions Board". It also represents a key element in complying with the relevant principles of investment practice laid out in Local Government Pension Scheme (Management and Investment of funds) regulations 2009 regarding Effective Decision making.

The Code is intended to be used in conjunction with the CIPFA Pension Finance Knowledge and Skills Frameworks (KSF) which enhances where necessary, levels of knowledge and skill held by all those, whether members or officers, involved in the management and oversight of public sector pension funds.

The Code became effective from 1 April 2012 and is mandatory for CIPFA members as part of their standards of professional practice, and was adopted by the Pension Fund Committee at its meeting on 3 February 2012 in order to ensure good governance and training practices, and to support the Treasurer who, as a CIPFA member, has a professional requirement to comply with the Code.

The Council currently subscribes to a web-based knowledge and skills self assessment tool, developed by Hymans Robertson in conjunction with the CIPFA Pensions Network, to enable officers and elected members to help identify any gaps in their knowledge or skills.

The toolkit comprises six areas of core technical requirements for both officers and members:

- Pensions legislation and governance context;
- Pension accounting and auditing standards;
- Financial services procurement and relationship management;
- Investment performance and risk management;
- Financial markets and products knowledge;
- Actuarial methods, standards and practices.

The frameworks are intended to have two primary uses, as a tool for organisations to determine whether they have the right skill mix to meet their pension scheme financial management needs and as an assessment tool for individuals to measure their progress and plan their development.

This process was initiated for officers in 2012/13 and needs to be fully completed for all relevant officers and members. Once completed, a training programme for both members and officers will be developed, incorporating the training materials available in the toolkit, relevant seminars, conferences and internal training days.

The implementation of the KSF has not advanced as quickly as intended, and it was decided to delay involving members of the Pension Fund Committee until after its reconstitution following the County Council elections in May 2013. (Since then, members of the new Committee and relevant officers have been provided access to the toolkit, and a modular programme established to assess particular areas of knowledge throughout the year. This will be supplemented with regular training and awareness sessions linked to Committee meetings and the identification of ad hoc training opportunities.)

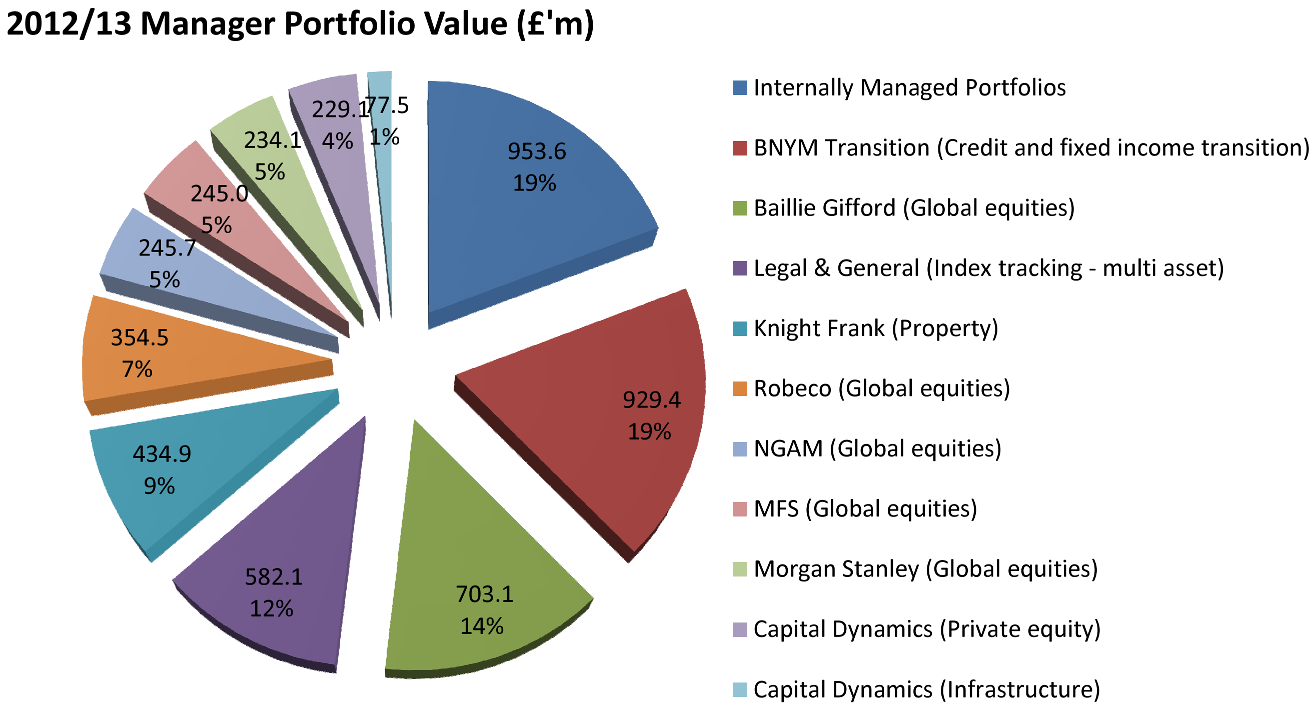
F. Investment Policy and Performance

Structure

There are three levels of responsibility for the investment management of the Lancashire County Pension Fund. First, the county council's Pension Fund Committee takes major policy decisions and monitors overall performance. Second, the Investment Panel recommends specific investment allocations in line with the Committee's policy decisions and monitors the activity of the Fund's managers. Third, the investment managers fix precise weightings and select stock within the allocations set by the Panel and Committee. A more detailed description of the responsibilities of the Committee, its Sub-Committees and the Panel is found in the Governance Policy Statement

The Panel consists of two independent external investment advisers, the Chief Investment Officer, the Deputy County Treasurer and the Treasurer to the Pension Fund, who acts as Chair. The investments of the Fund are currently principally managed by five specialist global equity managers, one external index-tracking manager (multi-asset) and in-house provision. The internal team carries out its own treasury management and holds investments in infrastructure funds and non-investment grade credit funds directly.

A summary of portfolio values by investment manager, as at 31 March 2013, is shown below.

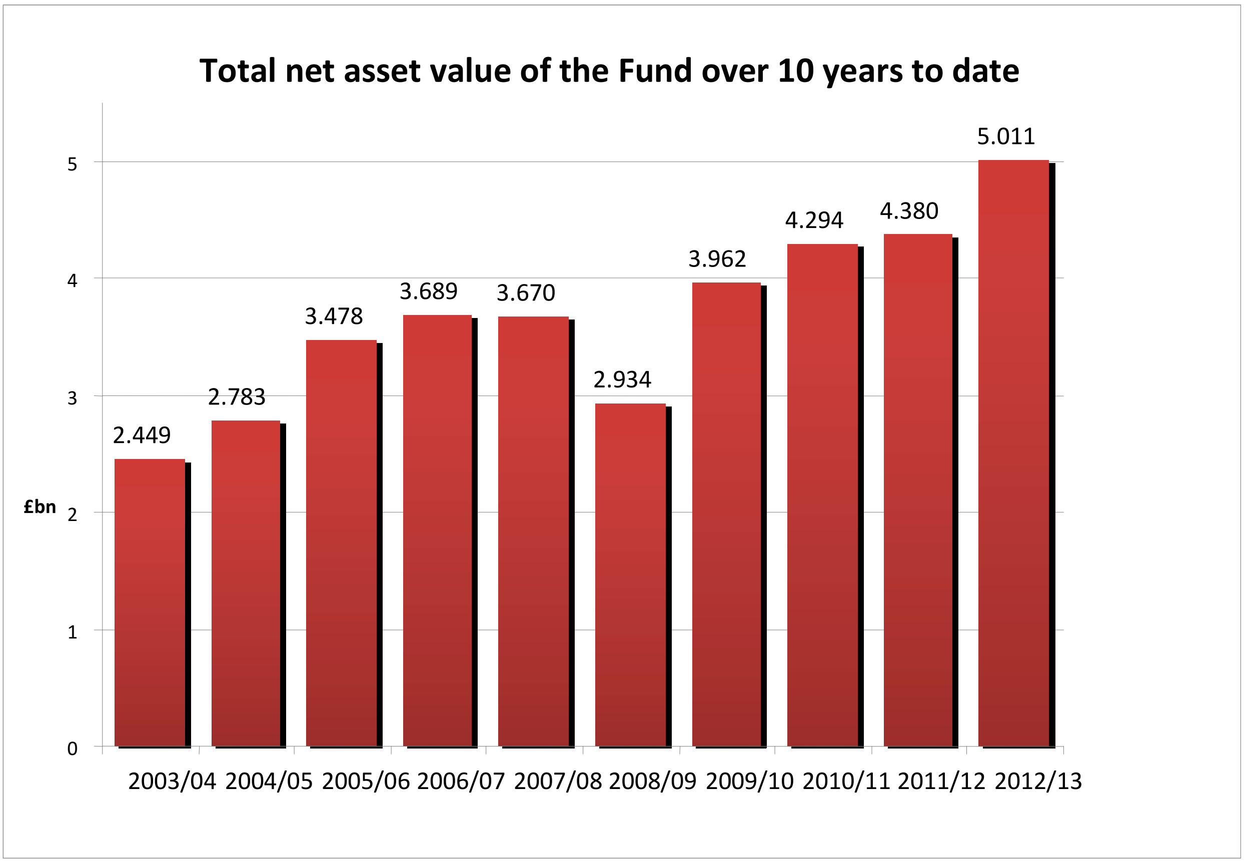


During 2012/13 the implementation of the revised investment strategy, agreed in 2010, continued. The Fund successfully completed the transition to the new global equities investment Managers with effect from 1 October 2012. The three existing equity mandates with JP Morgan (UK equities), Newton (Overseas equities) and BNY Mellon (Balanced tracking equity mandate) were sold and replaced by mandates with 5 managers each with an unconstrained global equity mandate (Baillie Gifford, MFS, Morgan Stanley, Robeco and NGAM) totalling £1.5 bn.

The transition of credit and fixed income assets has been undertaken by the appointed transition manager, Bank of New York Mellon. The resulting proceeds (£929m) are currently residing in a transition account in advance of future investment decisions being made into less commoditised and more specialist funds, including but not limited to secured lending, long-term lending, non-sterling lending, investment opportunities driven by changes to banking regulations, and index linked loans giving inflation protection.

Performance

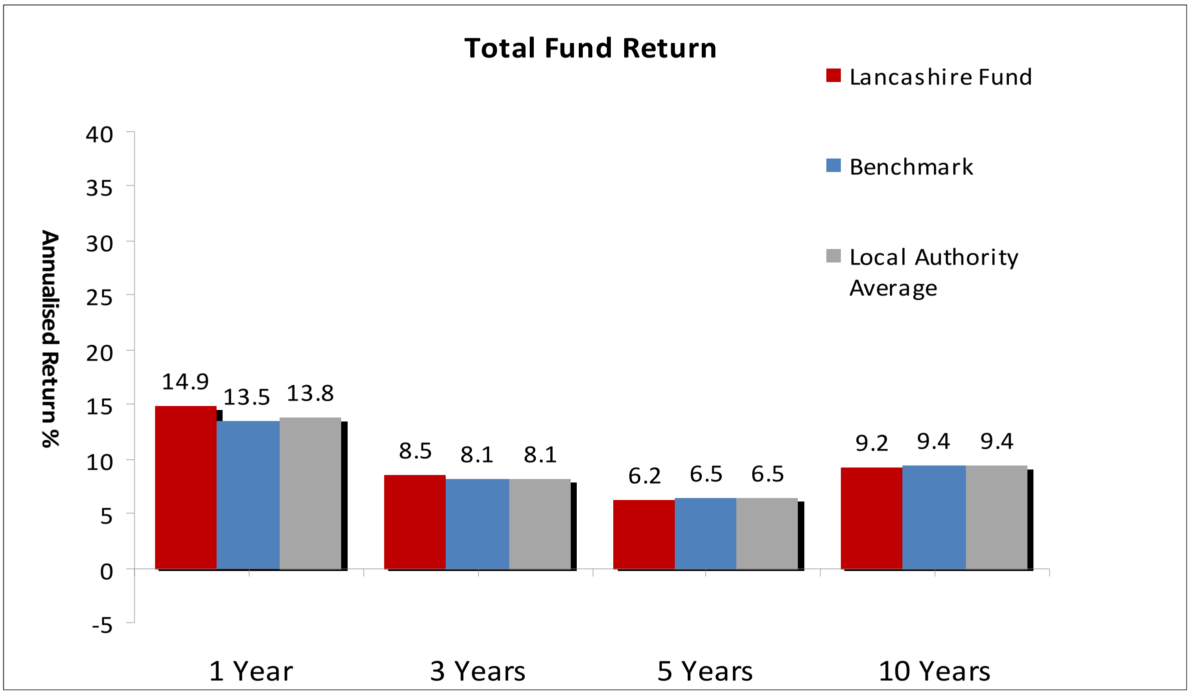
The value of the Fund's assets has more than doubled over the last ten years, as shown in the chart below:



The Fund is invested to meet liabilities over the medium to long-term and therefore its performance should be judged over a corresponding period. Annual returns can be volatile, as seen in 2008/09 and do not necessarily indicate the underlying health of the Fund.

The performance of the Fund is measured against a Fund specific benchmark with individual managers being given performance benchmarks and targets which are linked to index returns for the assets they manage. Details of these can be found in the Statement of Investment Principles. The Fund also subscribes to the annual WM Survey of UK Local Authority Pension Funds, which shows comparisons with other local authority pension funds. The performance of the investment managers is reviewed on a regular basis by the Panel and any recommendations arising from those reviews are considered by the Committee.

Looking first at total Fund returns, the chart below shows the total return of the Fund compared to the fund specific benchmark and the average local authority pension fund return measured over 1,3,5 and 10 years to 31 March 2013:



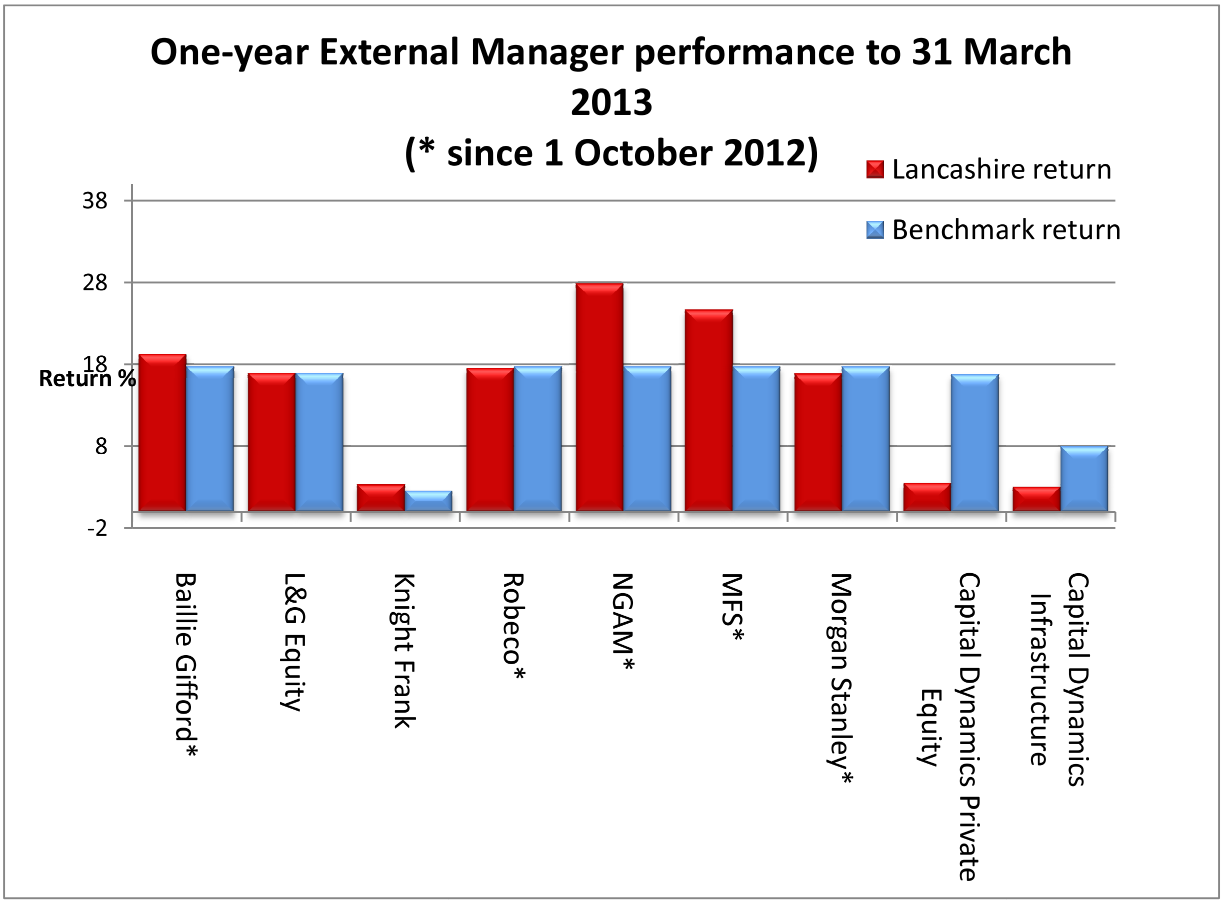
The Fund's return of almost 14.9% is above that of the average local authority pension fund of 13.8%. It ranks as the 24th percentile in the WM analysis of local authority funds.

In the year to 31 March 2013, The Total Fund return amounted to 14.9% against a benchmark of 13.5%. This significantly outperformed the Gilts +2.5% actuarial measure of 7.9% for the same period. A significant proportion of this performance was derived from global equities, delivering 20.9% in the year against a benchmark of 18.0%. Property and Bonds asset classes also exceeded their respective benchmarks, with non-investment grade assets being approximately on parity. Infrastructure assets, whose performance has been strong throughout the year, has now fallen back as the significant returns produced by the Red Rose infrastructure vehicle dropped out of the one year rolling performance.

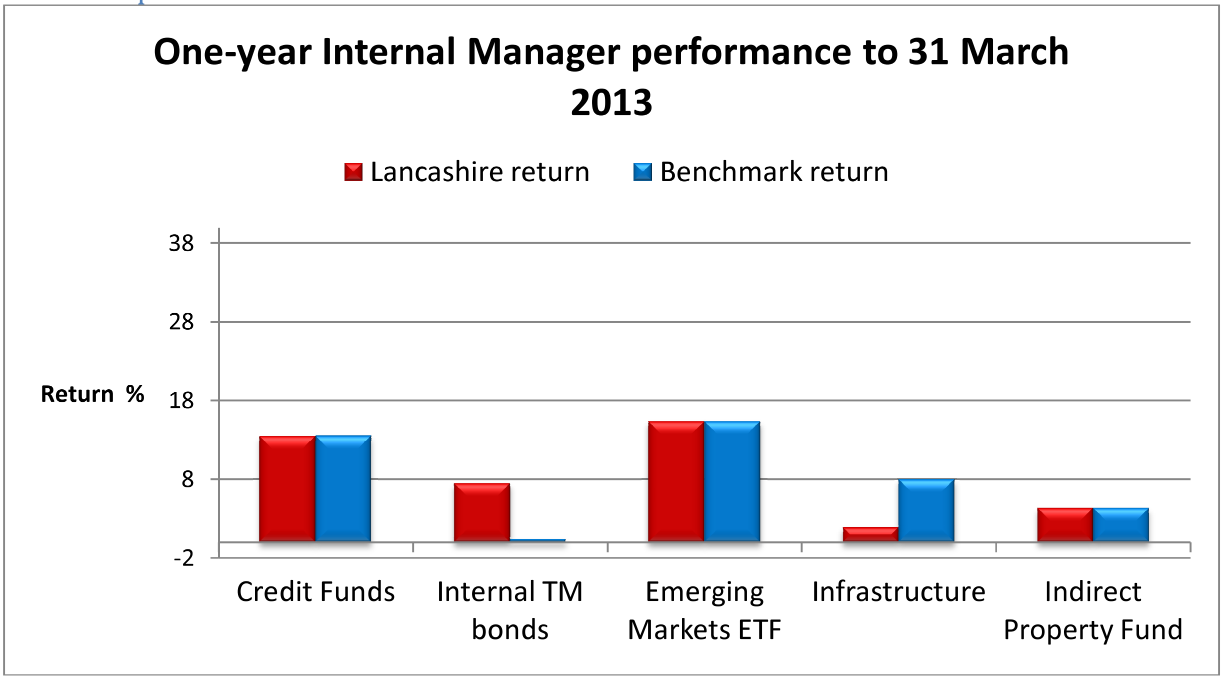
Whilst all of the new equity managers have produced significant returns since the October 2012 inception of their mandates, Baillie Gifford, MFS, and NGAM have exceeded their benchmarks most notably with the other two managers, with more defensive strategies, also close to benchmark. Capital Dynamics produced a disappointing return of 3.5% for the year to 31 March 2013 against a benchmark of 16.8% but continues to provide strong long-term performance with returns of 9.9% since inception against a benchmark of 4.98%.

The Fund's investment managers are set performance targets as shown in the Statement of Investment Principles. The overall performance target of each manager is measured over rolling three and five year periods, as inevitably there will be short-term fluctuations in performance. These targets are set for the active managers i.e. those with a mandate to outperform a benchmark through active stock picking and sector allocations. The transition portfolio and that managed by Legal and General are passive portfolios where the manager seeks to track the benchmark.

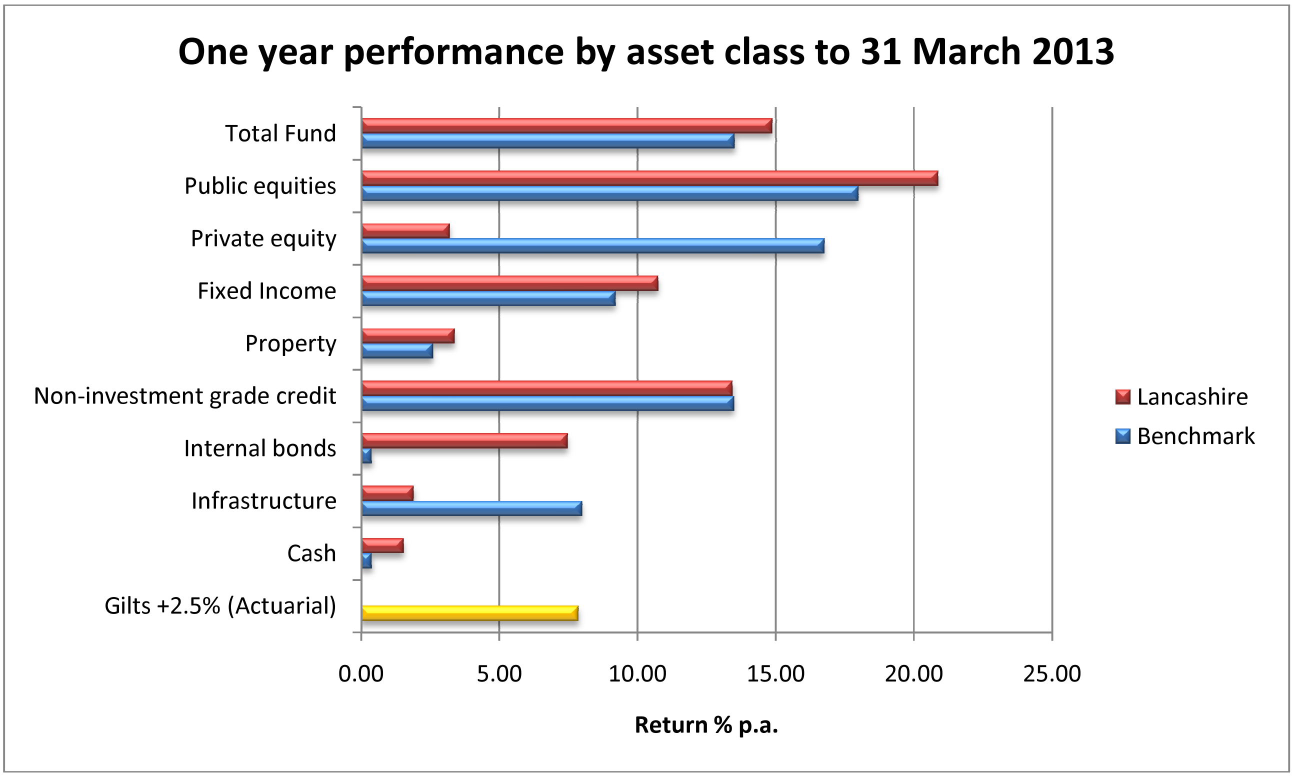
Active managers have the discretion to invest a smaller or greater amount than the benchmark allocation, within agreed constraints and tolerances. These decisions will reflect their views on market conditions within various countries or between different types of instruments. The one year performance of the managers and asset classes to 31 March 2013 are shown in the following charts:



As part of an overall portfolio strategy Robeco and Morgan Stanley were hired as defensive managers. As expected in a strongly performing market they have underperformed their benchmark. NGAM and MFS were appointed with a growth bias and the significant out - performance against benchmark reflects this. It can be argued that the long term nature of Private Equity and Infrastructure allocations are such that one year measures are invalid, as investment during the initial stages (years 1-3) generates returns in the later stages (years4-7).

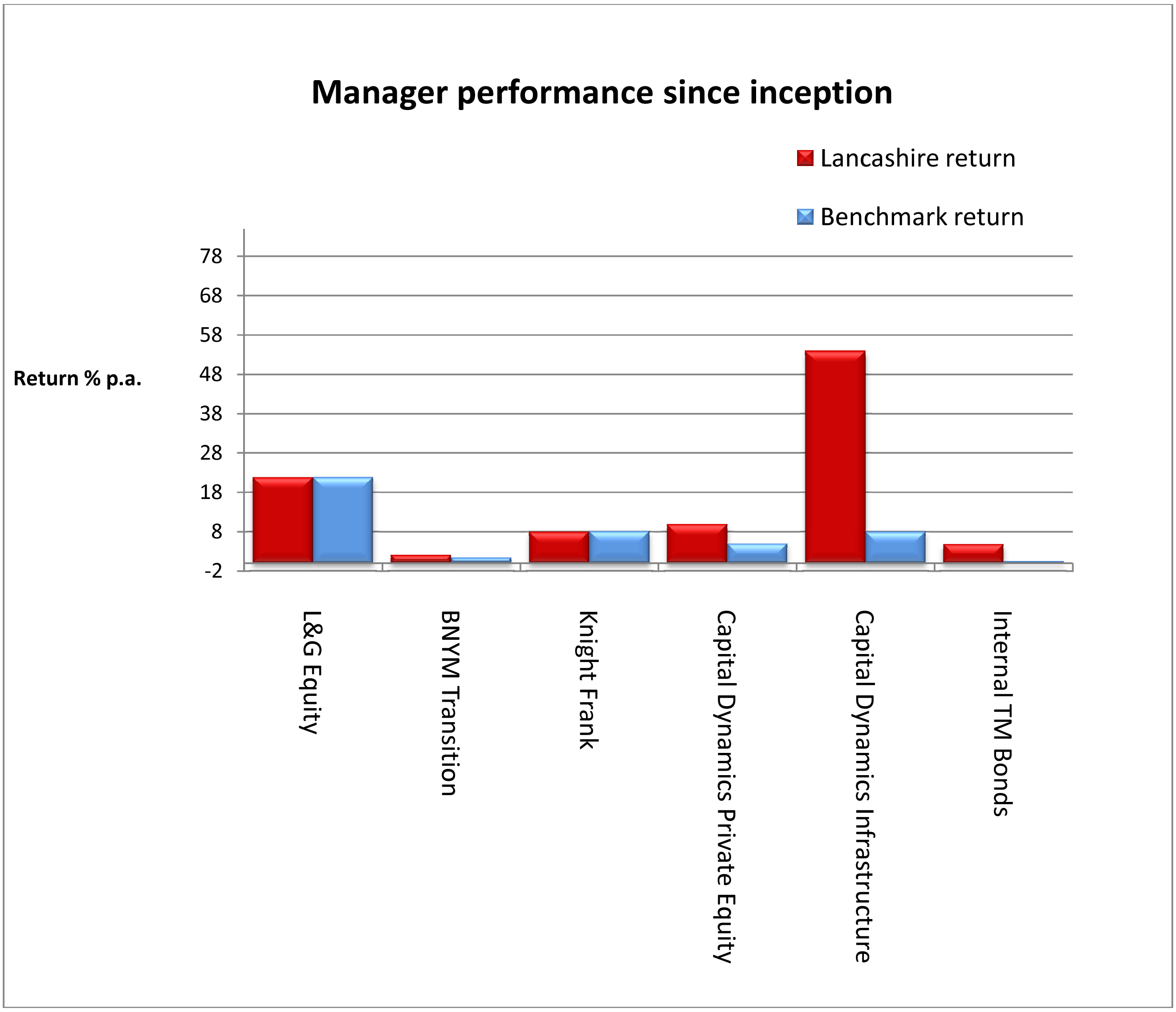


Emerging markets are passively managed and have therefore performed on a par with their benchmark. Whilst both credit funds and infrastructure are in the early stages of investment, credit funds are currently performing on a par with their benchmark whereas infrastructure as expected at a relatively early stage in the investment cycle is performing below benchmark.



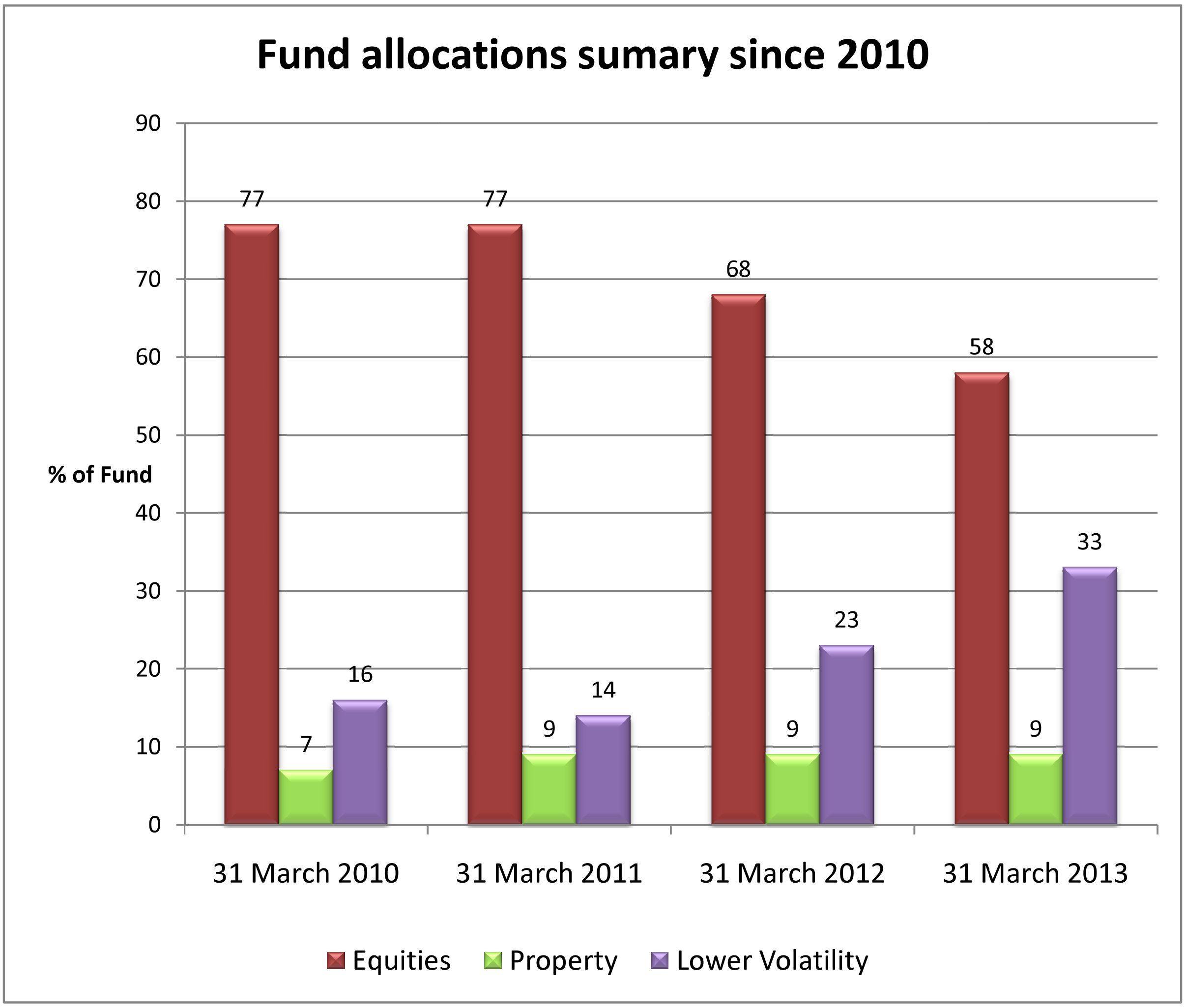
As a result of substantial asset allocation classes changes made in the period, the total fund performance is ahead of benchmark and ahead of actuarial assumptions.

An analysis of the specialist managers' performance since inception is shown in the chart below:



Since inception all managers have performed in line or in excess of their benchmark.

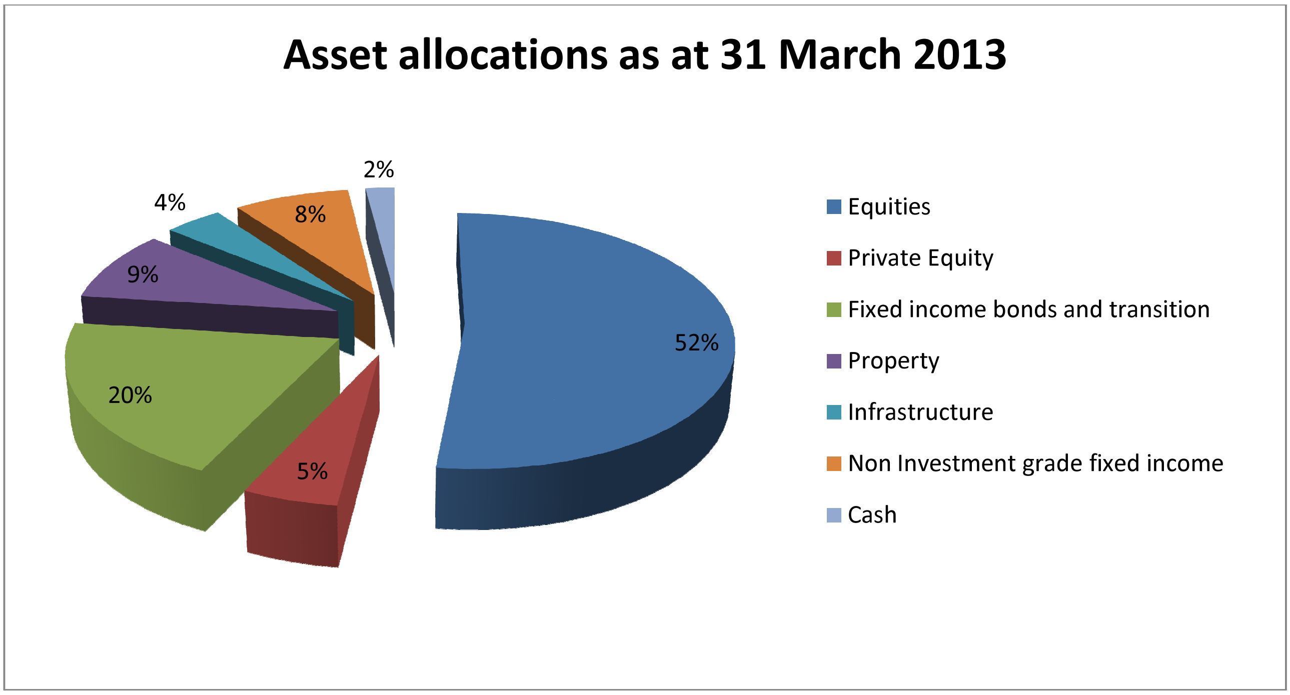
This move towards lower volatility asset classes has resulted in equities accounting for 58% of the Fund at 31 March 2013, compared with 77% three years ago. In the same period, lower volatility assets have increased from 16% to 33%. Against target allocations, equities however remain towards the top of their respective target (40%-60%), property remains just below the bottom of its target range (10%-20%), and lower volatility assets are mid-range (20%-40%).

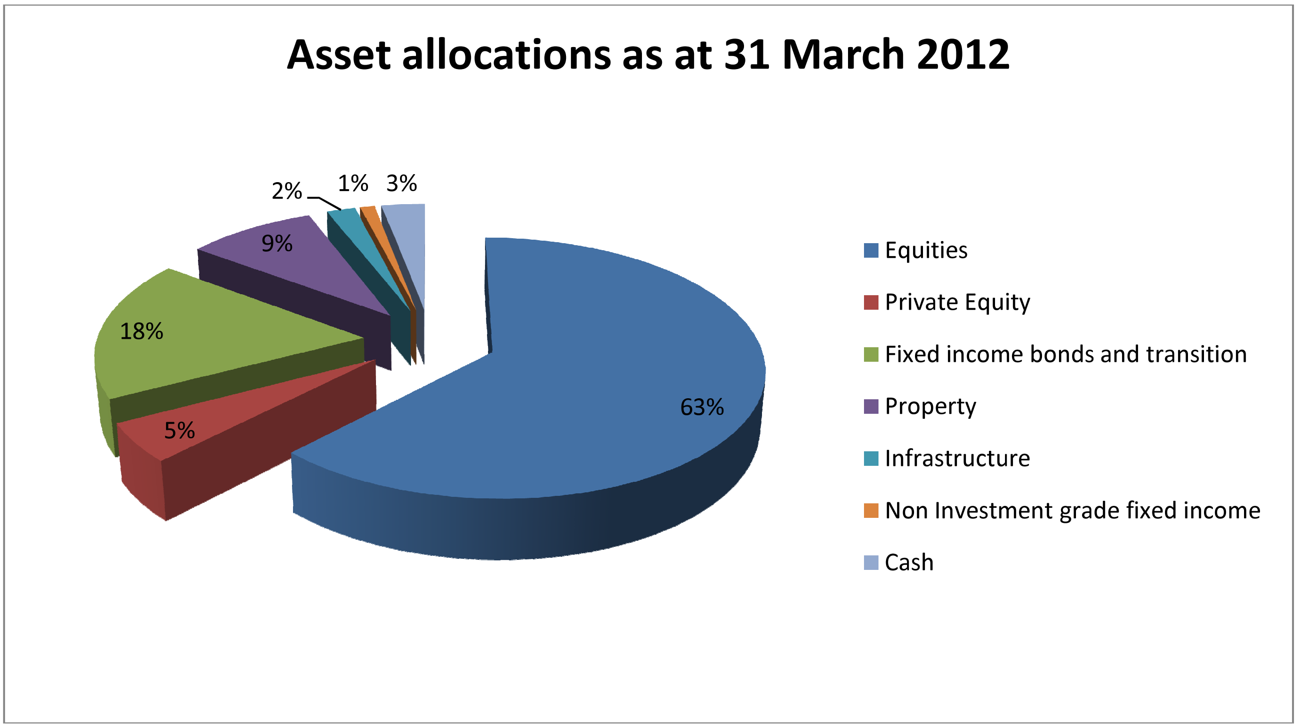


Asset allocations

The Fund is continuing to implement its revised investment strategy agreed in 2010, in actively bringing asset allocations up to the agreed benchmarks, in order to reduce the reliance on more volatile assets such as equities, in favour of less volatile asset classes such as infrastructure, senior secured loans, and emerging market debt funds.

Detailed asset class allocations, and a comparison with the previous year is shown below:





While paid up investments in infrastructure funds represent 4% of the value of the Fund, the Fund also has unpaid commitments to infrastructure funds equivalent to 3.8% of the value of the Fund at 31 March 2013.

Similarly, unpaid private equity commitments at 31 March 2013 are £137m, comprising 2.7% of The Fund in addition to the paid up investments representing 5.6% of the Fund.

The largest individual direct investments of the Fund are disclosed in the following paragraphs:

The Largest ten equity holdings of the Fund at 31 March 2013 were:

Equity	**Market value 31 March 2013 £m**	**Percentage of net assets of the Fund %**
Nestle SA CHF0.10 (Regd)	54.5	1.09
British American Tobacco Ord GBP0.25	33.8	0.68
Reckitt Benck Grp Ord GBP0.10	29.0	0.58
Visa Inc Com CL A STK	27.7	0.55
Omnicom Group Inc Com	24.8	0.50
Diageo Ord Plc	24.4	0.49
Accenture Plc SHA CL A New	23.4	0.47
CIE Financie Richemont CHF	22.2	0.45
Philip Morris Intl Com Stk NPV	22.0	0.44
Mastercard Inc CL A	21.9	0.44
Total	283.7	5.69%

The largest ten direct property holdings of the Fund at 31 March 2013 were:

Property	Sector	Market value 31 March 2013 £m
10 Brook St, London	Offices	34.5
Sainsburys Store, Elgiva Lane, Chesham	Shops	29.2
Princes Mead Shopping Centre, Farnborough	Shopping Centre	23.8
St Edmundsbury Retail Park, Bury St Edmunds	Retail Warehouse	18.7
Benson House, Leeds	Offices	17.2
Somerfield Store, Wymondham	Shops	15.3
1-3 Dufferin St, London	Offices	14.6
Stukeley Road Retail Park, Huntingdon	Retail Warehouse	14.5
Weir Road, Wimbledon	Industrial / Warehouse	14.4
Tuscany Park, Wakefield	Industrial / Warehouse	14.1
Total		196.3

Policies in respect of Socially Responsible Investment and Voting

Social, Environmental and Ethical Considerations

The Fund is active on governance issues through its membership of the Local Authority Pension Fund Forum ("LAPFF"), which exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest.

The Fund also uses the services of Pensions Investment Research Consultants ("PIRC"), which is a leading independent research and advisory consultancy providing services to institutional investors on corporate governance and corporate social responsibility.

Policy on Voting

For many years, the Fund has followed the voting recommendations of PIRC with the Fund's managers being instructed to vote at shareholder meetings in accordance with PIRC's recommendations. PIRC has been acting as the Fund's proxy since 2011 and casting the Fund's votes directly at shareholder meetings.

The Fund's investment managers receive advance notice of PIRC's voting intentions and may raise concerns with the Fund if they do not believe the recommended stance on a vote is in the best financial interests of the Fund.

The Committee delegates its agreement of any significant departure from the guidelines proposed by the managers, to the Treasurer as Chair of the Investment Panel. In all voting decisions the long-term financial interests of the Fund are paramount. There were no occurrences of this during 2012/13.

Policy on Risk

The overriding objective of the Fund in respect of its investments is to strike a balance between minimising risk and maximising return. The structure of the investment management arrangements has been implemented in order to produce a balanced spread of risk for the portfolio. Within this the managers are regularly challenged by the Panel about the risk profile of the portfolios that they manage for the Fund.

Compliance with Myners Principles

The Fund is compliant with the Myners Principles, details of which can be found in the Statement of Investment Principles

G. Accounts of the Fund

Responsibilities for the Statement of Accounts

The Responsibilities of the Administering Authority

The Administering Authority is required:

- To make arrangements for the proper administration of the financial affairs of the Lancashire County Pension Fund (Pension Fund), and to ensure that an officer has the responsibility for the administration of those affairs. For Lancashire County Council, the respective officer is the County Treasurer, who is also the Treasurer to the Pension Fund;
- To manage its affairs to secure economic, efficient and effective use of resources, and to safeguard its assets.

The Responsibilities of the Treasurer to the Pension Fund

The Treasurer to the Pension Fund is responsible for the preparation of the Pension Fund's statement of accounts. In accordance with the CIPFA Code of Practice on Local Authority Accounting in Great Britain (the Code), the statement is required to present fairly the financial position of the Pension Fund at the accounting date, and its income and expenditure for the year then ended.

In preparing this statement of accounts, the Treasurer to the Pension Fund has:

- Selected suitable accounting policies and then applied them consistently;
- Made judgements and estimates that were reasonable and prudent;
- Complied with the Code.

In addition, the Treasurer to the Pension Fund has:

- Kept proper accounting records which were up to date;
- Taken responsible steps for the prevention and detection of fraud and other irregularities.

The Statement of Accounts relate to the financial year ended 31 March 2013 and include the Fund Account and the Statement of Net Assets which are prepared in accordance with standard accounting practice as outlined in the notes to the accounts of the Pension Fund.

Gill Kilpatrick CPFA
Treasurer to the Lancashire County Pension Fund
28 June 2013

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LANCASHIRE COUNTY COUNCIL

Fund Account

	Note	2012/13 £m	2011/12 £m
Dealing with members, employers and others directly involved in the fund			
Contributions	6	202.7	209.3
Transfers in	7	9.9	11.1
		212.6	220.4
Benefits	8	(210.2)	(219.1)
Payments to and on account of leavers	9	(12.6)	(13.7)
Administrative expenses	10	(5.6)	(3.8)
		(228.4)	(236.6)
Net withdrawals from dealings with members		**(15.8)**	**(16.2)**
Return on investments			
Investment income	11	123.9	118.8
Profit and loss on disposal of investments and change in market value of investments	14	532.6	(7.9)
Investment management expenses	21	(9.7)	(8.3)
Net return on investments		**646.8**	**102.6**
Net increase (decrease) in the net assets available for benefits during the year		**631.0**	**86.4**

Net Asset statement for the year ended 31 March 2013

	Note	2013 £m	2012 £m
Investment assets	14	4,990.9	4,361.4
Investment liabilities	14	(1.9)	(1.5)
Current assets	22	31.7	23.3
Current liabilities	24	(9.7)	(3.2)
Net assets of the fund available to fund benefits at the period end		5,011.0	4,380.0

The Pension Fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end.

This statement of accounts is that upon which the auditor should enter his certificate and opinion. It presents fairly the position of the Lancashire County Pension Fund at 31 March 2013 and its income and expenditure for the year then ended.

Gill Kilpatrick CPFA

Treasurer to the Lancashire County Pension Fund

Cllr Clare Pritchard

Chair of the Audit Committee

Notes to the Financial Statements

1. **Pension Fund Operations and Membership**

The Lancashire County Pension Fund is part of the Local Government Pension Scheme and is administered by Lancashire County Council. The county council is the reporting entity for this pension fund.

The published accounts show that in 2012/13 cash inflows during the year consisted of £336.5 million and cash outflows were £238.2 million, representing a net cash inflow of £98.3 million (compared with an inflow of £94.3 million in the previous year). Benefits payable amounted to £210.2 million and were partially offset by net investment income of £123.9 million (including £21.6 million accrued dividends); contributions of £202.7 million and transfers in of £9.9 million produced the positive cash inflow.

The increase in net gain resulted from the fund executing a switch from a domestic equities strategy to a global strategy in October 2012. Since that date, the US Dollar has appreciated significantly against the Pound. This, along with long term interest rates which fell slightly whilst credit spreads tightened significantly, lead to an increase in the capital values of fixed-rate securities as the discount rates used to value them fell, contributing to an additional increase in market value

a) **General**

The fund is governed by the Superannuation Act 1972. The fund is administered in accordance with the following secondary legislation:

- the LGPS (Benefits, Membership and Contributions) Regulations 2007 (as amended)
- the LGPS (Administration) Regulations 2008 (as amended)
- the LGPS (Management and Investment of Funds) Regulations 2009

It is a contributory defined benefit pension scheme administered by Lancashire County Council to provide pensions and other benefits for pensionable employees of Lancashire County Council, the district councils in Lancashire County and a range of other scheduled and admitted bodies within the county area. Teachers, police officers and firefighters are not included as they come within other national pension schemes.

The investments of the Pension Fund are managed by nine external investment managers. The asset allocation and policy in respect of the investments of the Fund is determined by the Pension Fund Committee, which meets four times a year with the Investment Panel in attendance. The Investment Panel meet at least quarterly, or otherwise as necessary. The panel are responsible for making recommendations to the Pension Fund Committee in relation to the investment strategy of the fund as well as monitoring the activities and performance of the investment managers. Full details of the Panel and Committees responsibilities are published in the Funds Statement of Investment Principles and are available from the Funds website at http://www.yourpensionservice.org.uk

b) **Membership**

Membership of the LGPS is voluntary and employees are free to choose whether to join the scheme, remain in the scheme or make their own personal arrangements outside the scheme.

Organisations participating in the Lancashire County Pension Fund include:

- Scheduled bodies, which are local authorities and similar bodies whose staff are automatically entitled to be members of the fund.
- Admitted bodies, which are other organisations that participate in the fund under an admission agreement between the fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

Participation in the Pension Fund

		Number at 31 March 2013	Number at 31 March 2012
(1)	Active Scheme Members		
	Scheduled Bodies	49,391	46,422
	Admitted Bodies	3,572	3,716
	Total	**52,963**	**50,138**
(2)	Pensioners		
	Pensions in Payment	40,885	39,933
	Preserved Pensions	49,837	47,526
	Total	**90,722**	**87,459**

c) **Funding**

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the fund in accordance with the LGPS (Benefits, Membership and Contributions) Regulations 2007 and range from 5.5% to 7.5% of pensionable pay for the financial year ending 31 March 2013. Employee contributions are matched by employers' contributions which are set based on triennial actuarial funding valuations. The last such valuation was at 31 March 2010. Currently employer contributions range from 8.6% to 70.3% of pensionable pay.

d) **Benefits**

Pension benefits under the LGPS are based on final pensionable pay and length of pensionable service in the following summary:

	Service Pre 1 April 2008	Service post 31 March 2008
Pension	Each year worked is worth 1/80 x final pensionable salary	Each year worked is worth 1/60 x final pensionable salary
Lump sum	Automatic lump sum of 3 x salary. In addition, part of the annual pension can be exchanged for a one-off tax free cash payment. A lump sum of £12 is paid for each £1 of pension given up	No automatic lump sum. Part of the annual pension can be exchanged for a one-off tax free cash payment. A lump sum of £12 is paid for each £1 of pension given up

There are a range of other benefits provided under the scheme including early retirement, disability pensions and death benefits.

Benefits are index-linked in order to keep pace with inflation. In June 2010, the government announced that the method of indexation would change from the retail price index to the consumer price index. This change took effect from 1 April 2011.

LGPS 2014

A Statutory Consultation started on 21 December 2012 on new benefit regulations for the Local Government Pension Scheme (LGPS) from 1 April 2014. A number of further consultations have followed with the intention of having a new LGPS in place by 1 April 2014. This new Scheme will reflect the provisions of the Public Service Pensions Bill which having worked its way through Parliament reached Royal Assent on 25 April 2013.
The main provisions of the new LGPS 2014 are:

• The Scheme will be a Career Average Re-valued Earnings (CARE) Scheme with an accrual rate of 1/49th.
• The Scheme will be re-valued in line with Consumer Price Index (CPI).
• Pay will include non-contractual overtime and for part time staff pay will include additional hours.
• Flexibility in contributions will mean an optional arrangement allowing 50% of main benefits to be accrued by paying a 50% contribution rate.
• Normal Pension age will be the same as the individual member's State Pension Age (minimum 65).

The next step of the ongoing statutory consultation process is to ensure that the regulations covering the protections for current scheme members (known as the transitional regulations) are in place. These regulations describe how the move from current to new rules take place and set the foundations for protections. In particular protections will include a final salary link and protected retirement age for benefits built up to March 2014.
Over the forthcoming year the Fund will be putting together a comprehensive communications plan in order to keep scheme members informed of these changes.

2. Basis of Preparation

The Statement of Accounts summarises the fund's transactions for the 2012/13 financial year and its position at year-end as at 31 March 2013. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in United Kingdom 2012/13 which is based on International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the fund and report the net assets available to pay pension benefits. They do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of promised retirement benefits, value on an International Accounting Standard (IAS) 19 basis, is disclosed in note 31 of these accounts.

3. Accounting Policies

Fund Account revenue recognition

- **Contribution income**

Normal contributions both from members and from the employer are accounted for on an accruals basis at the percentage rate recommended by the fund actuary in the payroll period to which they relate.

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

- **Transfers**

Transfer values represent amounts received and paid during the period for individual members who have either joined or left the fund during the financial year and are calculated in accordance with Local Governance Pension Scheme Regulations.

Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in transfers in. Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

- **Investment Income**

i. Interest income

Interest income is recognised in the fund account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii. Dividend income

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the net asset statement as a current financial asset.

iii. Distribution from pooled funds

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the net asset statement as a current financial asset.

iv. Rental income

Rental income from operating leases on properties owned by the fund is recognised on a straight line basis over the term of the lease. Any lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease. Contingent rents are only recognised when contractually due.

v. Movement in the net market value of investments

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Fund Account –expense items

- **Benefits payable**

Pensions and lump sum benefits payable included all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed on the net asset statement as current liabilities.

- **Taxation**

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

- **Administrative expenses**

All administrative expenses are accounted for on an accruals basis. All other costs of administration are borne by the employer. The administration and processing expenses are a proportion of relevant officers' salaries in respect of the time allocated to pension administration and investment issues.

- **Investment Manager expenses**

Investment management expenses are accounted for on an accruals basis. They include the fees paid and due to the fund managers, custodian, actuarial fees and performance measurement and investment consultant fees.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of investments under their management and therefore increase or reduce as the value of these investments change.

In addition the fund has negotiated with the following managers that an element of their fee be performance related:

- MFS
- Morgan Stanley

As yet no performance related fees have been paid to these managers due to them having only been appointed in October 2012.

Where an investment manager's fee note has not been received by the net asset statement date, an estimate based on market value of their mandate as at year end is used for the inclusion in the fund account. In 2012/13 £2.2m of fees is based on such estimates (2011/12 £1.3m).

The costs of the council's in-house fund management team are charged direct to the fund and a proportion of the council's costs representing management time spent by officers on investment management are also charged to the fund.

Net asset statement

- **Financial Instruments**

Financial assets are included in the net asset statement on a fair value basis as at the reporting date. A financial asset is recognised in the net asset statement on the date the fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes in the fair value of the asset are recognised by the fund.

On initial recognition the Fund is required to classify financial assets and liabilities into held to maturity investments, available for sale financial assets, held for trading, designated at fair value through profit and loss or loans and receivables.

The assets and liabilities held by Lancashire County Pension Fund are classified as designated at fair value through profit and loss, loans and receivables and liabilities at amortised cost.

Financial instruments at fair value through profit or loss

Financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the fund manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Loans and receivables

Loans and receivables are non derivative financial assets with fixed or determinable payments that are not quoted in an active market.

The fund's loans and receivables comprise of trade and other receivables and cash deposits.

Financial liabilities at amortised cost

Financial liabilities at amortised cost are the default category for financial instruments that do not meet the definition of financial liabilities at fair value through profit and loss.

- **Valuation of Investments**

Investments are shown at their fair value as at 31 March 2013. The fair value is the current bid price for quoted securities and unitised securities.

Transaction costs are included in carrying value of investments. Transaction costs include costs charged directly to the Pension Fund, such as fees, commissions paid to agents, brokers and dealers, levies by regulatory agencies and securities exchanges and transfer taxes and duties.

Investments in Private Equity are valued at fair value in accordance with the guidelines issued by the British Venture Capital Association, or equivalent.

The methodologies adopted in valuing financial instruments are explained in greater detail in note 18.

- **Currency Translation**

Assets and liabilities denominated in foreign currency are stated in the accounts by the application of the appropriate closing rate of exchange ruling at 31 March 2013. Any gains or losses are treated as part of a change in market value of investments.

- **Acquisition costs of Investments**

The Acquisition costs of investments are included within the purchase price.

- **Property**

The fund's freehold and leasehold properties were valued on 31 March 2013 by Cushman & Wakefield, acting as External Valuer. The valuations were in accordance with the requirements of the RICS Valuation standards and the International Valuation Standards. The valuation of each property was on the basis of Market Value, assuming that the property would be sold subject to any existing leases. The valuer's opinion of Market Value and Existing Use Value was primarily derived using comparable recent market transactions on arm's length terms.

- **Derivatives**

The fund uses derivative financial instruments to manage its exposure to specific risks arising from its investment activities. The fund does not hold derivatives for speculative purposes.

Derivative contract assets are fair valued at bid prices and liabilities are fair valued at offer prices. Changes in fair value of derivative contracts are included in change in market value.

Future contracts are exchange traded and fair value is determined using exchange prices at their reporting date. Amounts due or owed to the broker are amounts outstanding in respect of initial margin and variation margin.

Forward foreign exchange contracts, are over the counter contracts and are valued by determining the gain or loss that arise from closing out the contract at the reporting date, by entering into an equal and opposite contract at that date.

- **Cash and cash equivalents**

Cash comprises of cash in hand and demand deposits.

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

- **Financial liabilities**

The fund recognises financial liabilities at fair value at the reporting date. A financial liability is recognised in the net asset statement on the date the fund becomes party to a liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised by the fund.

- **Actuarial present value of promised retirement benefits**

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS19 and relevant actuarial standards.

As permitted under IAS 26 the fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net asset statement (Note 31).

- **Additional voluntary contributions**

The AVC providers to the Pension Fund are Equitable Life and Prudential. The AVC's are invested separately from the Pension Fund's main assets and used to acquire additional money purchase benefits. These are not included in the Pension Fund accounts in accordance with section 4(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093). Members participating in these AVC arrangements each receive an annual statement confirming the amounts held in their account and the movements during the year. A summary of the information provided by Equitable Life and Prudential is shown in note 20.

- **Securities Lending**

Investments lent under securities lending arrangements continue to be recognised in the net asset statement to reflect the scheme's continuing economic interest in the securities and are measured in accordance with the accounting policy for assets 'At fair value through income statement' or 'Available for sale' as appropriate.
Collateral is marked to market, and adjusted daily. As the Fund has an obligation to return the collateral to the borrowers, collateral is excluded from the Fund valuation.

- **Contingent liabilities and contingent assets**

A contingent liability is a possible obligation that arises from past events whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events beyond the control of the Fund or a present obligation that is not recognised because it is not probable that an outflow of resources will be required to settle the obligation. A contingent liability also arises in extremely rare cases where there is a liability that cannot be recognised because it cannot be measured reliably. The Fund does not recognise a contingent liability but discloses its existence in the financial statements.

A contingent asset is a possible asset that arises from past events whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events beyond the control of the Fund. The Fund does not recognise contingent assets but discloses its existence where inflows of economic benefits are probable, but not virtually certain.

4. Critical Judgements in applying accounting policies

The fund has recognised a deposit with Landsbanki as an asset on the balance sheet as at 31st March 2013. Judgement is required in determining the recoverability of this asset at each balance sheet date. The Fund has assessed recoverability with reference to Landsbanki's financial position as at 31st December 2012 as published by the bank's Winding Up Board and considers that it is likely that 100% of the deposit, subject to exchange rate fluctuations, will be recovered. This is in line with advice issued by CIPFA and LAPFF.

5. Assumptions made about the future and other major sources of estimated uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Pension Fund about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Pension Fund's net asset statement at 31 March 2013 for which there is a significant risk of material adjustment in the forthcoming year are as follows:

Item	Uncertainties	Impact if actual results differ from assumptions
Private Equity and Infrastructure	Private Equity and Infrastructure investments are valued at fair value in accordance with British Private Equity and Venture Capital Association guidelines / International Private Equity and Venture Capital Valuation guidelines or equivalent. These investments are not publicly listed and as such there is a degree of estimation involved in the valuation.	The private equity and infrastructure investments in the financial statements are £383.5m. There is a risk that this investment may be under or overstated in the accounts.
Pensions Liability	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries (Mercers) is engaged to provide the authority with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, a 0.5% increase in the discount rate assumption would reduce the value of the liabilities by approximately £624 million. A 0.25% increase in assumed earnings inflation would increase the value of the liabilities by approximately £86m and a 1 year increase in assumed life expectancy would increase the liabilities by approximately £146m.

6. Contributions receivable

	2012/13 £m	2011/12 £m
Employers' contributions		
County Council	63.4	68.5
Scheduled Bodies	74.7	75.7
Admitted	12.9	12.9
	151.0	157.1

Employees' contributions		
County Council	20.6	20.5
Scheduled Bodies	26.3	26.8
Admitted	4.8	4.9
	51.7	52.2
Total contributions	202.7	209.3

Within the employee contributions figure for 2012/13, £0.2m is voluntary and additional regular contributions. All employer contributions are normal contributions.

7. Transfers in

	2012/13 £m	2011/12 £m
Individual transfers in from other schemes	9.9	11.1
	9.9	11.1

8. Benefits

	2012/13 £m	2011/12 £m
Pensions	176.5	163.6
Lump sum retirement benefits	28.3	51.0
Lump Sum death benefits	5.4	4.5
	210.2	219.1

9. Payments to and on account of leavers

	2012/13 £m	2011/12 £m
Refunds to members leaving service	0	0.1
Contributions equivalent premium	0	(0.1)
Individual transfers to other schemes	12.6	13.7
	12.6	13.7

10. Administrative expenses

	2012/13 £m	2011/12 £m
Administration and processing	3.8	3.4
Audit fee	0.1	0.1
Legal and other professional fees	1.7	0.3
	5.6	3.8

11. Investment income

	2012/13 £m	2011/12 £m
Fixed interest securities	21.5	27.7
Equity dividends	59.5	46.5
Index linked securities	1.2	2.8
Pooled investment vehicles	6.3	5.5
Rents from properties	28.1	26.0
Interest on cash deposits	2.8	0.7
Other	4.5	9.6
	123.9	118.8

12. Net rents from Properties

	2012/13 £m	2011/12 £m
Rental Income	28.1	26.0
Direct operating expenses	(3.1)	(1.2)
Net income	25.0	24.8

13. Stock Lending

Northern Trust the Fund's custodian, are authorised to release stock to a third party under stock lending arrangements up to the statutory limits for this activity. Stock lending income generated in 2012/13 was £643,034 (2011/12 £467,745)

Securities on loan at the 31st March 2013 were £107.9m and are included in the net asset statement to reflect the scheme's continuing economic interest in the securities. This consisted of £91.9m of equities and £16m of bonds.

Collateral is marked to market, and adjusted daily. Additional collateral of between 2% and 5% is requested as an additional measure of industry standard practice to mitigate risk. As the Fund has an obligation to return the collateral to the borrowers, collateral is excluded from the Fund valuation. The collateral is non cash and totalled £116.6m of government bonds.

14. Reconciliation of movements in investments and derivatives

	Market Value at 1 April 2012 £m	Purchases at cost and derivative payments £m	Sales proceeds and derivative receipts £m	Change in market value £m	Market value at 31 March 2013 £m
Fixed interest securities	623.4	501.1	(471.9)	191.0	843.6
Equities	1,613.7	1,409.8	(1,581.2)	307.0	1,749.3
Index linked securities	124.6	16.1	(29.1)	53.3	164.9
Pooled investments	1,466.3	696.6	(558.9)	(2.8)	1,601.2
Property	383.9	72.1	(5.3)	(15.8)	434.9
	4,211.9	2,695.7	(2,646.4)	532.7	4,793.9
Derivative contracts:					
Futures	0.2	0.4	(0.5)	(0.1)	0.0
Forward currency contracts	1.6				3.0
Cash deposits	126.8				170.5
Investment accruals	19.4				21.6
	4,359.9				4,989.0

	Market Value at 1 April 2011 £m	Purchases at cost and derivative payments £m	Sales proceeds and derivative receipts £m	Change in market value £m	Market value at 31 March 2012 £m
Fixed interest securities	559.1	696.0	(657.8)	26.1	623.4
Equities	1,735.1	401.0	(441.9)	(80.5)	1,613.7
Index linked securities	141.0	120.9	(159.1)	21.8	124.6
Pooled investments	1,395.5	399.2	(359.6)	31.2	1,466.3
Property	397.5	24.2	(34.1)	(3.7)	383.9
	4,228.2	1,641.3	(1,652.5)	(5.1)	4,211.9
Derivative contracts:					
Futures	0.9	41.4	(39.3)	(2.8)	0.2
Forward currency contracts	0.9				1.6
Cash deposits	36.6				126.8
Investment accruals	14.6				19.4
	4,281.2				4,359.9

Transaction costs are included in the cost of purchases and in sale proceeds. Transaction costs include costs charged directly to the Pension Fund, such as fees, commissions paid to agents, brokers and dealers, levies by regulatory agencies and securities exchanges and transfer taxes and duties. Transaction costs incurred during the year 2012/13 amounted to £2.2m (2011/12: £2.0m).

The investment assets at 31 March 2013 are managed by nine external investment managers, with the remaining cash deposits managed in-house. Details of the split of the investment assets by investment manager is below:

Summary of Manager's Portfolio Values as at 31st March 2013

	2012/13		**2011/12**	
	£m	%	**£m**	**%**
Externally Managed				
BNYM Transition (Credit and fixed income transition)	929.4	19%	-	0%
Baillie Gifford (Global equities)	703.1	14%	-	0%
Legal & General (Index tracking - multi asset)	582.1	12%	1,057.4	24%
Knight Frank (Property)	434.9	9%	383.9	9%
Robeco (Global equities)	354.5	7%	-	0%
NGAM (Global equities)	245.7	5%	-	0%
MFS (Global equities)	245.0	5%	-	0%
Morgan Stanley (Global equities)	234.1	5%	-	0%
Capital Dynamics (Private equity)	229.1	4%	222.4	5%
Capital Dynamics (Infrastructure)	77.5	1%	50.4	1%
Newton (Global equities)	-	0%	615.6	14%
JP Morgan (UK equities)	-	0%	501.4	12%
BNYM Transition (Global equities)	-	0%	617.1	14%
UBS (Bonds)	-	0%	672.7	15%
Externally Managed Portfolios	4,035.4	81%	**4,120.9**	**95%**
Internally Managed				
Credit Funds	424.0	9%	49.3	1%
Cash and bonds	226.1	5%	166.8	4%
Emerging markets ETF	219.1	4%	-	0%
Infrastructure Funds	76.9	1%	22.9	1%
Indirect Property Funds	7.5	0%	-	0%
Internally Managed Portfolios	953.6	19%	**239.0**	**5%**
Total Portfolio Values	4,989.0	100%	**4,359.9**	**100%**

	2012/13 £m	2011/12 £m
Fixed Interest Securities		
UK public sector quoted	294.9	234.3
UK corporate bonds quoted	225.0	289.0
Overseas corporate bonds quoted	323.7	100.1
	843.6	623.4

	2012/13 £m	2011/12 £m
Equities		
UK quoted	218.3	772.8
Overseas quoted	1,531.0	840.9
	1,749.3	1,613.7

	2012/13 £m	2011/12 £m
Index Linked Securities		
UK quoted	164.9	124.6
	164.9	124.6

	2012/13 £m	2011/12 £m
Pooled Investment Vehicles		
UK Managed Funds:		
Equities	166.0	537.0
Private Equity	120.6	31.9
Infrastructure	98.2	67.6
Fixed Income	-	192.2
O/S Managed Funds:		
Equities	632.2	400.3
Private Equity	108.5	182.3
Infrastructure	56.2	5.7
Property	7.5	-
Credit funds	412.0	49.3
	1,601.2	1,466.3

	2012/13 £m	2011/12 £m
Properties		
UK – Freehold	346.4	292.9
UK – Long Leasehold	88.5	91.0
	434.9	383.9

	2012/13 £m	2011/12 £m
Balance at start of the year	383.9	397.5
Additions	72.1	24.2
Disposals	(5.3)	(34.1)
Net gain/loss on fair value	(15.8)	(3.7)
Balance at the end of the year	434.9	383.9

	2012/13 £m	2011/12 £m
Derivatives Contracts		
Futures Contracts	-	0.2
	-	0.2

Derivative contracts (forward currency positions)

Settlement date	Bought £m EQV	Sold £m EQV	£m
Investment assets			
6 months and under	51.8	46.9	4.9
Investment liabilities			
6 months and under	65.5	67.4	(1.9)
Over 6 months	4.0	4.0	0.0

Forward Foreign currency contracts are used to hedge against foreign currency movements.

	2012/13 £m	2011/12 £m
Cash Deposits		
Sterling	116.6	110.9
Foreign currency	53.9	15.9
	170.5	126.8

15. **Financial Instruments classification**

Accounting policy describes how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses are recognised. The following table analyses the carrying amounts of financial assets and liabilities by category and net asset statement heading.

2013	Designated at fair value through profit or loss £m	Loans and receivables £m	Financial liabilities at amortised cost £m
Financial assets			
Fixed interest securities	843.6	-	-
Equities	1,749.3	-	-
Index linked securities	164.9	-	-
Pooled investment vehicles	1,601.2	-	-
Derivative contracts	4.9	-	-
Cash deposits	-	170.5	-
Investment accruals	21.6	-	-
Debtors	-	31.7	-
Total Financial Assets	**4,385.5**	**202.2**	**-**
Financial liabilities			
Derivative contracts	1.9	-	-
Creditors	-	-	9.7
Total Financial Liabilities	**1.9**	**-**	**9.7**

2012	Designated at fair value through profit or loss £m	Loans and receivables £m	Financial liabilities at amortised cost £m
Financial assets			
Fixed interest securities	623.4	-	-
Equities	1,613.7	-	-
Index linked securities	124.6	-	-
Pooled investment vehicles	1,466.3	-	-
Derivative contracts	3.4	-	-
Cash deposits	-	126.8	-
Investment accruals	19.4	-	-
Debtors	-	23.3	-
Total Financial Assets	**3,850.8**	**150.1**	**-**
Financial liabilities			
Derivative contracts	1.6	-	-
Creditors	-	-	3.2
Total Financial Liabilities	**1.6**	**-**	**3.2**

16. Net gains and losses on financial instruments

	2013 £m	2012 £m
Financial assets		
Fair value through profit and loss	532.6	7.9
Loans and Receivables	-	-
Financial Liabilities		
Fair value through profit and loss	-	-
Loans and Receivables		
Financial liabilities at amortised cost	-	-
Total	**532.6**	**7.9**

The increase in net gain resulted by the fund executing a switch from a domestic equities strategy to a global strategy in October 2012. Since that date, the US Dollar has appreciated significantly against the Pound. This, along with long term interest rates which fell slightly whilst credit spreads tightened significantly, lead to an increase in the capital values of fixed-rate securities as the discount rates used to value them fell, contributing to an additional increase in market value.

17. Financial Instruments – Fair Value of Financial Instruments and Liabilities

The following table summarises the carrying values of the financial assets and liabilities presented in the Fund's net asset statement. The fair values presented in the table are at a specific date and may be significantly different from the amounts which were actually paid or received on the maturity or settlement date.

	Carrying Value 2013 £m	Carrying Value 2012 £m	Fair Value 2013 £m	Fair Value 2012 £m
Financial assets				
Trading and other financial assets at fair value through profit and loss	3,784.4	3,347.5	4,385.5	3,850.8
Loans and Receivables	202.2	150.1	202.2	150.1
Total Financial Assets	**3,986.6**	**3,497.6**	**4,587.7**	**4,000.9**
Financial Liabilities				
Trading and other financial liabilities at fair value through profit and loss	1.9	1.6	1.9	1.6
Financial liabilities at amortised cost	9.7	3.2	9.7	3.2
Total Financial Liabilities	**11.6**	**4.8**	**11.6**	**4.8**

18. Financial Instruments – Valuation

Valuation of financial instruments carried at fair value

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

Level 1

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities, quoted fixed securities, quoted index linked securities and unit trusts.

Listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2

Level 2 investments are those where quoted market prices are not available, for example where an instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.
*This investment class comprises of credit funds which in 11/12 were classified as level 1. The technique for valuing these assets is independently verified.

Level 3

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include private equity, infrastructure, local authority bonds and indirect overseas property investments, which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings, public market comparables and estimated future cash flows.

The values of the investment in private equity and infrastructure are based on valuations provided to the private equity and infrastructure funds in which Lancashire County Pension Fund has invested. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or equivalent, which follow the valuation principles of IFRS and US GAAP. Valuations are performed annually mainly, and at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The overseas indirect property fund is valued monthly by external valuers, CB Richard Ellis (CBRE). CBRE are one of the largest firms of valuers in Europe, and are required to ensure that the assets in the Fund are valued each month at the current open market value, as defined by the RICS Appraisal and Valuation Standards. The valuation methodology is also subject to independent review by E&Y.

The local authority bond value is based on a valuation technique that requires management judgement including earning multiples, public market comparables and estimated future cash flows.

The table below provides an analysis of the financial assets and liabilities of the Pension Fund grouped into level 1 to 3 based on the level of which the fair value is observable.

2013	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Financial assets at fair value through profit and loss	3,553.0	424.0	408.5	4,385.5
Loans and Receivables	202.2	-	-	202.2
Total Financial assets	**3,755.2**	**424.0**	**408.5**	**4,587.7**

Financial Liabilities				
Financial liabilities at fair value through profit and loss	1.9	-	-	1.9
Financial liabilities at amortised cost	9.7	-	-	9.7
Total Financial Liabilities	**11.6**	**-**	**-**	**11.6**

2012	**£m**	**£m**	**£m**	**£m**
Financial assets				
Financial assets at fair value through profit and loss	3,497.4	*49.3	304.1	3,850.8
Loans and Receivables	150.1	-	-	150.1
Total Financial assets	**3,647 .5**	**49.3**	**304.1**	**4,000.9**
Financial Liabilities				
Financial liabilities at fair value through profit and loss	1.6	-	-	1.6
Financial liabilities at amortised cost	3.2	-	-	3.2
Total Financial Liabilities	**4.8**	**0**	**0**	**4.8**

19. Nature and extent of risks arising from Financial Instruments

Risk and risk management

The Fund's primary long-term risk is that the Fund's assets will fall short of its liabilities (i.e. promised benefits payable to members). The aim of investment risk management is to balance the minimisation of the risk of an overall reduction in the value of the Fund with maximising the opportunity for gains across the whole Fund portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and keep credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flow.

Responsibility for the Fund's risk management strategy rests with the Pension Fund Committee. Risk management policies are established to identify and analyse the risks faced by the Fund's operations. Policies are reviewed regularly to reflect change in activity and in market conditions.

a) Market risk

Market risk is risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings.

The objective of the Fund's risk management strategy is to identify, manage and keep market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Fund and its investment advisors undertake appropriate monitoring of market conditions and benchmarking analysis.

Other price risk

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

The Fund is exposed to share and derivatives 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.

The Fund's investment managers mitigate this price risk through diversification. The selection of securities and other financial instruments is monitored by the Fund to ensure it is within limits specified in the fund investment strategy.

Other price risk – sensitivity analysis

Following analysis of historical data and expected investment return movement during the financial year, in consultation with the Fund's investment advisors, the Fund has determined that the following movements in market price risks are reasonably possible for the 2012/13 reporting period.

Asset Type	Potential market movements (+/-)
UK Bonds	4.6%
Overseas bonds	8.7%
UK equities	12.8%
Overseas equities	12.8%
Index linked Gilts	8.1%
Cash	0%
Alternatives	3.6%
Property	1.8%

The potential price changes disclosed above are broadly consistent with a one-standard deviation movement in value of the asset. The sensitivities are consistent with the assumption contained in the investment advisors' most recent review. This analysis assumes that all other variables, in particular foreign currency exchange rates and interest rates, remain the same.
Had the market of the Fund's investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market place would have been as follows (the prior year comparator is shown below):

Asset Type	Value as at 31 March 2013	Percentage Change	Value on Increase	Value on Decrease
	£m	%	£m	£m
Cash and Cash equivalents	195.1	0.0%	195.1	195.1
Investment portfolio assets:				
UK bonds	519.9	4.6%	543.6	496.1
Overseas bonds	323.7	8.7%	351.8	295.6
Total equities	1,749.3	12.8%	1,973.2	1,525.4
Index linked gilts	164.9	8.1%	178.2	151.6
Alternatives	1,601.2	3.6%	1,658.9	1,543.6
Property	434.9	1.8%	442.7	427.0
Total asset available to pay benefits	4,989.0		5,343.5	4,634.4

Asset Type	Value as at 31 March 2012	Percentage Change	Value on Increase	Value on Decrease
	£m	%	£m	£m
Cash and Cash equivalents	147.9	0.0	147.9	147.9
Investment portfolio assets:				
UK bonds	695.7	5.7%	735.3	656.1
Overseas bonds	100.0	11.8%	111.8	88.2
UK equities	1,341.4	15.3%	1,547.3	1,135.6
Overseas equities	1,236.9	14.8%	1,420.3	1,053.5
Index linked gilts	166.9	7.6%	179.6	154.2
Alternatives	287.4	7.7%	309.6	265.2
Property	383.8	9.4%	419.7	347.9
Total asset available to pay benefits	4,359.9		4,871.5	3,848.5

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 represent the risks that the fair value of future cash flow of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is routinely monitored by the Investment Panel and its investment advisors. The Fund's direct exposure to interest rate movements as at 31 March 2013 and 31 March 2012 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value.

Asset Type	As at 31 March 2013	As at 31 March 2012
	£m	£m
Cash and cash equivalents	170.5	126.8
Fixed interest securities	1,255.5	815.6
Total	**1,426.0**	**942.4**

Interest rate risk sensitivity analysis

The Fund has recognised that interest rates can vary and can affect both income to the Fund and the value of the net assets available to pay benefits. A 110 basis point (BPS) movement in interest rates is consistent with the level of sensitivity applied as part of the Fund's risk management strategy. The Fund's investment advisor has advised that long–term average rates are expected to move less than 110 basis point for one year to the next and experience suggests that such movements are likely.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits of a +/- 100 BPS change in interest rates:

Asset Type	Carrying amounts as at 31 March 2013	Change in year in net assets available to pay benefits	
		+100BPS	-100BPS
	£m	£m	£m
Cash and cash equivalents	170.5	1.7	(1.7)
Fixed interest securities	1,255.5	12.5	(12.5)
Total change in asset available	**1,426.0**	**14.2**	**(14.2)**

Asset Type	Carrying amounts as at 31 March 2012	Change in year in net assets available to pay benefits	
		+100BPS	-100BPS
	£m	£m	£m
Cash and cash equivalents	126.8	1.3	(1.3)
Fixed interest securities	815.6	8.1	(8.1)
Total change in asset available			

Currency risk

Currency risk represents the risk that the fair value cash flow 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 (£). The Fund holds both monetary and non-monetary assets denominated in currencies other than £.

The Fund's currency rate risk is routinely monitored by the Fund and its investment advisors in accordance with the Fund's risk management strategy.

The following table summarises the Fund's currency exposure as at 31 March 2013 and as at the previous year end:

Currency exposure – asset type	**Asset value as at 31 March 2013**	**Asset value as at 31 March 2012**
	£m	**£m**
Overseas Equities	1,531.0	1,236.9
Overseas Bonds	323.7	100.0
Overseas Alternatives	164.7	187.9
Overseas Pooled	1,051.7	449.6
Total overseas assets	**3,071.1**	**1,974.4**

Currency risk – sensitivities analysis

Following analysis of historical data in consultation with the Fund's investment advisors, the Fund considers the likely volatility associated with foreign exchange rate movement to be 6.1% (as measured by one standard deviation).

A 6.1% fluctuation in the currency is considered reasonable based on the Fund advisor's analysis of long-term historical movements in the month-end exchange rates over a rolling 36-month period.

This analysis assumes that all other variables, in particular interest rates, remain constant.

A 6.1% strengthening/weakening of the pound against the various currencies in which the Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Currency exposure – asset type	**Asset value as at 31 March 2013**	**Change to net assets available to pay benefits**	
		+6.1%	**-6.1%**
	£m	**£m**	**£m**
Overseas Equities	1,531.0	1,624.4	1,437.2
Overseas Bonds	323.7	343.5	303.9
Overseas Alternatives	164.7	174.8	154.6
Overseas Pooled	1,051.7	1,115.8	987.5
Total change in assets available	3,071.1	3,258.5	2883.2

Currency exposure – asset type	**Asset value as at 31 March 2012**	**Change to net assets available to pay benefits**	
		+9.7%	**-9.7%**
	£m	**£m**	**£m**
Overseas Equities	1,236.9	1,357.0	1,116.8
Overseas Bonds	100.0	109.7	90.3
Overseas Alternatives	187.9	206.2	169.7
Overseas Pooled	449.6	493.3	406.0
Total change in assets available	1,974.4	2,166.2	1,782.8

a) Credit risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial asset and liabilities.

In essence the Fund's entire investment portfolio is exposed to some form of credit risk, with the exception of the derivatives positions, where the risk equates to the net market value of a positive derivative position. However the selection of high quality counterparties, brokers and financial institutions minimise the credit risk that may occur through the failure to settle a transaction in a timely manner.

Contractual credit risk is represented by the net payment or receipts that remain outstanding, and the cost of replacing the derivatives position in the event of a counterparty default. The residual risk is minimal due to the various insurance policies held by the exchanges to cover defaulting counterparties.

Credit risk on over-the-counter derivatives contracts is minimised as counterparties are recognised financial intermediaries with acceptable credit ratings determined by a recognised rating agency.

Deposits are not made with banks and financial instructions unless they are rated independent and meet the Fund's credit criteria. The Fund has also set limits as to the maximum percentage of the deposits placed with any class of financial institution.

The Fund's cash holding under its treasury management arrangements at 31st March 2013 was £170.5m (31 March 2012: £126.8m.) This was held with the following institutions:

Summary	Rating	Balances as at 31 March 2013	Balances as at 31 March 2012
		£m	£m
Bank deposit accounts			
Ulster Bank	Baa2	5.0	5.0
Northern Trust	A1	75.0	51.7

Bank of Scotland	A2	50.0	-
Bank Current Accounts			
NatWest Account	A3	40.5	70.1
Total		**170.5**	**126.8**

a) Liquidity risks

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund therefore takes steps to ensure that there are adequate cash resources to meet its commitments.

The Fund has immediate access to its cash holdings.

Management prepares periodic cash flow forecasts to understand and manage the timing of the Fund's cash flow. The appropriate strategic level of cash balances to be held forms part of the Funds investment strategy.

All financial liabilities at 31 March 2013 are due within the one year.

b) Refinancing risk

The Fund does not have any financial instruments that have a refinancing risk as part of its treasury management and investment strategies.

20. **Additional Voluntary Contributions (AVC's)**

Members participating in these AVC arrangements each receive an annual statement confirming the amounts held in their account and the movements during the year. A summary of the information provided by Equitable Life and Prudential is shown below. (This summary has not been subject to Audit and the Pension Fund relies on the individual contributors to check deductions made on their behalf are accurately reflected in the statements provided by the AVC providers). The figures relate to the financial year 1 April 2012 to 31 March 2013 for Prudential and 1 September 2011 to 31 August 2012 for Equitable Life.

Additional Voluntary Contributions

	Equitable life £m	**Prudential £m**	**Total £m**
Value at the start of the year	1.2	14.2	15.4
Income (incl. Contributions, bonuses, interest, transfers in)	0.1	4.0	4.1
Expenditure (incl. Benefits, transfers out, change in market value)	(0.2)	(2.3)	(2.5)
Value at the end of the year	1.1	15.9	17.0

21. Investment management expenses

	2012/13 £m	2011/12 £m
Administration, management and custody	7.8	6.7
Performance measurement service	0.2	0.1
Other advisory fees	1.7	1.5
	9.7	8.3

22. Current assets

	2012/13 £m	2011/12 £m
Contributions due from: Employers	12.5	10.4
:Members	4.4	2.4
Debtors: bodies external to general government	14.8	10.5
	31.7	23.3

23. Analysis of debtors

	2012/13 £m	2011/12 £m
Other local authorities	18.9	5.5
NHS bodies	0.1	-
Public corporations and trading funds	0.1	-
Other entities and individuals	12.6	17.8
	31.7	23.3

24. Current liabilities

	2012/13 £m	2011/12 £m
Unpaid benefits	2.3	2.8
Accrued expenses	7.4	0.4
	9.7	3.2

25. **Analysis of creditors**

	2012/13 £m	2011/12 £m
Other local authorities	4.2	(1.2)
NHS bodies	0.4	-
Other entities and individuals	5.1	4.4
	9.7	3.2

26. **Contingent Asset and Liability**

The Pension Fund is a member of two group litigation actions aimed at reclaiming tax credits on overseas dividends and foreign income dividends on the basis that the original denial of a full tax credit was in contravention of EU non-discrimination law. If successful the estimated potential income to the Pension Fund is in the region of £10.0m. The estimated fees payable in respect of the litigations, regardless of the outcome, are approximately £0.3m. This issue is still progressing through the courts.

27. **Contractual Commitments**

The commitments relating to outstanding call payments due to unquoted limited partnership funds held in the private equity and infrastructure income part of the portfolio totalled £327.2m. The amounts 'called' by these funds are irregular in both size and timing and commitments to these partnerships are drawn down over a number of years. The term of an individual investment can be up to 10 years. Realisation of these investments in the form of distributions normally occurs towards the end of the investment period, when portfolio companies have built value and can be liquidated.

There was also a signed commitment to a non-investment fixed grade income investment at 31 March 2013 which totalled £65.0m.

28. **Related Party Transactions**

In accordance with IFRS, the financial statements must contain the disclosures necessary to draw attention to the possibility that the reported financial position of the Pension Fund may have been affected by the existence of related parties and associated material transactions. They include:

- At 31 March 2013, Gill Kilpatrick, CPFA, was Treasurer to the Pension Fund and County Treasurer for Lancashire County Council.

- The Pension Fund includes 85 scheduled and 172 admitted bodies.

- The Pension Fund Committee comprises 14 County Councillors, 2 Councillors from Unitary Authorities, 2 Councillors from the Lancashire District Councils, 2 Trade Union representatives, 1 representative from the Higher/Further education establishments and the Investment Advisory Panel.

The Pension Fund Committee members and senior officers of the Pension Fund were asked to complete a related party declaration for 2012/13. This revealed no material transactions between the Council and the members / officers and their families affecting involvement with the Pension Fund. Each member of the Pension Fund Committee formally considers conflicts of interest at each meeting.

Lancashire County Council

The Lancashire Pension Fund is administered by Lancashire County Council. Consequently there is a strong relationship between the council and the pension fund.

The council incurred costs of £3.0 million (2011/12: £2.9 million) in relation to the administration of the fund and was subsequently reimbursed by the fund for these expenses. The council is also the single largest employer of the members of the pension fund and contributed £63.4 million to the fund in 2012/13 (2011/12:£68.5m million). All monies owing to and due from the fund were paid in year.

Part of the pension fund cash holdings are invested on the money markets by the treasury management operations of Lancashire Council County. During the year to 31 March 2013, the fund had an average investment balance of £125.2 million.

Key management personnel

Paragraph 3.9.4.3 of the Code exempts local authorities from key management personnel disclosure requirements of IAS24, on the basis that the disclosure requirements for officer remuneration and members' allowances detailed in section 3.4 of the code (which are derived from the requirements of Regulation 7 (2)-(4) of the Accounts and Audit (England)

Regulations 2011 and Regulation 7A of the Accounts and Audit (Wales) Regulations 2005) satisfy the key management disclosure requirements of paragraph 16 of IAS24. This applies in equal measure to the accounts of the Lancashire County Pension Fund.

The disclosure required by Regulation 7 (2)-(4) of the Accounts and Audit (England) Regulations can be found in the main accounts of Lancashire County Council. Statement of Accounts

29. **Icelandic Investment**

The Lancashire County Pension Fund had £2.4m on deposit. The Winding up Board published details of LBI's financial position as at 31 December 2012, this showed that LBI's assets, including partial payments already made in respect of priority claims were greater than the sum of priority claims. It is therefore still considered likely that UK local authorities will recover 100% of their deposits, subject to potential future exchange rate fluctuations. Approximately 49.7% of the total claim has now been repaid. The exact timing and amounts of future distributions is not known at this stage.

The deposit is treated as an asset on the balance sheet and the carrying value is written down as distributions are received.

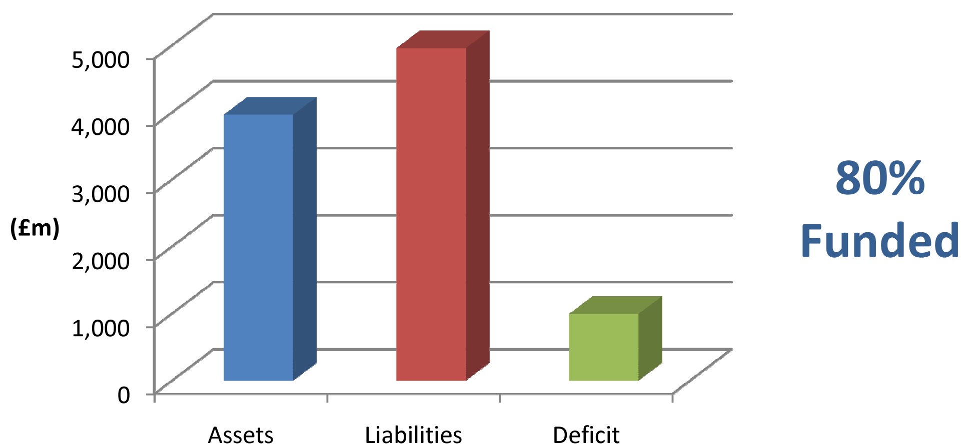
30. **Funding Arrangements**

Accounts for the year ended 31 March 2013 - Statement by the Consulting Actuary

This statement has been provided to meet the requirements under Regulation 34(1)(d) of The Local Government Pension Scheme (Administration) Regulations 2008.

An actuarial valuation of the Lancashire County Pension Fund was carried out as at 31 March 2010 to determine the contribution rates with effect from 1 April 2011 to 31 March 2014.

On the basis of the assumptions adopted, the Fund’s assets of £3,962 million represented 80% of the Fund’s past service liabilities of £4,955 million (the “Funding Target”) at the valuation date.



The valuation also showed that a common rate of contribution of 12.5% of pensionable pay per annum was required from employers. The common rate is calculated as being sufficient, together with contributions paid by members, to meet all liabilities arising in respect of service after the valuation date.

Adopting the same method and assumptions as used for assessing the Funding Target the deficit would be eliminated by an average additional contribution rate of 6.6% of pensionable pay for 19 years. This would imply an average employer contribution rate of 19.1% of pensionable pay in total.

Further details regarding the results of the valuation are contained in our formal report on the actuarial valuation dated 31 March 2011.

In practice, each individual employer's position is assessed separately and the contributions required are set out in our report. In addition to the certified contribution rates, payments to cover additional liabilities arising from early retirements (other than ill-health retirements) will be made to the Fund by the employers (although certain employers have some allowance for non-ill health early retirement costs included in their certified contribution rate).

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

The valuation was carried out using the projected unit actuarial method and the main actuarial assumptions used for assessing the Funding Target and the common contribution rate were as follows:

	For past service liabilities (Funding Target)	**For future service liabilities (Common Contribution Rate)**
Rate of return on investments (discount rate) - pre retirement - post retirement	7.0% per annum 5.5% per annum	6.75% per annum 6.75% per annum
Rate of pay increases	5.0% per annum	5.0% per annum
Rate of increases in pensions in payment (in excess of Guaranteed Minimum Pension)	3.0% per annum	3.0% per annum

The assets were assessed at market value.

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

31. Actuarial Present Value of Promised Retirement Benefits

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

To assess the value of the benefits on this basis, we have used the following financial assumptions as at 31 March 2013 (the 31 March 2012 assumptions are included for comparison):

	31 March 2012	31 March 2013
Rate of return on investments (discount rate)	4.9% per annum	4.2% per annum
Rate of pay increases	4.5% per annum	4.4% per annum
Rate of increases in pensions in payment (in excess of Guaranteed Minimum Pension)	2.5% per annum	2.4% per annum

The demographic assumptions are the same as those used for funding purposes other than the allowance for future improvements in life expectancy, which has been updated taking into account the latest evidence on this issue. The updated allowance underlying the 31 March 2013 calculations is in line with the projections model published in November 2009 by the Continuous Mortality Investigation (CMI) with a long-term improvement rate of 1.25% p.a. The previous allowance as at 31 March 2012 used a long-term improvement rate of 1.0% p.a.

During the year, corporate bond yields reduced, resulting in a lower discount rate being used for IAS26 purposes at the year end than at the beginning of the year (4.2% p.a. versus 4.9% p.a.). The impact of this was offset slightly by the 0.1% p.a. fall in assumed inflation.

The value of the Fund's promised retirement benefits for the purposes of IAS26 as at 31 March 2012 was estimated as £6,254 million. The effect of the changes in actuarial assumptions between 31 March 2012 and 31 March 2013 as described above is to increase the liabilities by *c*£814 million. Adding interest over the year increases the liabilities by a further *c*£306 million, and allowing for net benefits accrued/paid over the period decreases the liabilities by *c*£1 million. The net effect of all the above is that the estimated total value of the Fund's promised retirement benefits as at 31 March 2013 is therefore £7,373 million.

H. Actuarial Valuation

An actuarial valuation of the Fund is carried out every three years by the Fund's actuary Mercer. The most recent valuation carried out was at 31 March 2010 which determines contribution rates effective from 1 April 2011 to 31 March 2014.

The Funding objective is to achieve and then maintain assets equal to the Funding Target. The Funding Target is the present value of 100% of projective accrued liabilities, including allowance for projected final pay. This is to comply with the requirements of the LGPS regulations to secure the solvency of the Fund and is in accordance with the Funding Strategy Statement. The methodology and assumptions by which the Funding Targets and contribution rates are calculated have also been determined in accordance with the Funding Strategy Statement.

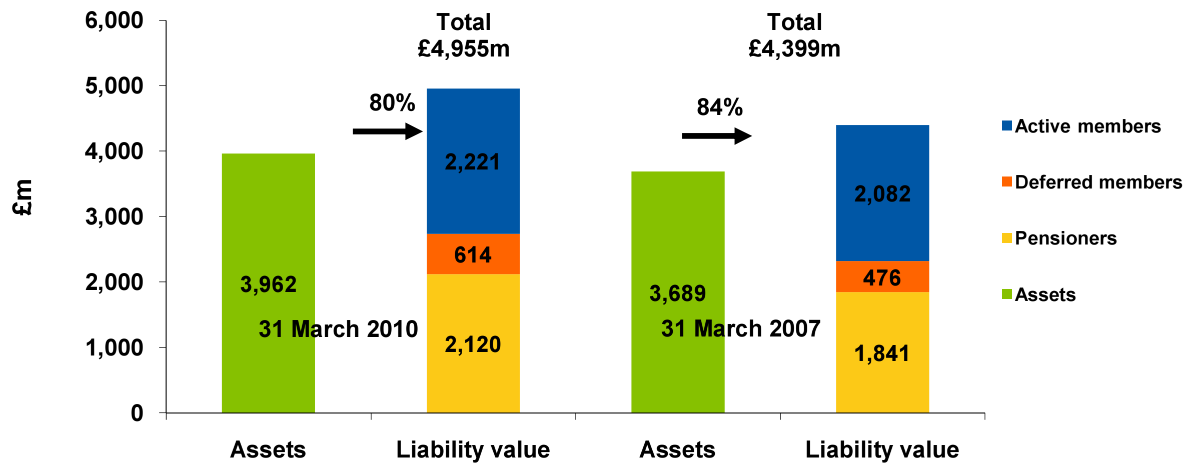
The Funding Strategy Statement specifies a maximum period for achieving full funding of 19 years, this compares to a maximum period of 22 years adopted at the 2007 valuation in accordance with the then published FSS. The maximum deficit recovery period is now three years shorter so that the same target date for achieving full funding is being maintained as at the 2007 valuation. The FSS also specifies any transitional arrangements ("phasing") for the implementation of revised employer contribution requirements.

The valuation (effective from 1 April 2011) revealed a funding level of 80% and an average employer's contribution rate of 19.1%. There have been a number of material developments which have impacted on the fund since the previous valuation in 2007. The introduction of an Inflation Risk Premium (IRP) into the determination of the pension increase assumption used for the valuation has offset the adverse impact of the fall in real yields since the 2007 valuation. The effect of the IRP in conjunction with the change from RPI to CPI indexation more than offsets the negative impact of the yields change. Revisions of the assumptions adopted for the 2010 valuation has overall acted to place a lower value on liabilities and has therefore improved the funding position.

An extract from the certified Actuarial Valuation produced by Mercer as at 31 March 2010, detailing the breakdown of the 80% funding level is as follows:

Funding results – Funding Target

The market value of the Fund's assets at the valuation date is compared with the value of the Fund's past service liabilities (the Funding Target) below. The funding position at the previous valuation is shown for comparison.



The employer contributions for 2011/2012 are based on the 2010 valuation and the recommended employer contributions for the period 1 April 2011 to 31 March 2014 are set out in the Schedule to the Rates and Adjustments at page 59 of this report.

The projected unit method of valuation was used for the valuation and is in common use for funding Pension Funds in the United Kingdom. The Valuation results depend on financial and demographic assumptions and these are detailed in full in the Actuarial Valuation and at Annex 1 of the Funding Strategy Statement.

The Rates and adjustments certified and accompanying schedule extracted from the actuarial valuation are as follows:

Rates and Adjustments Certificate issued in accordance with Regulation 36 of the Administration Regulations

Name of Fund	**Lancashire County Pension Fund**

I hereby certify that, in my opinion, the common rate of employers' contributions payable in each year of the period of three years beginning 1 April 2011 should be at the rate of 12.5 per cent of Pensionable Pay.

I hereby certify that, in my opinion, the amount of the employers' contributions payable in each year of the period of three years beginning with 1 April 2011, as set out above, should be individually adjusted as set out in the attached schedule.

Contributions will be payable monthly in arrears with each payment normally being due by the 19th of the following month. Pensionable Pay is pay as determined under the LGPS regulations for the calculation of employee contributions.

For employers where no allowance for non ill-health early retirement costs is included in the valuation a further individual adjustment shall be applied in respect of each non-ill health early retirement occurring in the period of three years covered by this certificate. This further individual adjustment will be calculated in accordance with methods agreed from time to time between the Fund's actuary and the Administering Authority.

The contributions set out in the attached schedule represent the minimum contribution which may be paid by each employer. Additional contributions may be paid if requested by the employer concerned.

The contributions may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured against a third party.

Regulation 36(8)

Allowance for ill health retirements has been included in each employer's contribution rate, on the basis of the method and assumptions set out in the report.

For four employers I have shown on the attached Schedule the allowance made for non-ill health early retirements over the period of three years beginning 1 April 2011 taken into account when setting this employer's contribution rate.

No allowance for non-ill health early retirements has been made in determining the results of the valuation for other employers, on the basis that the costs arising will be met by additional contributions.

Signature ______________________________

Name John Livesey

Qualification Fellow of the Institute of Actuaries

Date of signing 31 March 2011

Schedule to the Rates and Adjustments Certificate dated 31 March 2011

Employers	2011/12		2012/13		2013/14		Non-ill health early retirement allowance included for the 3 years 2011/14
	Individual Adjust-ment) %	Total Contribu-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Individua l Adjust-ment %	Total Contribu-tion Rate %	Amount £
ABM Catering Ltd	3.5	16.0	3.5	16.0	3.5	16.0	
Accrington & Rossendale College	7.1	19.6	7.1	19.6	7.1	19.6	
Accrington Academy	-1.8	10.7	-1.8	10.7	-1.8	10.7	
Alternative Futures	1.7	14.2	1.7	14.2	1.7	14.2	
Andron (City of Preston High)	-1.2	11.3	-1.2	11.3	-1.2	11.3	
Andron (Glenburn Sports College)	0.5	13.0	0.5	13.0	0.5	13.0	
Andron (Kennington)	0.0	12.5	0.0	12.5	0.0	12.5	
Andron (Ribblesdale High)	-0.3	12.2	-0.3	12.2	-0.3	12.2	
Arnold Schools	5.0	17.5	6.2	18.7	7.4	19.9	
Beaufort Avenue Day Care Centre	14.0	26.5	17.7	30.2	21.3	33.8	
Blackburn College	2.9	15.4	2.9	15.4	2.9	15.4	
Blackburn St Mary's College	1.7	14.2	1.7	14.2	1.7	14.2	
Blackburn with Darwen Borough Council	3.1	15.6	3.6	16.1	4.1	16.6	
Blackpool & The Fylde College	5.0	17.5	5.0	17.5	5.0	17.5	£246,000
Blackpool Airport Ltd (from July 2004)	20.5	33.0	24.5	37.0	27.8	40.3	
Blackpool Borough Council	3.9	16.4	4.4	16.9	4.9	17.4	£697,600
Blackpool Coastal Housing	-0.5	12.0	-0.5	12.0	-0.5	12.0	
Blackpool Sixth Form College	-0.5	12.0	-0.5	12.0	-0.5	12.0	
Blackpool Transport Services Ltd	-12.5	0.0	-12.5	0.0	-12.5	0.0	
Blackpool Zoo (Grant Leisure)	5.5	18.0	7.1	19.6	8.8	21.3	
Blackpool, Fylde & Wyre Society for the Blind	29.5	42.0	32.5	45.0	35.5	48.0	
Bootstrap Enterprise Ltd	0.2	12.7	0.2	12.7	0.2	12.7	
Bulloughs (Highfield)	-2.0	10.5	-2.0	10.5	-2.0	10.5	
Bulloughs (St Augustines)	1.9	14.4	1.9	14.4	1.9	14.4	
Bulloughs (St Marys)	4.0	16.5	4.0	16.5	4.0	16.5	

Employers	2011/12		2012/13		2013/14		Non-ill health early retirement allowance included for the 3 years 2011/14
	Individual Adjust-ment) %	Total Contrib u-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Individua l Adjust-ment %	Total Contribu-tion Rate %	Amount £
Burnley Borough Council	12.5	25.0	12.5	25.0	12.5	25.0	
Burnley College	2.3	14.8	2.3	14.8	2.3	14.8	
Calico Housing Ltd	6.8	19.3	6.8	19.3	6.8	19.3	
CAPITA	12.2	24.7	14.1	26.6	16.0	28.5	
Capita (Rossendale BC)	3.1	15.6	4.6	17.1	6.0	18.5	
Cardinal Newman College	3.3	15.8	3.3	15.8	3.3	15.8	
Caritas Care Ltd (was Catholic Caring Services)	6.2	18.7	6.2	18.7	6.2	18.7	
Catterall Parish Council	2.3	14.8	2.3	14.8	2.3	14.8	
Chorley Borough Council	6.8	19.3	7.3	19.8	7.8	20.3	
Chorley Community Housing	1.6	14.1	1.6	14.1	1.6	14.1	
Church Road Methodist Day Centre	6.7	19.2	7.0	19.5	7.3	19.8	
Commission for Education & Formation	8.0	20.5	8.0	20.5	8.0	20.5	
Community Council of Lancashire	8.3	20.8	8.3	20.8	8.3	20.8	
Community Gateway Association Ltd	1.7	14.2	2.4	14.9	3.0	15.5	
Connaught Environmental (Blackpool BC)	-3.9	8.6	-3.9	8.6	-3.9	8.6	
Connaught Environmental (Blackpool Coastal Housing)	0.5	13.0	0.5	13.0	0.5	13.0	
Consultant Caterers Ltd	2.5	15.0	2.5	15.0	2.5	15.0	
Contour Housing Association	4.1	16.6	4.1	16.6	4.1	16.6	
Creative Support Ltd	1.6	14.1	1.6	14.1	1.6	14.1	
CXL Ltd	-0.6	11.9	-0.6	11.9	-0.6	11.9	
Danfo (UK) Ltd	172.2	184.7	172.2	184.7	172.2	184.7	
Darwen Aldridge Community Academy	-1.2	11.3	-1.2	11.3	-1.2	11.3	
E ON UK Plc	6.2	18.7	6.2	18.7	6.2	18.7	
Edge Hill University College	1.5	14.0	2.0	14.5	2.5	15.0	
Enterprise Managed Services Ltd	1.1	13.6	2.4	14.9	3.6	16.1	
Eric Wright Commercial Ltd	5.4	17.9	5.4	17.9	5.4	17.9	
Fulwood Academy	-1.3	11.2	-1.3	11.2	-1.3	11.2	
Fylde Borough Council	7.0	19.5	8.3	20.8	9.5	22.0	
Fylde Coast YMCA (Fylde)	-2.0	10.5	-2.0	10.5	-2.0	10.5	

Employers	2011/12		2012/13		2013/14		Non-ill health early retirement allowance included for the 3 years 2011/14
	Individual Adjust-ment) %	Total Contribu-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Amount £
Fylde Community Link	4.3	16.8	4.3	16.8	4.3	16.8	
Galloways Society for the Blind	32.2	44.7	32.2	44.7	32.2	44.7	
Garstang Town Council	-1.3	11.2	-1.3	11.2	-1.3	11.2	
Housing Pendle Ltd	1.8	14.3	1.8	14.3	1.8	14.3	
Hyndburn Borough Council	12.3	24.8	12.3	24.8	12.3	24.8	
Hyndburn Homes Ltd	1.4	13.9	1.4	13.9	1.4	13.9	
I Care	-1.6	10.9	-1.6	10.9	-1.6	10.9	
Kirkham Grammar School	4.1	16.6	4.6	17.1	5.1	17.6	
Kirkland Parish Council	2.5	15.0	2.5	15.0	2.5	15.0	
Lancashire & Blackpool Tourist Board	1.1	13.6	1.1	13.6	1.1	13.6	
Lancashire County Branch Unison	8.0	20.5	8.0	20.5	8.0	20.5	
Lancashire County Council	5.8	18.3	6.2	18.7	6.6	19.1	
Lancashire Fire & Rescue Service	5.0	17.5	5.0	17.5	5.0	17.5	£199,000
Lancashire Police Authority	2.3	14.8	2.8	15.3	3.3	15.8	£450,500
Lancashire Probation Committee	6.6	19.1	6.6	19.1	6.6	19.1	
Lancaster & Morecambe College	4.1	16.6	4.1	16.6	4.1	16.6	
Lancaster City Council	8.1	20.6	8.1	20.6	8.1	20.6	
Lancaster University	1.9	14.4	2.2	14.7	2.6	15.1	
Leisure in Hyndburn	3.3	15.8	4.5	17.0	5.7	18.2	
Liberata	6.0	18.5	6.0	18.5	6.0	18.5	
Liberata UK Ltd (Chorley)	8.9	21.4	8.9	21.4	8.9	21.4	
Lytham Schools Foundation	2.2	14.7	2.2	14.7	2.2	14.7	
Mellor's (formerly Wyre)	1.7	14.2	1.7	14.2	1.7	14.2	
Mellor's Catering (Cardinal Newman)	5.0	17.5	5.0	17.5	5.0	17.5	
Myerscough College	0.8	13.3	1.0	13.5	1.1	13.6	
Nelson and Colne College	3.3	15.8	3.3	15.8	3.3	15.8	
New Fylde Housing	42.3	54.8	42.3	54.8	42.3	54.8	
New Progress Housing	3.9	16.4	3.9	16.4	3.9	16.4	

Employers	2011/12		2012/13		2013/14		Non-ill health early retirement allowance included for the 3 years 2011/14
	Individual Adjust-ment) %	Total Contribu-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Amount £
NHS PCT Blackburn	1.6	14.1	1.6	14.1	1.6	14.1	
NIC Services Group Ltd	2.5	15.0	2.5	15.0	2.5	15.0	
North Western & North Wales Sea Fisheries Committee	13.4	25.9	13.4	25.9	13.4	25.9	
Northgate Managed Services	0.1	12.6	0.1	12.6	0.1	12.6	
NSL Ltd (Lancaster)	4.5	17.0	4.5	17.0	4.5	17.0	
NSL Ltd (Wyre BC)	0.6	13.1	0.6	13.1	0.6	13.1	
Ormerod Home Trust Ltd	11.7	24.2	13.7	26.2	15.5	28.0	
Our Lady Queen of Peace (Bullough Contract Services)	3.5	16.0	3.5	16.0	3.5	16.0	
Pendle Borough Council	12.1	24.6	14.1	26.6	16.2	28.7	
Pendle Leisure Trust Ltd	1.2	13.7	1.2	13.7	1.2	13.7	
Penwortham Town Council	1.5	14.0	1.5	14.0	1.5	14.0	
Pilling Parish Council	4.8	17.3	4.8	17.3	4.8	17.3	
Preston Care and Repair	6.0	18.5	6.0	18.5	6.0	18.5	
Preston City Council	5.6	18.1	6.1	18.6	6.6	19.1	
Preston College	2.7	15.2	3.0	15.5	3.3	15.8	
Preston Council for Voluntary Services	9.4	21.9	9.4	21.9	9.4	21.9	
Progress Care Housing	3.9	16.4	3.9	16.4	3.9	16.4	
Progress Housing Group Ltd	3.9	16.4	3.9	16.4	3.9	16.4	
Progress Recruitments	2.9	15.4	2.9	15.4	2.9	15.4	
Queen Elizabeth's Grammar School	8.3	20.8	9.3	21.8	10.3	22.8	
Ribble Valley Borough Council	3.6	16.1	4.1	16.6	4.6	17.1	
Ribble Valley Homes	1.8	14.3	1.8	14.3	1.8	14.3	
Rossendale Borough Council	13.8	26.3	15.3	27.8	16.8	29.3	
Rossendale Leisure Trust	0.2	12.7	1.2	13.7	2.1	14.6	
Rossendale Transport Ltd	10.7	23.2	19.3	31.8	27.8	40.3	
Runshaw College	2.6	15.1	2.9	15.4	3.2	15.7	
Signposts MARC Ltd	-12.5	0.0	-12.5	0.0	-12.5	0.0	

Employers	2011/12		2012/13		2013/14		Non-ill health early retirement allowance included for the 3 years 2011/14
	Individual Adjust-ment) %	Total Contribu-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Individual Adjust-ment %	Total Contribu-tion Rate %	Amount £
Solar Facilities (Bishop Raws)	-12.5	0.0	-12.5	0.0	-12.5	0.0	
Solar Facilities (Ripley)	8.5	21.0	8.5	21.0	8.5	21.0	
Solar Facilities (Seven Stars)	3.4	15.9	3.4	15.9	3.4	15.9	
Solar Facilities (St Peters)	-3.0	9.5	-3.0	9.5	-3.0	9.5	
Solar Facilities (Tarelton)	1.4	13.9	1.4	13.9	1.4	13.9	
South Ribble Borough Council	6.8	19.3	7.8	20.3	8.8	21.3	
South Ribble Community Leisure Ltd	10.4	22.9	10.4	22.9	10.4	22.9	
St Anne's on Sea Town Council	-1.4	11.1	-1.4	11.1	-1.4	11.1	
Surestart Hyndburn	-2.0	10.5	-1.0	11.5	-0.1	12.4	
Twin Valley Homes Ltd	3.8	16.3	3.8	16.3	3.8	16.3	
University of Central Lancashire	1.6	14.1	1.6	14.1	1.6	14.1	
University of Cumbria (was St Martins College)	1.5	14.0	1.5	14.0	1.5	14.0	
Vita Lend Lease BSF ICT	0.2	12.7	0.2	12.7	0.2	12.7	
Vita Lend Lease Ltd	1.3	13.8	1.3	13.8	1.3	13.8	
West Lancashire Borough Council	7.5	20.0	7.5	20.0	7.5	20.0	
West Lancashire Community Leisure Ltd	-0.5	12.0	-0.5	12.0	-0.5	12.0	
Whitworth Town Council	3.6	16.1	3.6	16.1	3.6	16.1	
Wyre Borough Council	12.6	25.1	12.6	25.1	12.6	25.1	
Wyre Housing Association	57.8	70.3	57.8	70.3	57.8	70.3	

Other interested bodies with no pensionable employees

Former Employers	Proportion of Pension Increases to be Recharged %
Alzheimer's Society	See notes
Barnoldswick Town Council	See notes
Blackpool & Fylde Mind Association	See notes
Blackpool & Fylde Society for the Deaf	100
Blackpool Town Centre Forum Ltd	See notes
Bulloughs (St Albans)	See notes
Burnley & Pendle Development Association	100
Burton Manor Residential College	100
Carden Croft Ltd	See notes
Community Alliance (Burnley & Padiham) Ltd	See notes
CSB Contract Services	See notes
Elm House Management Committee	See notes

Former Employers	Proportion of Pension Increases to be Recharged %
Ex Department of Transport	100
Ex National Health Service	100
Ex National Water Council	100
Fylde Coast Development Association	100
Lancashire South East Probation Committee	100
Lancashire Valuation Tribunal	See notes
New Directions	See notes
Preston Vision Ltd	See notes
Salmesbury & Cuerdale Parish Council	See notes
Skelmersdale College	See notes
Spastics Society	100

Note:
Members of the Fund employed by Skelmersdale College have transferred to membership of the Tyne and Wear Fund, and so a bulk transfer payment will be required. Any residual funding shortfall in the LCPF after the transfer payment should then be recovered from the College.

For the remaining employers listed as "see notes" above further calculations are required in connection with them ceasing to participate in the Fund. Further details for these employers will be notified in due course.

I. Contacts

http://www.yourpensionservice.org.uk

Benefits and other Administrative Issues

Pensions Helpdesk
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PO Box 100
County Hall
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Pension Benefits and Administration

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Pension Fund Governance

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Pension Fund Committee
Meeting to be held on 6 September 2013

Electoral Division affected: 'All'

UK Stewardship Code compliance
(Appendices 'A' and 'B' refer)

Contact for further information:
Gill Kilpatrick, (01772) 534715, County Treasurer's Directorate,
Gill.kilpatrick@lancashire.gov.uk

Executive Summary

The Financial Reporting Council (FRC) strongly encourages all institutional investors to publish a statement on their website on the extent to which they have complied with the seven principles of the UK Stewardship Code. The Stewardship Code is principally aimed at asset managers, however other institutional investors, including pension funds, are encouraged to report under it.

Appendix 'A' is a copy of the Stewardship Code.

Appendix 'B' is a proposed response statement to the Stewardship Code by Lancashire County Pension Fund. The adoption of this statement will ensure the Fund's compliance with the Code.

Currently, 19 other Local Government Pension Funds have signed up to the Stewardship Code as Asset Owners.

Recommendation

The Committee is requested to approve the Stewardship Code Compliance Statement as set out at Appendix 'B'.

Background and Advice

Following the financial crisis of 2008, one of the recommendations of the Walker Review of Corporate Governance of the UK Banking Industry was that the Financial Reporting Council (FRC) should have responsibility for a new Stewardship Code, setting out best practice in respect of investor engagement. This Code was to be based upon the Institutional Shareholders Committee (ISC) document – 'the Responsibilities of Institutional Shareholders and Agents.'

The FRC published its first version of the Stewardship Code in 2010, and subsequently updated it in September 2012. A copy of the Code is attached as Appendix 'A'. It is expected that institutional investors publish a statement in respect of their adherence, or otherwise, to the Code in a way that mirrors 'comply or explain' statements made by companies under the Corporate Governance Code.

The FRC strongly encourages all institutional investors to publish a statement on their website on the extent to which they have complied with the seven principles of the Code. The Stewardship Code is principally aimed at asset managers, however other institutional investors, including pension funds, are encouraged to report under it.

The Principles of the Code are as follows:

So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:

1. *publicly disclose their policy on how they will discharge their stewardship responsibilities.*
2. *have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.*
3. *monitor their investee companies.*
4. *establish clear guidelines on when and how they will escalate their stewardship activities.*
5. *be willing to act collectively with other investors where appropriate.*
6. *have a clear policy on voting and disclosure of voting activity.*
7. *report periodically on their stewardship and voting activities.*

Appendix 'B' is a proposed response statement to the Stewardship Code by Lancashire County Pension Fund. The adoption of this statement will ensure the Fund's compliance with the Code.

Currently, 19 other Local Government Pension Funds have signed up to the Stewardship Code as Asset Owners.

Consultations

N/A

Implications:

In approving a compliance statement, Lancashire County Pension Fund is demonstrating its commitment to the UK Stewardship Code and the promotion of behavioural changes that will lead to better corporate governance by asset managers and companies.

Risk management

Signing up to the Code demonstrates that the Pension Fund believes that companies should adhere to the highest standards of governance. By not doing so, the Fund's reputation may be weakened.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
Financial Reporting Council – UK Stewardship Code	2012	Andrew Fox/ County Treasurer's Directorate x35916

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Financial Reporting Council

September 2012

The UK Stewardship Code

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Stewardship and the Code

1. Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.

2. In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.

3. The UK Corporate Governance Code identifies the principles that underlie an effective board. The UK Stewardship Code sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the "comply or explain" system.

4. For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.

5. Institutional investors' activities include decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling specific securities. The division of duties within and between institutions may span a spectrum, such that some may be considered asset owners and others asset managers.

6. Broadly speaking, asset owners include pension funds, insurance companies, investment trusts and other collective investment vehicles. As the providers of capital, they set the tone for stewardship and may influence behavioural changes that lead to better stewardship by asset managers and companies. Asset managers, with day-to-day responsibility for managing investments, are well positioned to influence companies' long-term performance through stewardship.

7. Compliance with the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.

Application of the Code

1. The UK Stewardship Code traces its origins to 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles,' first published in 2002 by the Institutional Shareholders Committee (ISC), and which the ISC converted to a code in 2009. Following the 2009 Walker Review of governance in financial institutions, the FRC was invited to take responsibility for the Code. In 2010, the FRC published the first version of the UK Stewardship Code, which closely mirrored the ISC code. This edition of the Code does not change the spirit of the 2010 Code.

2. The Code is directed in the first instance to institutional investors, by which is meant asset owners and asset managers with equity holdings in UK listed companies. Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their responsibility for stewardship. They remain responsible for ensuring those activities are carried out in a manner consistent with their own approach to stewardship. Accordingly, the Code also applies, by extension, to service providers, such as proxy advisors and investment consultants.

3. The FRC expects signatories of the Code to publish on their website, or if they do not have a website in another accessible form, a statement that:

   - describes how the signatory has applied each of the seven principles of the Code and discloses the specific information requested in the guidance to the principles; or
   - if one or more of the principles have not been applied or the specific information requested in the guidance has not been disclosed, explains why the signatory has not complied with those elements of the Code.

4. Disclosures under the Code should improve the functioning of the market for investment mandates. Asset owners should be better equipped to evaluate asset managers, and asset managers should be better informed, enabling them to tailor their services to meet asset owners' requirements.

5. In particular the disclosures should, with respect to conflicts of interest, address the priority given to client interests in decision-making; with respect to collective engagement, describe the circumstances under which the signatory would join forces with other institutional investors to ensure that boards acknowledge and respond to their concerns on critical issues and at critical times; and, with respect to proxy voting agencies, how the signatory uses their advice.

6. The statement of how the Code has been applied should be aligned with the signatory's role in the investment chain.

7. Asset owners' commitment to the Code may include engaging directly with companies or indirectly through the mandates given to asset managers. They should clearly communicate their policies on stewardship to their managers. Since asset owners are the primary audience of asset managers' public statements as well as client reports on stewardship, asset owners should seek

to hold their managers to account for their stewardship activities. In so doing, they better fulfil their duty to their beneficiaries to exercise stewardship over their assets.

8. An asset manager should disclose how it delivers stewardship responsibilities on behalf of its clients. Following the publication in 2011 of the Stewardship Supplement to Technical Release AAF 01/06, asset managers are encouraged to have the policies described in their stewardship statements independently verified. Where appropriate, asset owners should also consider having their policy statements independently verified.

9. Overseas investors who follow other national or international codes that have similar objectives should not feel the application of the Code duplicates or confuses their responsibilities. Disclosures made in respect of those standards can also be used to demonstrate the extent to which they have complied with the Code. In a similar spirit, UK institutions that apply the Code should use their best efforts to apply its principles to overseas equity holdings.

10. Institutional investors with several types of funds or products need to make only one statement, but are encouraged to explain which of their funds or products are covered by the approach described in their statements. Where institutions apply a stewardship approach to other asset classes, they are encouraged to disclose this.

11. The FRC encourages service providers to disclose how they carry out the wishes of their clients with respect to each principle of the Code that is relevant to their activities.

12. Signatories are encouraged to review their policy statements annually, and update them where necessary to reflect changes in actual practice.

13. This statement should be easy to find on the signatory’s website, or if they do not have a website in another accessible form, and should indicate when the statement was last reviewed. It should include contact details of an individual who can be contacted for further information and by those interested in collective engagement. The FRC hosts on its website the statements of signatories without their own website.

14. The FRC retains on its website a list of asset owners, asset managers and service providers that have published a statement on their compliance or otherwise with the Code, and requests that signatories notify the FRC when they have done so, and when the statement is updated.

15. The FRC regularly monitors the take-up and application of the Code. It expects the content of the Code to evolve over time to reflect developments in good stewardship practice, the structure and operation of the market, and the broader regulatory framework. Unless circumstances change, the FRC does not envisage proposing further changes to the Code until 2014 at the earliest.

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Comply or Explain

1. As with the UK Corporate Governance Code, the UK Stewardship Code should be applied on a "comply or explain" basis.

2. The Code is not a rigid set of rules. It consists of principles and guidance. The principles are the core of the Code and the way in which they are applied should be the central question for the institutional investor as it determines how to operate according to the Code. The guidance recommends how the principle might be applied.

3. Those signatories that choose not to comply with one of the principles, or not to follow the guidance, should deliver meaningful explanations that enable the reader to understand their approach to stewardship. In providing an explanation, the signatory should aim to illustrate how its actual practices contribute to good stewardship and promote the delivery of the institution's or its clients' investment objectives. They should provide a clear rationale for their approach.

4. The Financial Services Authority requires any firm authorised to manage funds, which is not a venture capital firm, and which manages investments for professional clients that are not natural persons, to disclose "the nature of its commitment" to the Code or "where it does not commit to the Code, its alternative investment strategy" (under Conduct of Business Rule 2.2.3[1]).

5. The FRC recognises that not all parts of the Code are relevant to all signatories. For example, smaller institutions may judge that some of its principles and guidance are disproportionate in their case. In these circumstances, they should take advantage of the ''comply or explain'' approach and set out why this is the case.

6. In their responses to explanations, clients and beneficiaries should pay due regard to the signatory's individual circumstances and bear in mind in particular the size and complexity of the signatory, the nature of the risks and challenges it faces, and the investment objectives of the signatory or its clients.

7. Whilst clients and beneficiaries have every right to challenge a signatory's explanations if they are unconvincing, they should not evaluate explanations in a mechanistic way. Departures from the Code should not be automatically treated as breaches. A signatory's clients and beneficiaries should be careful to respond to the statements from the signatory in a manner that supports the "comply or explain" process and bears in mind the purpose of good stewardship. They should put their views to the signatory and both parties should be prepared to discuss the position.

[1] http://fsahandbook.info/FSA/html/handbook/COBS/2/2

The Principles of the Code

So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

The UK Stewardship Code

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Guidance

Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.

The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.

The statement should reflect the institutional investor's activities within the investment chain, as well as the responsibilities that arise from those activities. In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.

Where activities are outsourced, the statement should explain how this is compatible with the proper exercise of the institutional investor's stewardship responsibilities and what steps the investor has taken to ensure that they are carried out in a manner consistent with the approach to stewardship set out in the statement.

The disclosure should describe arrangements for integrating stewardship within the wider investment process.

Principle 2

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Guidance

An institutional investor's duty is to act in the interests of its clients and/or beneficiaries.

Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

Principle 3

Institutional investors should monitor their investee companies.

Guidance

Effective monitoring is an essential component of stewardship. It should take place regularly and be checked periodically for effectiveness.

When monitoring companies, institutional investors should seek to:

- keep abreast of the company's performance;
- keep abreast of developments, both internal and external to the company, that drive the company's value and risks;
- satisfy themselves that the company's leadership is effective;
- satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members;
- consider the quality of the company's reporting; and
- attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

Institutional investors should consider carefully explanations given for departure from the UK Corporate Governance Code and make reasoned judgements in each case. They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position.

Institutional investors should endeavour to identify at an early stage issues that may result in a significant loss in investment value. If they have concerns, they should seek to ensure that the appropriate members of the investee company's board or management are made aware.

Institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.

Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

Guidance

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the company's advisers;
- meeting with the chairman or other board members;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of General Meetings;
- submitting resolutions and speaking at General Meetings; and
- requisitioning a General Meeting, in some cases proposing to change board membership.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate.

Guidance

At times collaboration with other investors may be the most effective manner in which to engage.

Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.

Institutional investors should disclose their policy on collective engagement, which should indicate their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure companies are aware of concerns. The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.

Principle 6

Institutional investors should have a clear policy on voting and disclosure of voting activity.

Guidance

Institutional investors should seek to vote all shares held. They should not automatically support the board.

If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records.

Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

Institutional investors should disclose their approach to stock lending and recalling lent stock.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities.

Guidance

Institutional investors should maintain a clear record of their stewardship activities.

Asset managers should regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported and the format used, should be a matter for agreement between agents and their principals.

Asset owners should report at least annually to those to whom they are accountable on their stewardship policy and its execution.

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

Asset managers that sign up to this Code should obtain an independent opinion on their engagement and voting processes having regard to an international standard or a UK framework such as AAF 01/06[2]. The existence of such assurance reporting should be publicly disclosed. If requested, clients should be provided access to such assurance reports.

[2] Assurance reports on internal controls of service organisations made available to third parties: http://www.icaew.com/en/technical/audit-and-assurance/assurance/technical-release-aaf-01-06

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Appendix 'B'

Lancashire County Pension Fund

Compliance with the UK Stewardship Code - July 2013

Context

The UK Stewardship Code, which has been prepared by the Financial Reporting Council, sets out the principles of effective ownership by investors. In so doing, the Code assists institutional investors to better exercise their stewardship responsibilities.

The Financial Reporting Council encourages Institutional investors to report their compliance with the Code. This document summarises the approach of the Lancashire County Pension Fund to corporate governance and compliance with the Code.

Principle 1 – Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Lancashire County Pension Fund takes its responsibilities as a shareholder seriously.

The Fund believes that good corporate governance and the informed use of voting rights are an integral part of the investment process that will improve the performance of the companies in which the Fund is invested.

Various policy documents are produced which identify how we meet our Stewardship responsibilities including our Statement of Investment Principles and Governance Compliance Statement.

In practice the Fund's policy is to apply the Code both through its arrangements with asset managers and through membership of the Local Authority Pension Fund Forum (LAPFF).

The Fund seeks to use its position as a shareholder to actively encourage good corporate governance practice in those companies in which it invests. It does this by contracting the Pensions & Investment Research Consultants Limited (PIRC) to provide a global service for a standard voting policy and casting of votes along with the provision of company research and reporting tools.

Principle 2 – Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

Lancashire County Pension Fund encourages all its fund managers to have effective policies in place to address potential conflicts of interests. The need to avoid conflicts of interest is also highlighted in our investment manager mandates and contracts with external parties.

Should a conflict arise the investment manager must notify the Fund and the ultimate decision would be made by the Fund's Investment Panel, in consultation with the Chair of the Pension Fund Committee as required.

In respect of conflicts of interests within the Fund, Committee members and officers are required to make declarations of interest at the start of all meetings. A public register of interests is also maintained for all Councillors.

Principle 3 – Institutional investors should monitor their investee companies.

Day-to-day responsibility for managing the Fund's equity holdings is delegated to the appointed fund managers, and the Fund expects them to monitor companies, intervene where necessary, and report back regularly on engagement activities.

Lancashire County Pension Fund contracts with PIRC who provides a global service for standard voting policy and casting of votes along with the provision of company research and reporting tools. In addition the Fund receives an 'Alerts' service from the Local Authority Pension Fund Forum, which highlights corporate governance issues of concern at investee companies.

Principle 4 – Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

As highlighted above, responsibility for day to day interaction with companies is delegated to the fund managers, including the escalation of engagement. Their guidelines for such activities are anticipated to be disclosed in their own statement of adherence to the Stewardship Code.

Occasionally, the Fund may choose to escalate activity, principally through engagement activity through the Local Authority Pension Fund Forum. When this occurs, the Investment Panel will decide whether to participate in the proposed activity, consulting with the Chair as necessary.

Principle 5 – Institutional investors should be willing to act collectively with other investors where appropriate.

Lancashire County Pension Fund seeks to work collaboratively with other institutional shareholders in order to maximise the influence that it can have on individual companies.

The Fund seeks to achieve this through membership of the Local Authority Pension Fund Forum and National Association of Pension Funds (NAPF), which engages with companies over environmental, social and governance issues on behalf of its members.

Principle 6 – Institutional investors should have a clear policy on voting and disclosure of voting activities.

Lancashire County Pension Fund contracts with PIRC who provides a global service for a standard voting policy and casting of votes. The Pension Fund Committee have reviewed and agreed to adopt the voting guidelines of PIRC. These voting guidelines are regularly updated and publicly available on their website. PIRC provide a proxy voting service for all our global equity managers.

Principle 7 – Institutional investors should report periodically on their stewardship and voting activities.

Lancashire County Pension Fund annually reviews and updates its Statement of Investment Principles, which sets out the Fund's approach to responsible investing. The activity undertaken by PIRC and the Local Authority Pension Fund Forum is regularly made available to Committee.

Pension Fund Committee
Meeting to be held on 6 September 2013

Electoral Division affected:
'All'

Fund Shareholder Voting and Engagement Report
(Appendices 'A' and 'B' refer)

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Executive Summary

In accordance with its policies on promoting corporate social responsibility in the businesses in which it invest the Fund works through Pensions and Investment Research Consultants Ltd (PIRC) as its Governance Adviser and the Local Authority Pension Fund Forum (LAPFF) to both ensure that shares are voted in accordance with sound governance principles and influence companies' behaviour.

This report provides the latest quarterly update for the Committee on the work undertaken on the Fund's behalf by PIRC and the engagement activity undertaken by LAPFF.

The attached report from PIRC (Appendix 'A') covers the period 1 April to 30 June 2013. The Fund has voted on 2,866 occasions and has opposed or abstained in 29% of votes. PIRC recommends not supporting resolutions where it does not believe best governance practice is being applied. PIRC's focus has been on promoting independent representation on company boards, separating the roles of CEO and Chairman and ensuring remuneration proposals are aligned with shareholders' interests.

The attached engagement report from LAPFF (Appendix 'B') also covers the period 1 April to 30 June 2013.

Details of live class actions in relation to companies in which Lancashire County Pension Fund has, or had, owned shares is also set out in the report.

Recommendation

The Committee is asked to note the report.

Background and Advice

Shareholder Voting and Governance

PIRC, acts as the Fund's proxy and casts the Fund's votes on its investments at shareholder meetings. PIRC are instructed to vote in accordance with their guidelines unless the Fund

Lancashire County Council

instructs an exception. PIRC analyses investee companies and produces publically available voting recommendations to encourage companies to adhere to high standards of governance and social responsibility. The analysis includes a review of the adequacy of environmental and employment policies and the disclosure of quantifiable environmental reporting. PIRC is also an active supporter of the Stewardship Code, a code of practice published by the Financial Reporting Council with the aim of enhancing the quality of engagement between institutional investors and companies.

There may be occasions when the Fund wishes to cast a vote at a shareholder meeting in a way which does not accord with PIRC's recommendations. For example, an investment manager might request the Fund to vote in a particular way to support or oppose a corporate action. Such requests would be considered by the Fund on a case by case basis and PIRC instructed to cast the Fund's vote accordingly.

PIRC also lobbies actively on behalf of its investing clients as well as providing them with detailed support. It works closely with NAPF (the National Association of Pension Funds) and LAPFF (the forum of Local Authority Pension Funds).

PIRC's quarterly report to 30 June 2013 is presented at Appendix A. This report not only provides details of the votes cast on behalf of the Fund but also provides a commentary on events during the period relevant to environmental and social governance issues.

In addition PIRC produces a detailed document which is reviewed by the Fund's officers, which sets out the circumstances and reasoning for every resolution opposed, abstained or withheld. This document is available on request.

The Fund's voting record using PIRC as its proxy for the three months ended 30 June 2013 is summarised below:

TABLE 1: GEOGRAPHIC VOTING OVERVIEW

Geographic Region	Meeting	Resolutions	For	Oppose	Abstain	Withheld	Non-Voting
UK	17	354	279	32	43	0	0
EU	42	584	376	109	30	0	67
JAPAN	25	315	274	40	1	0	0
NORTH AMERICA	118	1404	749	418	61	173	1
SOUTH AND CENTRAL AMERICA	8	42	14	22	0	6	0
ASIA	16	144	84	51	9	0	0
REST OF THE WORLD	4	23	12	6	3	0	2

TABLE 2: ANALYSIS OF UK ALLSHARE VOTING RECOMMENDATIONS

Resolution Type	For	Percentage %	Abstain	Percentage %	Oppose	Percentage %	Total
Annual Reports	10	58.82	3	17.65	4	23.53	17
Remuneration Reports	1	5.88	5	29.41	11	64.71	17
Articles of Association	1	100.0	0	0.0	0	0.0	1
Auditors Appointment	8	47.06	8	47.06	1	5.88	17
Directors	156	84.78	19	10.33	9	4.89	184
Dividend	14	100.0	0	0.0	0	0.0	14
Executive Pay Scheme	1	16.67	0	0.0	5	83.33	6

The Fund was party to 2,866 resolutions during this period, of which 62% resulted in positive votes for shareholder resolutions and 29% were opposed or an abstention given. Voting abstention is regularly used by institutional investors as a way of signalling a negative view on a proposal without active opposition. In addition, within certain foreign jurisdictions, shareholders either vote for a resolution or not at all, opposition to these votes is described as vote withheld. These totalled 179 within the period, just over 6%. The remaining agenda items required no vote.

In relation to the **UK**, this quarter's report focuses upon remuneration issues at Aggreko plc, issues with external audit fees at Rolls Royce Holdings plc, and regulatory criticisms at Prudential plc. In addition, the corporate governance of Halifax Bank of Scotland (HBOS) was noted as “a model of self-delusion, of the triumph of process over purpose”, according to the Parliamentary Commission on Banking Standards (PCBS).

Within **European** markets, Swiss shareholder groups taking action over executive pay was noted, as well as the difficulties faced by the Spanish banking sector in maintaining acceptable levels of corporate governance. The biggest German bank, Deutsche Bank, witnessed significant opposition to its supervisory board and some other resolutions put to vote at its AGM. In addition, Deutsche Post DHL faced accusations at its AGM that it abuses workplace rights in some countries in which it operates. Regarding employee directors and diversity, the proportion of females at board level is significantly higher amongst companies that have employee representation than those that don’t, PIRC has found.

Within the **United States**, the quarterly report references several shareholder-relevant events involving several major US listed companies including Hewlett-Packard, News Corp, JP Morgan, and Walmart. In addition, two leading governance practitioners called for directors of US companies to be more open to engagement with shareholders.

Shareholder Engagement through LAPFF

Lancashire County Pension Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), which exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest.

Members of the Committee may be interested to note the attached engagement report from LAPFF (Appendix B) which covers the period 1 April to 30 June 2013.

It sets out details of their activities in influencing governance, employment standards, reputational risk, climate change, finance and accounting, and Board composition, and provides a slightly different and wider perspective than the PIRC report.

Class Actions

United States

The Fund has appointed Barrack, Rodos and Bacine (BR&B) to provide a US class actions monitoring service with the aim of ensuring that the Lancashire County Pension Fund receives all monies due to the Fund by filing its proof of claim from these cases. This service is at no cost to the Fund.

BRB will identify class actions where the Fund has a potential loss arising from an alleged fraud or a securities law violation. This is achieved by the BR&B 'BEAMS' monitoring system which follows each securities case from the beginning to the end by ensuring its filing of the proof of claim so that the Fund may receive its payment.

Occasionally the Fund may be asked to participate in a class action, and/ or to apply to become the lead or co-lead plaintiff, but under US law any shareholder subject to such a loss will be automatically entered into and benefit from a class action without having to file an individual claim.

Details of current US live cases to 30 June 2013 are set out below:

Company Name	Ticker	Effective Class Period Begin	Effective Class Period End	Case Status	Estimated Loss--FIFO	Estimated Loss--LIFO
Medtronic, Inc.	MDT	08/12/10	03/08/11	NEW	($27,712.00)	($27,712.00)
CenturyLink, Inc.	CTL	08/08/12	14/02/13	ACTIVE	($521,629.00)	($521,629.00)
Barrick Gold Corp.	ABX	07/05/09	23/05/13	ACTIVE	($364,669.00)	($411,360.00)
Intuitive Surgical, Inc.	ISRG	19/10/11	18/04/13	ACTIVE	($251,535.00)	($251,535.00)
ITT Educational Services, Inc.	ESI	24/04/08	25/02/13	ACTIVE	($760,060.00)	($678,368.00)
Verisign, Inc.	VRSN	25/06/12	25/10/12	ACTIVE	($246,205.00)	($246,205.00)

(Losses are typically valued either on FIFO (First In First Out) or LIFO (Last In First Out) accounting methodologies.)

United Kingdom

Unlike class actions within the US jurisdiction, where all relevant recipients benefit from a class action when filed, class actions within the UK require investors to file their actions individually in order to potentially benefit from a successful class action.

The Fund previously held significant share holdings in Royal Bank of Scotland during which time it is alleged that the company materially misled investors with respect to its sub-prime-related credit market exposure, and in addition allegedly misreported other asset values and goodwill. These alleged actions, it is argued, caused investors to suffer losses relating to a subsequent Rights Issue on 30 April 2008. A class action against RBS on behalf of investors has been in development over the last two years and is now at the point where individual investors need to decide whether or not to participate. Lancashire County Pension Fund's potential losses arising out of the Rights Issue is estimated at $3.2million, although there is no guarantee that all or any of these losses can be recovered.

Whilst insurance to the value of £15m has now been secured by the lead legal firm, there is still a risk of cost exposure dependent upon relative holdings and number of participants should the insurance in place be insufficient in the event of a lost case. The amount of recoverable losses is also subject to debate, particularly given the legal fees that will be 'top-sliced' prior to any recovered amounts being distributed. Consequently, and in keeping with the majority of other affected LGPS, the Fund is keeping a watching brief over developments. The deadline for filing a claim, after which the case would be statute-barred, is April 2014.

In order to facilitate transparent and effective decision-making, a class action protocol is currently being developed to enable the relevant criteria to be assessed in advance of participating in a non-US class action or where a request is made by BR&B for the Fund to consider applying for lead plaintiff. Since Lancashire County Pension Fund has not previously applied for lead plaintiff status, advice is currently being taken from other Funds with such experience in order to benefit from it.

Ethical Investment

Following discussion of ethical investment issues at the March meeting of the Committee, a number of LGPS funds have also considered their position and an update will be provided at the Committee's next meeting.

Consultations

N/A

Implications:

It is a key component of good governance that the Fund is an engaged and responsible investor complying with the Stewardship Code.

Well run responsible companies are more likely to be successful and less likely to suffer from unexpected scandals.

Risk management

The promotion of good responsible corporate governance in the companies the Fund is invested in reduces the risk of unexpected losses arising as a result of poor over-sight and lack of independence.

Involvement in a non-US class action may result in losses incurred being recovered for the Fund, but should a case be lost then the Fund may incur related costs which may not be known with certainty at the time of filing. Applying for lead plaintiff status in the US may incur significant officer time and resources in bring a potential case to fruition.

Local Government (Access to Information) Act 1985
List of Background Papers

N/a

Lancashire Council

Proxy Voting Review
April 2013 – June 2013

July 2013

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UK Corporate Governance Review

Aggreko Plc - AGM 25th April

Remuneration was an issue at Aggreko.

There were concerns over incentive award arrangements insofar as they are too narrowly focused on the Company's Diluted Earnings per Share (D-EPS) results. The long-term incentive plan(s) apply the same performance criteria, which potentially rewards executives twice for achieving the same outcomes and this was the case during the year. The LTIP does not incorporate a relative performance element, which is considered to be a minimum pre-requisite for all long-term incentives and should be applied along with an absolute measure in concurrent fashion. The LTIP applies a multiplier which, subject to a three-year performance hurdle, allows for potentially excessive awards, which was the case during the year under review. 2009 awards vested in full subject to the maximum multiplier of two-times and as was the case for 2008 awards. One-third of CIP awards are solely determined on the basis of a three-year shareholding requirement. Whilst salaries are below median for the sector, combined awards are considered excessive in both potential and actual terms. The CEO received variable pay during the year representing more than 1100% of salary, which is considered to be wholly excessive.

We recommended shareholders oppose the remuneration report.

Rolls Royce Holdings Plc - AGM 2nd May

Fees paid to the audit firm were an issue at Rolls Royce.

KPMG Audit was proposed as auditor. The total non-audit fees were approximately 27.66% of audit fees during the year under review, and the three year average is 16.18%. Additionally, KPMG billed the Company for internal audit support services valued at £600,000. It is considered highly inappropriate for the statutory auditors to undertake any work in relation to internal audit work. An oppose vote was recommended.

We also recommended shareholders oppose the election of Lewis Booth, chair of the audit committee. In financial year 2012, the committee approved non audit services of £600,000 in relation to internal audit support services provided by KPMG who were also involved in a new IT system. Any services provided by the statutory auditor in relation to the company's internal audit is considered inappropriate, and the IT work creates a self-review threat. Moreover, the audit committee report fails to describe the safeguards put in place to ascertain KPMG's independence following approval of these support services.

Prudential Plc - AGM 16th May

Regulatory criticism relating to the role of the chief executive was a concern at insurer Prudential.

Since the publication of the Annual Report Prudential was fined £30m in respect of two regulatory breaches that relate directly to its proposal to acquire the AIA business unit from AIG. The first of £14m, relates to not informing the UKLA part of the FSA of the proposed acquisition at an early stage. The second of £16m, relates to not informing FSA Supervision of a proposed acquisition which “had the potential to impact on the stability and confidence of the financial system in the UK and abroad”. The transaction was in the end pulled due to intense opposition from shareholders. This resulted in a break fee of £153m.

That failed deal in itself would raise serious concerns about judgement of the CEO and the board. However, the regulatory breaches take those concerns to another level. The regulatory breaches relate to matters involving the CEO himself in a meeting where the information should have been but was not disclosed, and involving Prudential failing to follow the advice of the company Sponsor to disclose the proposed acquisition to the UKLA at an early stage.

In PIRC's opinion any doubt about the suitability of Mr Thiam to continue in office as a result of the decision to acquire, were then reinforced by the regulatory breaches. PIRC expects a statement about Mr Thiam's future from the new chairman.

We recommended shareholders oppose Mr Thiam's re-election.

UK Corporate Governance Review

Listing rules: the party is over

Developments at both ENRC and Bumi in April may have significant long-term implications for the listing regime in the UK.

Most significantly, following recent speculation, the SFO confirmed that it was, indeed, beginning a criminal investigation into ENRC. The SFO said, simply: "The Director of the SFO has accepted ENRC Plc. for criminal investigation. The focus of the investigation will be allegations of fraud, bribery and corruption relating to the activities of the company or its subsidiaries in Kazakhstan and Africa."

Earlier in the month troubled Indonesian mining business Bumi Plc had suspended its shares, citing concerns about the balance sheet of subsidiary PT Berau Coal Energy. The company said that it was unable to publish audited full-year results by the end of April. As a result, and after consultation with the UKLA, it had agreed to suspend its shares.

Both ENRC and Bumi are examples of extractives businesses that are not UK companies in any meaningful sense, and are effectively controlled by major shareholders, but nonetheless have been allowed to list here. To state the obvious, problems at both companies are not a surprise to many.

To governance types these companies have raised more red flags than a May Day parade in North Korea. Both are dominated by controlling shareholders, and both have seen major fall-outs within their own boards, amidst allegations of irregularities of various kinds. The Bumi bust-up resulted in an EGM called by rebel shareholders earlier this year. At ENRC there had already been a boardroom coup in the summer of 2011, with Sir Richard Sykes one of those deposed. To a growing number of investors these companies represent the way that commercial interests trump investor protection in the UK listings regime.

To the vested interests in the system, the slam-dunk defence has always been 'caveat emptor'. It's up to investors to do the due diligence on companies and if they don't like what they see then they can simply not invest. It's an incredible attitude when you give it a minute's thought. We sell a London listing on the basis that it is some kind of mark of status, and that it provides access to international capital. Yet at the same time there is a get-out clause that a London listing shouldn't be taken, by investors, to say anything about quality. It's a bit Gerald Ratner isn't it?

But regardless of the cynicism of such an approach, last week we saw its practical consequences. Both domestic and foreign investors have been badly let down by the 'anything goes' approach to listing standards that has prevailed in recent years. London's reputation is damaged by these cases. The message we send out to the world is that, if the price is right, then we can probably do business with you, even if this means we squeeze our own standards a bit.

Something has to change. We remain hopeful that the Financial Conduct Authority's work on listings, taking over that already undertaken by its predecessor, will result in a positive outcome. As many readers may be aware, we have also suggested to the Business Secretary Vince Cable that he could also take action. Specifically we suggested that he use his powers under Section 1035 Companies Act 2006 to appoint independent inspectors and instigate an investigation under Part 14 Companies Act 1985 into both companies. The UK has the opportunity to demonstrate that it is serious about the quality of companies that are allowed to list here. In light of April's events it is imperative that it does so.

HBOS: a model of self-delusion

The corporate governance of Halifax Bank of Scotland (HBOS) was "a model of self-delusion, of the triumph of process over purpose", according to the Parliamentary Commission on Banking Standards (PCBS).

In a highly critical report on the failure of HBOS, the PCBS makes the vital point that its failure was fundamentally one of solvency – not liquidity. The PCBS says that results have shown that HBOS would have become insolvent without capital injections from the taxpayer and Lloyds Banking Group. The PCBS is also extremely critical of the bank's governance. It says there was insufficient banking expertise in HBOS's top management. In consequence, they were incapable of understanding the risks some parts of the bank were running, let alone managing them.

The report says the non-executives lacked the experience or expertise to identify many of the core risks that the bank was running. The report says the board was composed in a manner which appeared suitable for a retail-oriented financial services company, but lacked the necessary banking experience among its non-executives, particularly in relation to higher risk activities, for a bank whose strategy and business model was posited on asset-led growth led by non-retail divisions of the bank.

The report states: "We are shocked and surprised that, even after the ship has run aground, so many of those who were on the bridge still seem so keen to congratulate themselves on their collective navigational skills."

Following the publication of the report, Business Secretary Vince Cable said he would investigate whether former HBOS board members could be barred from serving as company directors.

Church of England bonus cap

Directors should not receive bonuses of more than 100% of salary unless they have delivered exceptional performance, according to the Church of England's new executive remuneration policy.

The policy also stresses the importance of schemes prioritising long-term over short-term performance. It argues that companies should have long-term incentive plans for executive directors covering periods of five to seven years which should be paid in shares held for the long-term. Companies are encouraged to reward performance on ethical, social and environmental issues as well as financial issues.

National Express after its AGM

Employment standards in the US and executive pay policy in the UK were at the forefront of the National Express AGM in May. Voting results showed significant shareholder discomfort with the current management.

The AGM was dominated by criticism of its employment practices. Members of the US Teamsters union protested about the company's alleged anti-union stance and questionable labour standards at its US Durham business.

Shareholders showed disapproval of the company's management with one of the highest oppose votes this AGM season. Votes against the remuneration report amounted to 28 per cent and a further 5 per cent of votes were withheld. Moreover, there were 26 per cent votes against the amendments to LTIPs.

There was a 4 per cent vote cast against the annual report and accounts, which sounds low, but most of these resolutions pass without any opposition. The report and accounts had been targeted by those concerned by the company's employment policies. Whilst some shareholders are less alarmed by the company's labour policies than governance issues, a reputation for being anti-union can be problematic for a company that is dependent on good relationships with public bodies, which award it business.

The company came under fire from the Unite group of 80 UK Labour MPs, who wrote to shareholders to inform them about the ill-treatment of the drivers of the iconic yellow school buses. They raised concerns about a "systemic approach to deny workers their rights to freedom of association and to engage in collective bargaining for their working conditions". The group asked shareholders to vote down the company's reports and accounts. Jim Sheridan, the group's chairman argued that the move was needed to "signal the necessity for improved oversight and reporting of human capital policies and practices" and spoke at the AGM.

No, Mr Bond, we expect you to go

In one of the most notable meetings so far, Sir John Bond and three other directors were voted off the board of Glencore Xstrata at the company's AGM in May.

With a vote against his re-election of over 80%, Bond was the most unpopular of the directors facing re-election. Con Fauconnier, Peter Hooley and Ian Strachan were also voted off. As he acknowledged in a statement issued after the meeting, one of the reasons for Bond being put in the ejector seat was investor anger at retention awards provided to Xstrata directors. Bond's departure also means that former BP chief executive Tony Hayward becomes chair of the FTSE100 constituent on an interim replacement whilst a replacement is sought.

Gilbert to leave FirstGroup

Martin Gilbert will step down as chair of FirstGroup later this year, according to reports.

A number of press reports state that Gilbert will stay on until a successor has been found. His expected departure follows shareholder unease at his other commitments, as chief executive of Aberdeen Asset Management, and non-executive at BSkyB, a point PIRC has raised. The news that he is likely to step down also comes as the company is seeking to raise fresh capital, having cut it dividend as profits have slumped.

JKX survives billionaire battle

JKX Oil & Gas saw a major vote against its remuneration report and share issue authorities, driven by its two largest shareholders.

The company's figures show that there was a vote of just under 48% against it remuneration report, with votes of almost the same size against chief executive Dr Paul Davies, and three resolutions relating to share issue authorities. However the company also released the voting results excluding those cast by Eclairs' nominee and Glengary's nominee (its two major shareholders). This revealed overwhelming support from other investors. Ahead of the AGM the company had taken the unusual action of issuing notices to both Eclairs Group Glengary Overseas Limited restricting each of them, amongst other things, from voting.

The company will consider the result to be a good one. It complained that Ukrainian duo Gennadiy Bogolyubov and Igor Kolomoisky wanted to take the company over by stealth. The Independent reports they had previously sought to oust some of the incumbent directors and appoint their own nominees, whilst at the AGM they directly targeted the current chief executive.

Afren and WPP: contrasting votes

Afren broke new ground in June, not only becoming the first company to lose its remuneration report vote this AGM season, but also becoming the first company to lose such a vote twice. But the ease with which WPP pushed through its pay plan suggests that shareholder activism really has tailed off this year.

Afren's AGM saw the highest level of shareholder opposition so far at this year's AGMs. Investors' anger was directed towards the company's remuneration policy and leadership. Many shareholders were opposed to the £3.4m pay package for the CEO and co-founder Osman Shahenshah. As a result, they cast a whopping 80% of votes against the company's remuneration report. Considering a further 8% abstained, this was one of the biggest ever shareholder revolts over executive pay in the UK.

PIRC had recommended investors oppose Afren's remuneration plans because it deemed the company's 2012 variable pay as excessive. Despite a historic shareholder revolt the vote remains non-binding. Mr. Shahenshah is, thus, expected to receive his full package, comprising a £625,000 basic salary, generous benefits and a pension pot, as well as a bonus of £1.3m and £1.3m in shares under Afren's long-term incentive scheme.

This was, of course, not a first for Afren, as it had previously lost the vote on its remuneration report at its 2011 AGM. This makes it the first company to lose such a vote in the UK twice. And the company is a repeat offender. At the 2010 AGM its remuneration report barely passed with little more than 50 per cent approval, while 20 per cent of votes were withhold. Shareholder concerns' have clearly not been taken seriously. Unsurprisingly investors became fed up with Afren's management. At last week's AGM Peter Bingham, a non-executive director, scraped barely 56% approval for his re-election, while five other directors faced opposition in the range of 25-30%.

But if Afren demonstrated that some shareholders are still revolting, as it were, WPP's result was probably more indicative of the trend this year. A little less then 20% of voting shares were against the company's remuneration report, with abstentions pushing the total not in favour to 27%. This could be considered disappointing given that the advertising company had been defeated on its pay plans last year and has made few improvements since then. PIRC recommended shareholders oppose WPP's remuneration report because pay awards for 2012 remained high.

At WPP's AGM Deborah Gilshan, representing the Railways Pension Fund, which voted against the remuneration report, told the board and remuneration committee that they had not gone far enough to address shareholder concerns around either the size of pay awards or on succession planning. The company made some concessions but some shareholders still consider the potential awards under incentive schemes excessive. But whilst such concerns might have led to a defeat last year, this year the asset managers seem to have backed off. This does not bode well for the future.

UK Voting Analysis

Table 1: Top Oppose Votes

	Company	Type	Date	Resolution	Proposal	Funds Vote	Oppose %
1	CATLIN GROUP LTD	AGM	09 May 13	13	Approve new long term incentive plan	Oppose	24.21
2	ASTRAZENECA PLC	AGM	25 Apr 13	5.g	Re-election of Jean-Philippe Courtois	Abstain	24.17
3	PRUDENTIAL PLC	AGM	16 May 13	22	Issue shares with pre-emption rights	For	20.00
4	RECKITT BENCKISER GROUP PLC	AGM	02 May 13	2	Approve the Remuneration Report	Oppose	17.84
5	BRITISH AMERICAN TOBACCO PLC	AGM	25 Apr 13	17	Issue shares with pre-emption rights	For	17.13
6	ADMIRAL GROUP PLC	AGM	25 Apr 13	21	Meeting notification related proposal	For	16.54
7	ASTRAZENECA PLC	AGM	25 Apr 13	11	Meeting notification related proposal	For	16.24
8	REED ELSEVIER PLC	AGM	25 Apr 13	2	Approve the Remuneration Report	Oppose	14.49
9	BRITISH AMERICAN TOBACCO PLC	AGM	25 Apr 13	21	Meeting notification related proposal	For	13.52
10	RECKITT BENCKISER GROUP PLC	AGM	02 May 13	20	Meeting notification related proposal	For	12.96

Note: Levels of opposition percentage represent opposition votes cast as a percentage of all votes cast either in favour or against a resolution.

Table 2: Votes by Resolution

Resolution Type	For	%	Abstain	%	Oppose	%	Withdrawn	%	Total
All Employee Schemes	3	100	0	0	0	0	0	0	3
Annual Reports	11	32	8	23	15	44	0	0	34
Articles of Association	1	100	0	0	0	0	0	0	1
Auditors	23	71	8	25	1	3	0	0	32
Corporate Actions	0	0	0	0	0	0	0	0	0
Corporate Donations	8	80	1	10	1	10	0	0	10
Debt & Loans	0	0	0	0	0	0	0	0	0
Directors	156	84	19	10	9	4	0	0	184
Dividend	14	100	0	0	0	0	0	0	14
Executive Pay Schemes	1	16	0	0	5	83	0	0	6
Miscellaneous	14	100	0	0	0	0	0	0	14
NED Fees	0	0	0	0	0	0	0	0	0
Non Voting	0	0	0	0	0	0	0	0	0
Say On Pay	0	0	0	0	0	0	0	0	0
Share Capital Restructuring	0	0	0	0	0	0	0	0	0
Share Issue/Re-purchase	45	84	7	13	1	1	0	0	53
Shareholder Resolution	0	0	0	0	0	0	0	0	0
Undefined	0	0	0	0	0	0	0	0	0

UK Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

Total Resolutions	
For	279
Oppose	32
Abstain	43
Withdrawn	0
Total	354

Meetings	AGM	EGM	Total
Total Meetings	17	0	17
1 (or more) oppose or abstain vote	17	0	17

UK Voting Record

UK AGM Record

UK EGM Record

There where no EGMs during the last period in the clients portfolio.

UK Voting Timetable Q1 2013

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 3: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	BUNZL PLC	17 Apr 13	AGM	2013-04-03
2	AGGREKO PLC	25 Apr 13	AGM	2013-04-16
3	ADMIRAL GROUP PLC	25 Apr 13	AGM	2013-04-16
4	REED ELSEVIER PLC	25 Apr 13	AGM	2013-04-16
5	BRITISH AMERICAN TOBACCO PLC	25 Apr 13	AGM	2013-04-10
6	ASTRAZENECA PLC	25 Apr 13	AGM	2013-04-12
7	GLAXOSMITHKLINE PLC	01 May 13	AGM	2013-04-19
8	RECKITT BENCKISER GROUP PLC	02 May 13	AGM	2013-04-23
9	ROLLS-ROYCE HOLDINGS PLC	02 May 13	AGM	2013-04-18
10	BAE SYSTEMS PLC	08 May 13	AGM	2013-04-24
11	CRH PLC	08 May 13	AGM	2013-04-25
12	PROVIDENT FINL GROUP	09 May 13	AGM	2013-04-25
13	CATLIN GROUP LTD	09 May 13	AGM	2013-04-26
14	UNILEVER PLC	15 May 13	AGM	2013-05-01
15	NEXT PLC	16 May 13	AGM	2013-05-02
16	AMLIN PLC	16 May 13	AGM	2013-05-07
17	PRUDENTIAL PLC	16 May 13	AGM	2013-05-03

UK Upcoming Meetings Q3 2013

List of meetings scheduled to be held throughout the period by UK companies currently in the fund's portfolio.

Table 4: Upcoming Meetings

	Company	Meeting Date	Type
1	SAINSBURY (J) PLC	10 Jul 13	AGM
2	EXPERIAN PLC	17 Jul 13	AGM
3	VODAFONE GROUP PLC	23 Jul 13	AGM
4	SSE PLC	25 Jul 13	AGM
5	NATIONAL GRID PLC	29 Jul 13	AGM
6	GREENE KING PLC	04 Sep 13	AGM

AIM UK Market Voting Timetable Q1 2013

There were no meetings held by the client during the period.

AIM UK Market Upcoming Meetings Q3 2013

There are no upcoming meetings for this region.

Fledgling UK Market Voting Timetable Q1 2013

There were no meetings held by the client during the period.

Fledgling UK Market Upcoming Meetings Q3 2013

There are no upcoming meetings for this region.

European Corporate Governance Review

A virtuous banker?

In April the head of one of the biggest Austrian banks returned €2m (£1.2) of his pay because he believes that executives are sometimes overpaid.

Herbert Stepic, chief executive of Raiffeisen Bank, gave back the amount because he believes his total pay of €4.9m is "neither in accord with my own self-conception nor with the Raiffeisen banking group's foundation of values". Mr Stepic said that although his compensation was "market compliant" and "fair", repaying some of it was an "acknowledgement that remunerations can also turn out to be too high". While the bank’s shares performed well from 2009 to 2012, its profits fell last year.

Since the financial crisis, several bank bosses have voluntarily waived the right to bonuses. However, it is very rare for a chief executive to return a portion of their pay that has been awarded. Stepic, explained that due to a share incentive plan, his pay had been inflated by a surge in Raiffeisen’s share prices.

Second Swiss ‘say on pay’ defeat

The Swiss continued their hunt on excessive executive pay in April. Shareholders of the Swiss biotech firm Actelion rejected a $5.6m pay award for the chief executive Jean-Paul Clozel after shareholder groups urged investors to oppose the compensation package.

Actelion became the second company in two weeks to have its pay plans voted down by shareholders, following the Swiss private bank Julius Baer. Shareholder groups Actares and Ethos opposed the company’s pay policy leading to a 60 per cent vote against the biotechnology firm’s remuneration plans. Despite protest, Mr. Clozel will receive his award, which is even 15 per cent higher than the previous year, because the vote is only advisory in nature. This will soon change once the Swiss regulator starts implementing one of the world’s strictest controls on executive pay that the Swiss public backed in a referendum this March. Public anger and shareholder scrutiny of executive salaries is also continuing to run high after Switzerland had to rescue UBS from risky investments blamed on a lavish bonus culture.

Spanish banks breaking records

Spain continues to break the wrong kind of records as ongoing troubles in its financial sector make the UK’s banking sector look almost respectable.

The country is currently seeing numerous criminal investigations, while prison sentences have been awarded for directors of Caixa Penedes. At the same time Banco Santander awarded the highest pension pot ever recorded to its departing chief executive, who stood down due to the possibility he could be banned from the industry as a result of a previous conviction.

There are currently nine ongoing trials against national banks, including Bankia, Caja Madrid, Banca Civica, Caja Mediterráneo, Banco de Valencia, Eurobank and others. 74 bank executives are now on trial i n various Spanish courts - a number that might soon reach 90. The alleged financial crimes span falsifying accounts, excessive remuneration practices, and failed IPOs, all of which endangered whole institutions for the benefit of a few.

Public outrage against the financial sector was further fuelled by the fact that many Spanish banks received bailouts of €37.7bn of public money and €39.5bn by the EU. A prime example of banking mismanagement of the worst kind has been CAM, which by riding the construction boom saw a meteoric rise and a catastrophic fall before being nationalised in 2011.

More recently Caixa Pendes, which has also received European bailout funds, underwent corporate crime investigations. Four of its executives, Ricard Pagès Font, Manuel Troyano Molina, Juan Caellas

Fernández, and Santiago José Abella Rodríguez were found guilty of misappropriation. They awarded themselves excessive severance payments of 31.6 million in total, which the court considered to be misappropriation of funds. The court sentenced Mr. Pages to 3.5 years in prison and the other three to 3 years in prison, while the payments must be returned in full.

With a controversial pension payout on the horizon the next bank to break a record is Santander. Chief executives' pensions have normally attracted little investor and public attention in contrast to bonus payouts. However the highest pensions can be much more generous than annual bonuses as Santander has now demonstrated.

Despite a 26 per cent fall in net profits in the first-quarter Santander plans to award Alfredo Sáenz, its departed chief executive, a €88.2m pension pot. This is the biggest retirement provision ever publicly disclosed by a large bank. The issue is controversial not only because of the astronomical sum but also because Mr. Sáenz resigned ahead of a decision by the financial regulator that could make him legally ineligible to serve as a banker. He had been convicted in 2004 on grounds of making false accusations and was only allowed to stay in his position due to a controversial pardon by the previous government and several law changes.

UBS breezes through pay vote

Swiss banking giant UBS saw a relatively peaceful AGM. Although there was some opposition to its remuneration report, support was higher than in 2012.

Given the widespread public support for regulating executive pay in Switzerland, expectations of shareholder opposition to UBS' pay policy were running high. The voting results, however, showed around 16 per cent opposition to the remuneration report, even though Switzerland's biggest bank by assets recorded a net loss of 2.5 billion Swiss francs in 2012. In comparison, last year there was a 37 per cent vote against the pay plan. PIRC recommended an oppose vote at both this year's and last year's AGM to oppose the remuneration reports.

Earlier this year, UBS disclosed that the bank's chief executive Sergio Ermotti received 8.9m Swiss francs in compensation for 2012, of which 2.5m francs was his regular salary, the remainder being performance awards. The Bern-based shareholder group Actares said last Wednesday that "big bonuses and a big (annual) loss do not go together." Some activist investors present at the AGM in Zurich, called for a split from UBS' investment bank and said pay levels for top managers were too high.

The annual report got strong support with only 0.5 per cent votes against. However shareholders showed some discontent with the management of the bank as around 10 per cent opposed the discharge of the members of the Board.

Deutsche Bank shareholder revolt

The biggest German bank witnessed significant opposition to its supervisory board and some other resolutions put to vote at its AGM.

The biggest oppose votes at Deutsche Bank's AGM were cast against the re-election of the prominent German industrialist Henning Kagermann. 26.5 per cent of shareholders objected to his re-election, which included several institutional investors such as Hermes. The vote represents a clear sign of shareholder discontent with the past performance of the bank's supervisory board.

Mr. Kagermann is one of a few remaining board members to have overseen the bank's haphazard search for a successor to Josef Ackermann, former CEO, as a result of which some strong candidates were deterred from applying for the position. Shareholders were also concerned that he sits on too many company boards. Also several other supervisory Board members received noticeable shareholder opposition: Dr Johannes Teyssen, for instance, received around 14 per cent against his re-election.

Investors also voiced concerns about the high levels of pay at Deutsche Bank for staff below board level in comparison with the level of dividends paid to shareholders. The compensation of the Management Board received 11 per cent opposition, while the management board received 6 per cent votes against.

Earlier in the year Deutsche Bank announced it would cap pay for co-chief executives. This development follows a report by a panel which Deutsche set up to introduce changes to its pay policy. The report has revamped benchmarks for the bank's executive bonuses. It proposed to link bonuses better to earnings and to the bank cost structure, as well as demanding more "softer" indicators of executive performance such as employee satisfaction. For the first time, the management board are also required to buy Deutsche shares to twice the value of their base annual salary.

Deutsche Post DHL AGM protests

Logistics giant Deutsche Post DHL faced accusations at its AGM that it abuses workplace rights in some countries in which it operates.

The company saw a protest outside the meeting, whilst inside representatives of the International Transport Workers Federation (ITF) and UNI Global Union criticised the company's behaviour. Unions claim that it exhibits behaviour in some countries that it would "never dare" of allowing in Germany.

Specifically, the unions say they have evidence that the company has backed fake unions and unlawfully fired workers in Turkey; used lie detectors against staff in Colombia, Panama and South Africa; and relied on agency workers on lower wages and with no job security in the UK, Malaysia, Indonesia and India.

Employee directors and diversity

The proportion of females at board level is significantly higher amongst companies that have employee representation than those that don't, PIRC has found.

Looking at the FTSE Eurofirst, amongst those companies which do not have employee representation, the proportion of females at board level is 19%. However, amongst those companies that do have employee representation at board level, the proportion of females is over a third greater, at 26%. To be sure this wasn't just a quirk in the nature of the companies that have employee representation on the boards, we also looked at what proportion of employee representatives are female in the same sample. The answer is 25.7%. Notably this is even slightly higher than the proportion of female non-executives, at 23.8%.

Besides other benefits employee representation might bring, such as greater diversity of views, it seems that, in practice, it also leads to greater gender diversity.

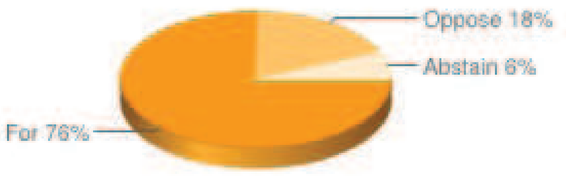
European Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

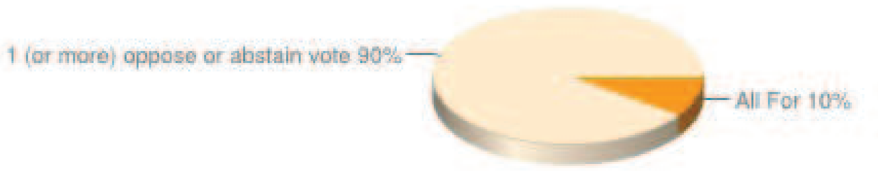
Total Resolutions	
For	294
Oppose	68
Abstain	25
Withdrawn	0
Total	387

Meetings	AGM / Combined	EGM	Total
Total Meetings	31	2	33
1 (or more) oppose or abstain vote	28	2	30

European Voting Record



European AGM Record / Combined



European EGM Record

European Voting Timetable Q1 2013

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 5: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	SWISSCOM AG	04 Apr 13	AGM	2013-03-15
2	VOLVO AB	04 Apr 13	AGM	2013-03-15
3	SES SA	04 Apr 13	AGM	2013-03-18
4	FIAT INDUSTRIAL SPA	08 Apr 13	AGM	2013-03-20
5	DAIMLER AG	10 Apr 13	AGM	2013-03-19
6	JULIUS BAER GRUPPE AG	10 Apr 13	AGM	2013-03-20
7	NESTLE SA	11 Apr 13	AGM	2013-03-19
8	INVESTOR AB	15 Apr 13	AGM	2013-03-26
9	BELGACOM SA	17 Apr 13	AGM	2013-03-25
10	D.E MASTER BLENDERS 1753	17 Apr 13	**EGM**	2013-04-02
11	SAMPO OYJ	18 Apr 13	AGM	2013-03-28
12	ADECCO SA	18 Apr 13	AGM	2013-03-28
13	LVMH (MOET HENNESSY - LOUIS VUITTON) SA	18 Apr 13	AGM	2013-04-10
14	HEINEKEN NV	25 Apr 13	AGM	2013-04-08
15	MUENCHENER RUECK AG (MUNICH RE)	25 Apr 13	AGM	2013-04-09
16	SWEDISH MATCH AB	25 Apr 13	AGM	2013-04-16
17	DANONE	25 Apr 13	AGM	2013-04-10
18	GJENSIDIGE FORSIKRING BA	25 Apr 13	AGM	2013-04-15
19	CREDIT SUISSE GROUP	26 Apr 13	AGM	2013-04-10
20	AKZO NOBEL NV	26 Apr 13	AGM	2013-04-15
21	ATLAS COPCO AB	29 Apr 13	AGM	2013-04-18
22	SANOFI	03 May 13	AGM	2013-04-18
23	KUEHNE + NAGEL INTERNATIONAL AG	07 May 13	AGM	2013-04-24
24	NORSK HYDRO ASA	08 May 13	AGM	2013-04-24
25	TERNA - RETE ELETTRICA NAZIONALE SPA	14 May 13	AGM	2013-04-30
26	DEUTSCHE BOERSE AG	15 May 13	AGM	2013-04-30
27	DEUTSCHE TELEKOM	16 May 13	AGM	2013-05-01
28	TOTAL SA	17 May 13	AGM	2013-05-03
29	LEGRAND SA	24 May 13	AGM	2013-05-13
30	DEUTSCHE POST AG	29 May 13	AGM	2013-05-14
31	LINDE AG	29 May 13	AGM	2013-05-15
32	SAP AG	04 Jun 13	AGM	2013-05-21
33	RYANAIR HOLDINGS PLC	18 Jun 13	**EGM**	2013-06-10

European Upcoming Meetings Q3 2013

List of meetings scheduled to be held throughout the period by European companies currently in the fund's portfolio.

Table 6: Upcoming Meetings

	Company	Meeting Date	Type
1	COMPAGNIE FINANCIERE RICHEMONT SA	05 Sep 13	AGM
2	SEADRILL LTD	21 Sep 13	AGM
3	RYANAIR HOLDINGS PLC	21 Sep 13	AGM

US Corporate Governance Review

HP revolt: board members quit

In April the board of Hewlett Packard acknowledged the scale of shareholder dissent expressed at its AGM, with two directors announcing their resignation and the chair will relinquishing his role.

HP's AGM in March was the first major event of the US proxy season and now looks to have been an important moment in shareholder activism. The board has taken significant flak from investors recently, particularly since the write-down on its takeover of Autonomy was announced. What has particularly irked shareholders has been the failure of board members, who were in place at the time of the deal, to take responsibility.

As a result the company was hit with a concerted push from shareholders against a number of directors, led by US public funds and US trade union shareholder activists CtW Investment Group. Those particularly in the frame were John Hammergren and G. Kennedy Thompson, who received votes against their re-election of 46% and 45% respectively. But HP chair Ray Lane also faced a 41% vote against.

HP clearly recognised the strength of shareholder opinion and Hammergren and Thompson announced they were stepping down as directors later this year. Lane will stay on the board but has given up his role as chair. He has been replaced by activist investor Ralph Whitworth, who sits on the board and who will act as interim chair.

Call for more US engagement

Directors of US companies should be more open to engagement with their shareholders, according to two leading governance practitioners.

In an online article for the Harvard Law School Forum on Corporate Governance and Financial Regulation, Deborah Gilshan of Railpen and Catherine Jackson of PGGM argued that sentiment about shareholder engagement is changing but that companies could develop better strategies. They called for independent director meetings with shareholders to become a routine part of a board's approach to outreach with its shareholders, rather than only in exceptional circumstances or in times of crisis.

News Corp Shareholder revolt

Several shareholder groups have filed two resolutions calling for an independent chairman and the elimination of News Corporation dual-class share structure.

In May, dissident shareholders from the UK, US and Canada filed a resolution demanding appointment of an independent chairman. Demands for the media mogul Rupert Murdoch to step down as chairman of News Corp attracted strong support at last year's AGM, when two thirds of independent shareholders supported a similar resolution. This year the joint shareholder proposal was filled by the Christian Brothers Investment Services and the British Columbia Investment Management Corporation. The resolution got also support from the Local Authority Pension Fund Forum.

The media company faces pressure from a separate resolution filled by the ethical investment group Nathan Cummings Foundation in which it proposes to end the dual class share structure. This allows the Murdoch family to exercise de facto control of its media empire despite owning only 14 per cent of the company's equity. Again, a similar resolution last year got 62 per cent support of the public shareholders.

Shareholders believe that by responding positively to these corporate governance issues, News Corporation can improve oversight of management, reduce business risk and better represent the interests of all shareholders. Pressure for corporate governance reforms has been increasing since the phone-hacking scandal at News Corp's UK newspapers.

JPM risk committee takes the hit

In the end, the vote to split the roles of chair and chief executive at JP Morgan, currently both held by Jamie Dimon, was lower than expected. But the scale of shareholder pressure on members of the board's risk committee is likely to herald a shake-up.

The vote in favour of the resolution, filed by US union AFSCME, the Connecticut Retirement Plans and Trust Funds, Hermes, and the NYC Pension Funds was 32%, lower than last year's result. However the media storm around the AGM and the high votes against several members of the bank's risk committee are likely to result in changes to the board.

Shareholders cast 47% votes against Ellen Futter, and 43% and 41% against James Crown and David Cote respectively. At last year's meeting the respective votes against were Cote 3%, Crown 3% and Futter 14%. The directors were targeted by shareholders who were seeking changes to the bank's risk management.

The results look to have already had an impact on JP Morgan's thinking, with lead director Lee R. Raymond reportedly telling the AGM: "In terms of the composition of the risk committee, you should stay tuned." Bloomberg also speculates that the bank might choose to strengthen Raymond's own role, presumably in an effort to counter-act concerns about concentration of power. It has also been suggested that the chair and chief executive roles could be split once Dimon leaves the board.

Walmart hit by rare AGM protest

Shareholders of Wal-Mart Stores Inc expressed significant opposition to the company's management at its annual meeting.

At its AGM 12% of voting shares were cast against Chief Executive Mike Duke. Board chairman Robson Walton, son of the founder Sam Walton, received a 10% vote against. Christopher Williams, chair of the audit committee, received a 12% vote against. The votes reflect shareholders dissatisfaction with Wal-Mart's response to allegations of violations of U.S. law prohibiting bribery in foreign countries, its treatment of workers and its safeguards to ensure that its products are made in humane conditions. There was also a vote of more than 17% in favour of a shareholder proposal to empower the board to call for a special shareowner meeting in order to vote on important matters. The request for this arose in the shadow of the recent disasters at textile factories in Bangladesh, which supply also Wal-Mart.

More News Corp news

News Corp's split into two separate businesses was approved in June. There's an interesting theory about one reason behind the split.

In a piece for New Republic this week, Peter Jukes (who has written a book on the hacking scandal) suggest that splitting new News Corp off from Fox allows the latter to remain clear of any legal or financial liabilities relating to the publishing business. Specifically, he suggests this may in part be intended to deal with a possible settlement with the Department of Justice relating to breaches of the Foreign Corrupt Practices Act. Given well-documented cases of News Corp titles paying for information, action under the FCPA has long been considered a possibility.

Separately, key figures in the hacking scandal soon face their day in court. The trial of former News International chief executive Rebekah Brooks will take place in September. Brooks faces charges relating to hacking phones, paying public officials for information and conspiring with others to hide information relating to hacking from the police. The Prime Minister's former director of communications, Andy Coulson, also faces a charge of phone hacking.

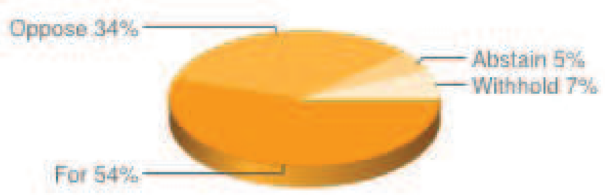
US Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

Total Resolutions	
For	561
Oppose	346
Abstain	55
Withhold	68
Withdrawn	0
Total	1030

Meetings	AGM	EGM	Total
Total Meetings	81	0	81
1 (or more) oppose or abstain vote	81	0	81

US Voting Record



US AGM Record

US EGM Record

There where no EGMs during the last period in the clients portfolio.

US Voting Timetable Q1 2013

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 7: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	BANK OF NEW YORK MELLON CORP.	09 Apr 13	AGM	2013-03-25
2	MOODY'S CORP.	16 Apr 13	AGM	2013-04-10
3	SHERWIN-WILLIAMS CO	17 Apr 13	AGM	2013-04-02
4	eBAY INC.	18 Apr 13	AGM	2013-04-11
5	TEXAS INSTRUMENTS INC.	18 Apr 13	AGM	2013-04-10
6	HONEYWELL INTERNATIONAL INC.	22 Apr 13	AGM	2013-04-15
7	AMEREN CORPORATION	23 Apr 13	AGM	2013-04-15
8	PRAXAIR INC.	23 Apr 13	AGM	2013-04-15
9	AMERICAN ELECTRIC POWER CO INC	23 Apr 13	AGM	2013-04-15
10	LIFE TECHNOLOGIES CORP	24 Apr 13	AGM	2013-04-15
11	AT&T INC.	24 Apr 13	AGM	2013-04-16
12	HCP INC	25 Apr 13	AGM	2013-04-16
13	JOHNSON & JOHNSON	25 Apr 13	AGM	2013-04-16
14	INTUITIVE SURGICAL INC	25 Apr 13	AGM	2013-04-16
15	SNAP-ON INC.	25 Apr 13	AGM	2013-04-16
16	CENTERPOINT ENERGY	25 Apr 13	AGM	2013-04-16
17	PFIZER INC.	25 Apr 13	AGM	2013-04-16
18	FLIR SYSTEMS INC.	26 Apr 13	AGM	2013-04-17
19	CINCINNATI FINANCIAL CORP.	27 Apr 13	AGM	2013-04-18
20	HARLEY-DAVIDSON INC	27 Apr 13	AGM	2013-04-18
21	UNITED TECHNOLOGIES CORP	29 Apr 13	AGM	2013-04-19
22	TERADATA CORP	30 Apr 13	AGM	2013-04-22
23	INTERNATIONAL FLAV/FRAG INC.	30 Apr 13	AGM	2013-04-22
24	L-3 COMMUNICATIONS HOLDINGS INC	30 Apr 13	AGM	2013-04-22
25	THE HERSHEY COMPANY	30 Apr 13	AGM	2013-04-22
26	MEAD JOHNSON NUTRITION CO	30 Apr 13	AGM	2013-04-22
27	PEPSICO INC.	01 May 13	AGM	2013-04-23
28	DTE ENERGY CO.	02 May 13	AGM	2013-04-23
29	KIMBERLY CLARK CORP	02 May 13	AGM	2013-04-24
30	WISCONSIN ENERGY CORP.	02 May 13	AGM	2013-04-23
31	VERIZON COMMUNICATIONS INC	02 May 13	AGM	2013-04-23
32	UNITED PARCEL SERVICE INC	02 May 13	AGM	2013-04-23
33	EOG RESOURCES INC	02 May 13	AGM	2013-04-23
34	EQUIFAX INC.	02 May 13	AGM	2013-04-24
35	TENET HEALTHCARE CORP.	03 May 13	AGM	2013-04-24
36	ENTERGY CORP.	03 May 13	AGM	2013-04-24
37	LILLY (ELI) & CO	06 May 13	AGM	2013-04-24
38	ALTERA CORP.	06 May 13	AGM	2013-04-25

39	PHILIP MORRIS INTERNATIONAL INC.	08 May 13	AGM	2013-05-01
40	LABORATORY CORP. OF AMERICA	08 May 13	AGM	2013-05-02
41	WATERS CORPORATION	09 May 13	AGM	2013-05-03
42	REYNOLDS AMERICAN INC	09 May 13	AGM	2013-05-07
43	MATTEL INC.	10 May 13	AGM	2013-05-07
44	3M COMPANY	14 May 13	AGM	2013-05-02
45	NISOURCE INC.	14 May 13	AGM	2013-05-07
46	DISCOVERY COMMUNICATIONS INC	14 May 13	AGM	2013-05-07
47	PINNACLE WEST CAPITAL CORP	15 May 13	AGM	2013-05-09
48	NORTHROP GRUMMAN CORP.	15 May 13	AGM	2013-05-09
49	PPL CORP.	15 May 13	AGM	2013-05-10
50	WELLPOINT INC	15 May 13	AGM	2013-05-10
51	INTEL CORP	16 May 13	AGM	2013-05-03
52	DR PEPPER SNAPPLE GROUP INC.	16 May 13	AGM	2013-05-09
53	ALTRIA GROUP INC.	16 May 13	AGM	2013-05-10
54	UNION PACIFIC CORP.	16 May 13	AGM	2013-05-13
55	PROGRESSIVE CORP.	16 May 13	AGM	2013-05-13
56	CONSOLIDATED EDISON INC	20 May 13	AGM	2013-05-14
57	ALLSTATE CORP.	21 May 13	AGM	2013-05-13
58	GAP INC	21 May 13	AGM	2013-05-14
59	OMNICOM GROUP INC	21 May 13	AGM	2013-05-15
60	MONDELEZ INTERNATIONAL INC	21 May 13	AGM	2013-05-15
61	TERADYNE INC.	21 May 13	AGM	2013-05-15
62	AMGEN INC.	22 May 13	AGM	2013-05-16
63	XCEL ENERGY INC.	22 May 13	AGM	2013-05-16
64	CENTURYLINK INC	22 May 13	AGM	2013-05-16
65	NATIONAL OILWELL VARCO INC	22 May 13	AGM	2013-05-16
66	SOUTHERN CO.	22 May 13	AGM	2013-05-16
67	KRAFT FOODS GROUP INC	22 May 13	AGM	2013-05-16
68	THERMO FISHER SCIENTIFIC INC.	22 May 13	AGM	2013-05-16
69	HOME DEPOT INC	23 May 13	AGM	2013-05-16
70	NEXTERA ENERGY INC	23 May 13	AGM	2013-05-16
71	AMAZON COM INC.	23 May 13	AGM	2013-05-16
72	DEVON ENERGY CORP.	05 Jun 13	AGM	2013-05-22
73	Google Inc.	06 Jun 13	AGM	2013-05-23
74	WAL MART STORES INC	07 Jun 13	AGM	2013-05-28
75	TJX COS INC	11 Jun 13	AGM	2013-05-30
76	MASTERCARD INC	18 Jun 13	AGM	2013-06-10
77	CARMAX INC	24 Jun 13	AGM	2013-06-18
78	YAHOO INC.	25 Jun 13	AGM	2013-06-18
79	BED BATH & BEYOND INC	28 Jun 13	AGM	2013-06-18
80	TRIPADVISOR INC -SPN	28 Jun 13	AGM	2013-06-18

Not Voted Meetings

Table 8: Meetings not voted in quarter

	Company	Meeting Date	Type	Reason Not Voted
1	MCCORMICK & CO	03 Apr 13	AGM	Non Voting Shares.

US Upcoming Meetings Q3 2013

List of meetings scheduled to be held throughout the period by US companies currently in the fund's portfolio.

Table 9: Upcoming Meetings

	Company	Meeting Date	Type
1	SMUCKER (JM) CO.	14 Aug 13	AGM
2	XILINX INC.	14 Aug 13	AGM
3	MEDTRONIC INC	23 Aug 13	AGM
4	H&R BLOCK INC.	13 Sep 13	AGM
5	NIKE INC.	20 Sep 13	AGM
6	CONAGRA FOODS INC.	21 Sep 13	AGM
7	FEDEX CORPORATION	24 Sep 13	AGM

Japanese Voting Charts

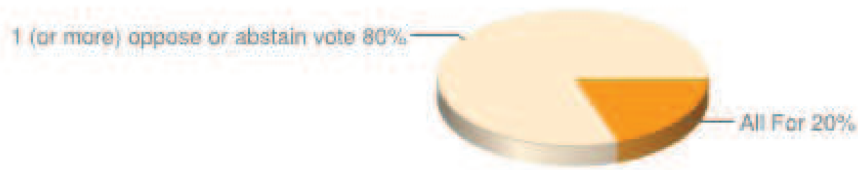
These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

Total Resolutions	
For	274
Oppose	40
Abstain	1
Withdrawn	0
Total	315

Meetings	AGM	EGM	Total
Total Meetings	25	0	25
1 (or more) oppose or abstain vote	20	0	20

Japanese Voting Record

Japanese AGM Record



Japanese EGM Record

There where no EGMs during the last period in the clients portfolio.

Japanese Voting Timetable Q1 2013

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 10: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	LAWSON INC	21 May 13	AGM	2013-05-09
2	KEYENCE CORP	13 Jun 13	AGM	2013-06-03
3	TOYOTA MOTOR CORP	14 Jun 13	AGM	2013-06-04
4	NTT DOCOMO INC	18 Jun 13	AGM	2013-06-04
5	ASTELLAS PHARMA INC	19 Jun 13	AGM	2013-06-06
6	ITOCHU TECHNO-SOLUTIONS CORP	20 Jun 13	AGM	2013-06-06
7	OMRON CORP	20 Jun 13	AGM	2013-06-10
8	TOKYO ELECTRON LTD	21 Jun 13	AGM	2013-06-07
9	EISAI CO LTD	21 Jun 13	AGM	2013-06-10
10	KYOWA EXEO CORP	21 Jun 13	AGM	2013-06-13
11	NAMCO BANDAI HLDGS INC	24 Jun 13	AGM	2013-06-12
12	SANTEN PHARMACEUTICAL	25 Jun 13	AGM	2013-06-12
13	INPEX CORP	25 Jun 13	AGM	2013-06-13
14	SQUARE ENIX HLDGS CO LTD	25 Jun 13	AGM	2013-06-12
15	TAKEDA PHARMACEUTICAL CO	26 Jun 13	AGM	2013-06-14
16	ONO PHARMACEUTICAL CO LTD	26 Jun 13	AGM	2013-06-14
17	DAIWA SECURITIES GROUP INC	26 Jun 13	AGM	2013-06-14
18	OLYMPUS CORP	26 Jun 13	AGM	2013-06-14
19	SHIONOGI & CO LTD	26 Jun 13	AGM	2013-06-14
20	HIROSE ELECTRIC CO LTD	27 Jun 13	AGM	2013-06-17
21	KAKEN PHARMACEUTICAL CO LTD	27 Jun 13	AGM	2013-06-17
22	KANSAI PAINT CO LTD	27 Jun 13	AGM	2013-06-17
23	ROHM CO LTD	27 Jun 13	AGM	2013-06-18

Not Voted Meetings

Table 11: Meetings not voted in quarter

	Company	Meeting Date	Type	Reason Not Voted
1	THK CO LTD	15 Jun 13	AGM	Shares not held at record date.
2	SMC CORP	27 Jun 13	AGM	No holdings at record date

Japanese Upcoming Meetings Q3 2013

List of meetings scheduled to be held throughout the period by Japanese companies currently in the fund's portfolio.

Table 12: Upcoming Meetings

	Company	Meeting Date	Type
1	ORACLE CORP JAPAN	24 Aug 13	AGM

Global Corporate Governance Review

Factory collapse kills hundreds

In April the collapse of a factory, and a subsequent fire, killed over 1,000 workers in Bangladesh. The disaster should lead to renewed investor scrutiny of safety issues.

The collapse of the Rana Plaza building, which to date has claimed the lives of over 1,000 people, has already led to the arrest of the factory owner, Sohel Rana, who appears to have sought to flee the country. Around 3,000 workers were in the building when it collapsed, of whom over 2,400 are known to have escaped. However the disaster may yet claim more lives, especially given a subsequent fire caused by rescue equipment.

The building housed a number of garment factories which produced clothing for Western companies, including Primark, which has already offered to pay compensation, according to reports. The Rana Plaza collapse also comes less than six months after another factory fire when over 110 people died. In that case the factory was producing clothes for Walmart. As such the disaster may lead to further scrutiny of supply chains.

However, these disasters should prompt investors to devote more attention to the question of safety standards at investee companies. Ironically the factory collapse coincided with World Day for Safety and Health at Work, which seeks to draw attention to emerging trends in the field of occupational safety and health and the magnitude of work-related injuries, diseases and fatalities worldwide.

Investor initiatives around safety issues have been limited in recent years, despite some reactive work done in response to the BP Gulf of Mexico disaster. Canadian shareholder group SHARE produced useful guidance on health and safety in 2012, but such examples are rare. We noted previously in PIRC Alerts, the UK's attempt at a safety index, to allow investors and others to compare companies, called CHaSPI, was withdrawn last year.

However, cases like BP demonstrate that there is a real risk to shareholder value from getting safety wrong. So, if any good is to come out of the disaster in Bangladesh, greater investor scrutiny of these issues should be part of it.

Barrick bonuses badly battered

If the UK saw no repeat of its 'shareholder spring' in 2013, April did see a truly impressive shareholder revolt over pay in Canada.

At Barrick Gold a staggering 85% of votes were cast against the company on the resolution seeking approval for its executive compensation policy. There was considerable shareholder dissent as a result of the $11.9 million signing-on bonus John Thornton received as part of his appointment as executive co-chairman. PIRC had recommended opposition.

First Female CEO at Tepco

Rieko Sato became the first female corporate officer at Tokyo Electric Power Company (Tepco).

Gender balance at Japan's company boards is still a far cry, with less then 5 per cent of listed company boards including female directors. The gender pay gap of 40 per cent in the workplace is one of the highest in the world.

Ms. Sato's calm manner and perfect posture is very much in opposition to other male senior executive stuff and seems to be a well needed attribute for a company that is in the midst of a major restructuring, cuttings costs and seeking to restore public confidence. Tepco is, namely, still struggling to recover from the international infamy after its Fukushima power plant was severely damaged in the March 2011 earthquake and tsunami.

The female CEO remembers that at the beginning of her career she would never get challenging roles as men were always trying to be kind and spare her from doing “too hard work”. She believes that all women start their career with the same mentality as men but as they realise that companies do not expect so much from them they often loose their sense of ambition.

In Ms. Sako’s view women are responsible for the persistence of the salaryman culture. She says “women need to be bold and take responsibility and say, ‘I can do this’ and show the boss what they can do” if they want to avoid that men will keep getting all the roles.

China’s carbon trading scheme

China’s first pilot carbon-trading scheme will be launched next month. But the resulting carbon market may have little effect on the country’s carbon emissions as long as the State controls electricity prices.

China, which is responsible for the surge in CO_2 emissions since the 2000s due to its catch-up growth, has released details of its first pilot carbon-trading scheme in Shenzhen. The biggest country emitter of CO_2 plans to experiment with carbon trading schemes in the next three years as it seeks to cut emissions. The scheme in Shenzen will be joined by an additional six in other Chinese cities by 2014. The schemes seek to cut emissions by encouraging companies to curb their carbon dioxide emissions, by distributing permits equal to one tonne of carbon to each emitter. This will create a price on carbon dioxide, the main man-made greenhouse gas considered to be responsible for climate change.

The seven schemes, which would in total cover around seven per cent of China’s total carbon emissions, are the first step towards what might become a nationwide scheme in the future. However, the whole initiative might have no effect on electricity producers, which account for the bulk of carbon emissions, because of the Chinese government’s control of electricity prices. A CO_2 trading scheme requires a functioning market in order to be effective.

Japan’s flood of investor props

There have been already more than hundred shareholder proposals in Japan this year, according to PIRC research.

More then 100 shareholder proposals have been filed at the largest Japanese companies, while more ballots are to be disclosed over the next few days. The majority of shareholder resolutions on a variety of issues were filed at electric companies, the same as last year, with 28 at Kansai Electric Power, 15 at Tokyo Electric Power Co Inc (TEPCO) and seven each at Chubu Electric Power Co Inc and Kyushu Electric Power Co Inc. The optical glass manufacturer HOYA Corp received 9 shareholder resolutions. Its investors propose, among others, individual disclosure of remunerations to directors and executive officers, separation of roles of chairman of the board and CEO, and a director nominee.

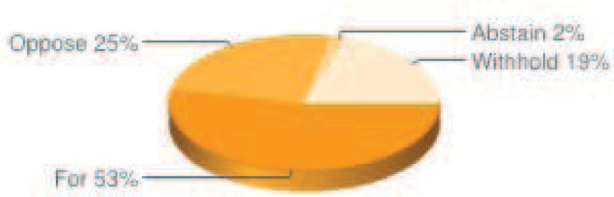
Global Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

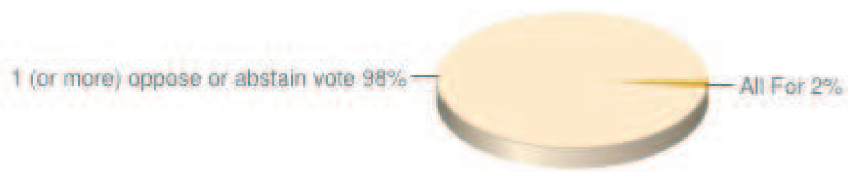
Total Resolutions	
For	304
Oppose	142
Abstain	14
Withhold	111
Withdrawn	0
Total	571

Meetings	AGM	EGM	Total
Total Meetings	57	2	59
1 (or more) oppose or abstain vote	56	2	58

Global Voting Record



Global AGM Record



Global EGM Record

Global Voting Timetable Q1 2013

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 13: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	ODONTOPREV SA	02 Apr 13	AGM	2013-03-19
2	SYNOPSYS INC	03 Apr 13	AGM	2013-03-19
3	BANK OF MONTREAL	10 Apr 13	AGM	2013-03-25
4	FAIRFAX FINANCIAL HOLDINGS	11 Apr 13	AGM	2013-03-26
5	BM&F BOVESPA SA	15 Apr 13	**EGM**	2013-04-08
6	BM&F BOVESPA SA	15 Apr 13	AGM	2013-04-08
7	AMERICA MOVIL SA DE CV	22 Apr 13	**EGM**	2013-04-15
8	AMERICA MOVIL SA DE CV	22 Apr 13	AGM	2013-04-15
9	CANADIAN NATIONAL RAILWAY CO	23 Apr 13	AGM	2013-04-15
10	NATIONAL BANK CANADA	24 Apr 13	AGM	2013-04-16
11	CANADIAN IMPERIAL BANK	25 Apr 13	AGM	2013-04-16
12	RITCHIE BROS AUCTIONEERS INC	25 Apr 13	AGM	2013-04-16
13	HERBALIFE LTD	25 Apr 13	AGM	2013-04-22
14	NATIONAL HEALTH INVESTORS	29 Apr 13	AGM	2013-04-23
15	PETROBRAS-PETROLEO BRASILIER	29 Apr 13	AGM	2013-04-23
16	TURKIYE GARANTI BANKASI AS	30 Apr 13	AGM	2013-04-22
17	SCHIBSTED ASA	30 Apr 13	AGM	2013-04-22
18	DAVIDE CAMPARI SPA	30 Apr 13	AGM	2013-04-22
19	DRAGON OIL PLC	30 Apr 13	AGM	2013-04-23
20	BELL ALIANT INC	02 May 13	AGM	2013-04-25
21	GPT GROUP	02 May 13	AGM	2013-04-25
22	CHURCH & DWIGHT INC	02 May 13	AGM	2013-04-30
23	COCA-COLA AMATIL LTD	07 May 13	AGM	2013-04-30
24	MOHAWK INDUSTRIES INC	08 May 13	AGM	2013-05-07
25	CALLOWAY REAL ESTATE INVT TR	09 May 13	AGM	2013-05-06
26	MANITOBA TELECOM SVCS INC	09 May 13	AGM	2013-05-06
27	MULLEN GROUP LTD	09 May 13	AGM	2013-05-06
28	BCE INC	09 May 13	AGM	2013-05-08
29	MARKEL CORP	13 May 13	AGM	2013-05-10
30	RHEINMETALL AG	14 May 13	AGM	2013-05-06
31	AIMIA INC	14 May 13	AGM	2013-05-09
32	FIRST REPUBLIC BANK	14 May 13	AGM	2013-05-13
33	BIM BIRLESIK MAGAZALAR	15 May 13	AGM	2013-05-01
34	BIC SOCIETE	15 May 13	AGM	2013-05-02
35	CIMAREX ENERGY CO	15 May 13	AGM	2013-05-13
36	JARDINE MATHESON HLDGS LTD	16 May 13	AGM	2013-05-06
37	SYDNEY AIRPORT	16 May 13	AGM	2013-05-09
38	PARTNERRE LTD	17 May 13	AGM	2013-05-16

39	ULTRA PETROLEUM CORP	21 May 13	AGM	2013-05-15
40	ROYAL CARIBBEAN CRUISES LTD	22 May 13	AGM	2013-05-15
41	NATIONAL RETAIL PROPERTIES	23 May 13	AGM	2013-05-21
42	HEALTH NET INC	23 May 13	AGM	2013-05-21
43	VECTOR GROUP LTD	28 May 13	AGM	2013-05-22
44	WESTFIELD GROUP	29 May 13	AGM	2013-05-22
45	ILLUMINA INC	29 May 13	AGM	2013-05-24
46	SBERBANK OF RUSSIA OJSC	31 May 13	AGM	2013-05-20
47	ARES CAPITAL CORP	04 Jun 13	AGM	2013-05-31
48	TESLA MOTORS INC	04 Jun 13	AGM	2013-05-31
49	NEW YORK COMMUNITY BANCORP INC	06 Jun 13	AGM	2013-06-04
50	LIVE NATION ENTERTAINMENT	06 Jun 13	AGM	2013-06-04
51	OMEGA HEALTHCARE INVS INC	06 Jun 13	AGM	2013-06-04
52	FACEBOOK INC	11 Jun 13	AGM	2013-06-07
53	CI FINANCIAL CORP	13 Jun 13	AGM	2013-06-04
54	MAIN STREET CAPITAL CORP	13 Jun 13	AGM	2013-06-12
55	QIAGEN NV	26 Jun 13	AGM	2013-06-12

Not Voted Meetings

Table 14: Meetings not voted in quarter

	Company	Meeting Date	Type	Reason Not Voted
1	WEIGHT WATCHERS INTL INC	07 May 13	AGM	No shares available to vote
2	AMERICAN WATER WORKS CO INC	13 May 13	AGM	Admin error
3	MFA FINANCIAL INC	22 May 13	AGM	Shares bought after record date.
4	GENERAL MOTORS CO	06 Jun 13	AGM	Shares not held at record date.

Global Upcoming Meetings Q3 2013

List of meetings scheduled to be held throughout the period by Global companies currently in the fund's portfolio.

Table 15: Upcoming Meetings

	Company	Meeting Date	Type
1	BAIDU INC -ADR	01 Aug 13	AGM
2	EMS-CHEMIE HOLDING AG	11 Aug 13	AGM
3	NASPERS LTD	31 Aug 13	AGM

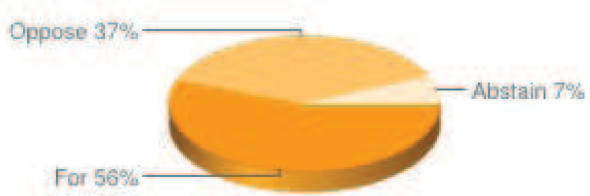
Asian Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

Total Resolutions	
For	76
Oppose	50
Abstain	9
Withdrawn	0
Total	135

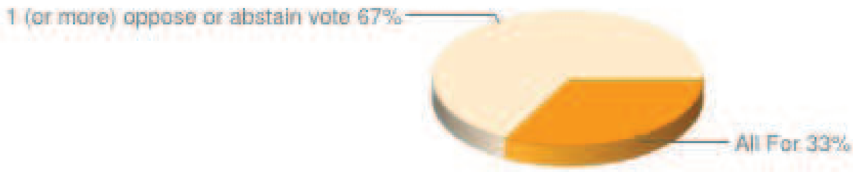
Meetings	AGM	EGM	Total
Total Meetings	12	3	15
1 (or more) oppose or abstain vote	11	2	13

Asian Voting Record



Asian AGM Record

Asian EGM Record



Asian Voting Timetable Q1 2013

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 16: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	M 1 LTD	05 Apr 13	AGM	2013-03-28
2	STARHUB LTD	15 Apr 13	AGM	2013-04-09
3	STARHUB LTD	15 Apr 13	**EGM**	2013-04-09
4	COMFORTDELGRO CORP LTD	26 Apr 13	AGM	2013-04-17
5	HANG SENG BANK LTD	16 May 13	AGM	2013-05-13
6	TELEVISION BROADCASTS LTD	22 May 13	AGM	2013-05-14
7	CHINA RESOURCES ENTERPRISES	24 May 13	AGM	2013-05-21
8	CHINA MOBILE LTD	30 May 13	AGM	2013-05-17
9	SHANDONG WEIGAO GP MED POYL	31 May 13	AGM	2013-05-24
10	TAIWAN SEMICONDUCTOR MFG CO	11 Jun 13	AGM	2013-06-04
11	SINGAPORE PRESS HOLDINGS LTD	18 Jun 13	**EGM**	2013-06-10
12	TSINGTAO BREWERY CO LTD	25 Jun 13	AGM	2013-06-18
13	SINGAPORE POST LTD	28 Jun 13	AGM	2013-06-19
14	SINGAPORE POST LTD	28 Jun 13	**EGM**	2013-06-18

Not Voted Meetings

Table 17: Meetings not voted in quarter

	Company	Meeting Date	Type	Reason Not Voted
1	ICICI BANK LTD	24 Jun 13	AGM	No ballot

Asian Upcoming Meetings Q3 2013

There are no upcoming meetings for this region.

PIRC Summary Report Appendices

UK

Analysis and final proxy results on "Oppose" and "Abstain" votes for resolutions at UK meetings for companies held by the fund during the period.

European

Analysis for "Oppose" and "Abstain" votes for resolutions at European meetings for companies held by the fund during the period.

US

Analysis for "Oppose", "Withhold" and "Abstain" votes for resolutions at US meetings for companies held by the fund during the period.

Japanese

Analysis for "Oppose" and "Abstain" votes for resolutions at Japanese meetings for companies held by the fund during the period.

Global

Analysis and final proxy results on "Oppose" and "Abstain" votes for resolutions at Global meetings for companies held by the fund during the period.

Asian

Analysis and final proxy results on "Oppose" and "Abstain" votes for resolutions at Asian meetings for companies held by the fund during the period.

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Appendix 'B'

QUARTERLY ENGAGEMENT REPORT

APRIL TO JUNE 2013

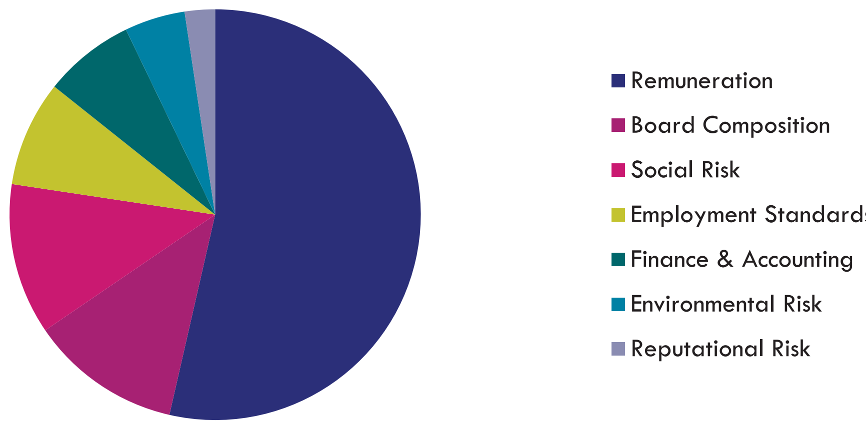
Local Authority Pension Fund Forum

LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Formed in 1990, the Forum brings together a diverse range of local authority pension funds in the UK with combined assets of over £115 billion.

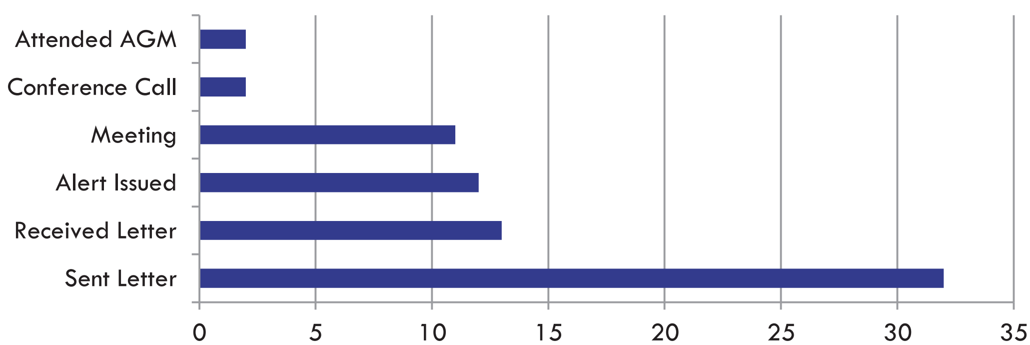
ENGAGEMENT SUMMARY

APRIL TO JUNE 2013

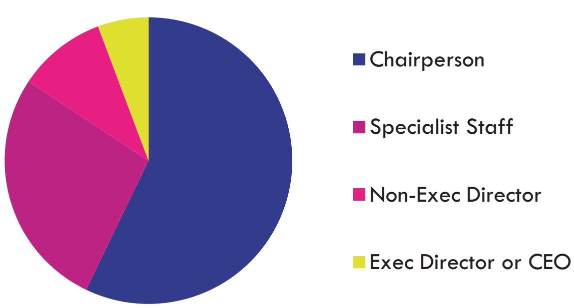
Topics



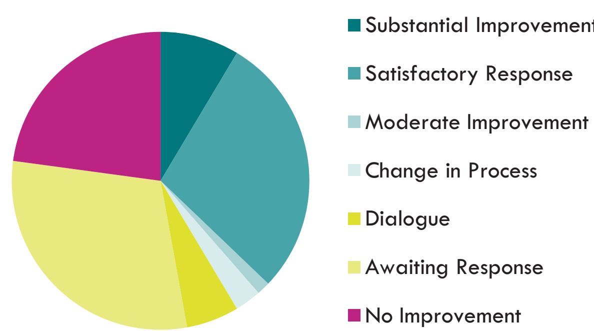
Activities



Company Contact



Outcomes



ACHIEVEMENTS

- Issued 14 voting alerts in the proxy season on a number of issues including on executive pay, joint Chair/CEO and carbon management: **Carnival, AstraZeneca, Barclays, National Express, BAE Systems, Aviva, Royal Bank of Scotland, Prudential, Comcast, JP Morgan, ExxonMobil, WPP, Marks & Spencer,** and **Freeport McMoRan.**

- Attended the AGMs of **Barclays** and **National Express**.

- Met with the Chair of **Associated British Foods** regarding supplier employment standards following the Bangladesh factory tragedy. LAPFF also signed an investor statement calling for improvements to factory standards for workers' safety.

- Sent LAPFF's new **Expectations on Executive Pay** to the FTSE 350 seeking feedback from a list of 16 companies in advance of their AGMs.

- Held meetings with **Société Générale**, **WM Morrison Supermarkets**, and **Legal & General** on executive pay.

- Met with **Imperial Tobacco** to discuss the health risks of tobacco products and the company's harm-reduction strategy.

- Discussed carbon management strategy with representatives of **Rio Tinto. R**eceived feedback from **Centrica** regarding opportunities and risks in the UK shale gas market.

- Met with the Chairman of **Standard Chartered** regarding Board structure and renewal.

THE FORUM IN THE NEWS

Pension funds call for review of accounting standards
The Telegraph, Bloomberg, Reuters, Washington Post, The Guardian

LAPFF questions RBS' accounts
The Times, Financial News, Bloomberg, The Scotsman

Investors push for independent Chair at News Corp
Professional Pensions, The Guardian

LAPFF opposes Barclays' accounts
The Independent, The Wall Street Journal, Fox Business, Bloomberg

LAPFF recommends against AstraZeneca's pay
The Telegraph, Financial Times, Reuters, The Independent, Bloomberg

View more press coverage: http://lapfforum.org/TTx2/press/in-the-news

COMPANY ENGAGEMENT

LEADERSHIP ON KEY CAMPAIGNS

In response to member concerns regarding the social and public health concerns associated with tobacco companies, LAPFF met with representatives of **Imperial Tobacco**. The issues discussed included harm reduction initiatives, regulatory risks, marketing and advertising practices, and global supply chain standards.

LAPFF also met with the Chairman of **Standard Chartered** at the Company's request to discuss ongoing changes at the Board level. Increasingly, companies are approaching LAPFF to initiate proactive discussions regarding governance, which demonstrates the progress LAPFF has made in terms of developing mutually beneficial relationships with the companies our members invest in.

We also held a meeting with **Trinity Mirror** to discuss ongoing investigations into phone hacking and the reputational consequences for the media industry.

PROMOTING GOOD GOVERNANCE

Global Focus List Engagement

Engagement with our focus list of companies on governance issues continued this quarter. Our activities focused more on issuing voting alerts in the run up to company annual meetings. We issued an alert on **JP Morgan**, recommending members vote for a shareholder proposal to appoint an independent Chair, and to vote against the re-election of Jamie Dimon, the Company's Chairman and CEO. The shareholder proposal received support from 32% of shareholders. LAPFF first initiated engagement with JP Morgan in 2012 in relation to the joint Chair/CEO role and on executive pay.

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LAPFF issued a similar alert on the joint Chair/CEO role at **Comcast Corporation**, a 2013 Global Focus List company. In this case, LAPFF recommended a vote against the Chairman and CEO, and against the Chairman of the Nomination Committee.

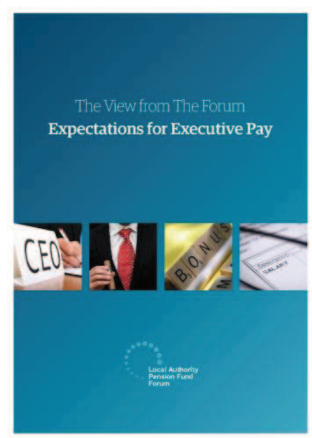
Financial Reporting & Audit

The Forum continues to be one of the leading advocates on the need for accounting standards to properly reflect a true and fair view of companies' financial position. The Forum is concerned that the true and fair view has been misrepresented, equating it to proper reporting against the accounting standards, rather proper reporting in line with the spirit of the law.

This quarter, we issued voting alerts at **Royal Bank of Scotland (RBS)** and **Barclays**, recommending members vote against the report and accounts on the basis that the companies' true financial position is not accurately reflected in their reports due to the use of International Financial Reporting Standards (IFRS). The Forum is concerned that the banks' reporting has implications for capital adequacy, noting that the Financial Policy Committee is making material adjustments to the public accounts. Press reports on the true capital positions of the banks are very similar to numbers LAPFF published in its Bank Post Mortem in 2011. RBS, which has the largest capital gap by both LAPFF's calculations and press reports, has not made any public disclosure of the company's estimate of the size of the gap.

LAPFF submitted evidence to the Commission to the **Parliamentary Commission on Banking Standards**, which reported in June. The QC opinion commissioned by LAPFF and several other investors raises significant concerns regarding the legal position of IFRS adoption and endorsement. The findings of the QC opinion have serious implications for all companies, the Financial Reporting Council, and the International Accounting Standards Board. As a result, the Forum has written to Standard Chartered, Barclays, HSBC and Lloyds seeking the Boards' views on the Opinion. You can view the full text of the QC opinion on the LAPFF website.

Executive Pay



In April, LAPFF launched its "**Expectations for Executive Pay**" document, which outlines LAPFF's new strategy on executive pay. There are a total of fifteen "expectations" set out for companies, some of which reference several long-standing LAPFF policies, such as "no golden hellos," the provision of fair pension arrangements, and exercising "reasonableness" with regard to the quantum of pay. The document also sets out several new policy positions, including the phase out of long-term incentive plans, the consideration of employee views, transparency in the executive recruitment process, and the publication of pay ratios.

Copies of the document were sent to the Chairmen of the FTSE 350 for their information, and a subset of 16 companies was asked for their specific response to our new proposals. Thirteen companies from the FTSE 350 list responded to indicate they had circulated the document to their Remuneration Committees, with two companies (**Centrica** and **Dunelm Mill**) indicating their Committees would specifically consider the document at upcoming Board meetings.

Four voting alerts recommending a vote against companies' remuneration reports were issued on the back of the launch of the Expectations document. At **AstraZeneca**, concerns were raised regarding a golden hello payment to the incoming CEO. For **Aviva**, **BAE Systems** and **Prudential**, LAPFF had concerns regarding the overall quantum of awards. On **Barclays**, LAPFF recommended an abstain vote on the remuneration report, in recognition of the Company's intention to review pay practices next year with a mind to simplifying the bank's pay.

LAPFF also held meetings with **WM Morrisons Supermarkets** and **Legal & General** to receive feedback on the Forum's new approach to pay.

MANAGING ENVIRONMENTAL RISK

Climate Change

LAPFF was joined by the Church Commissioners and the Church of England at a meeting with **Rio Tinto** to discuss the company's approach to carbon management. This is part of a wider investor initiative, 'Aiming for A' which aims to support companies working towards a transition to low-carbon production and to encourage improvement in CDP (carbon disclosure project) scorings. Rio Tinto agreed to continue communications regarding its business strategy for long-term sustainability.

"Adopt quantitative goals, based on current technologies, for reducing total greenhouse gas emissions from the Company's products and operations and report to shareholders…on its plans to achieve these goals"

- Shareholder Resolution at ExxonMobil

In keeping with previous years, LAPFF issued a voting alert at **ExxonMobil** recommending a vote in favour of a shareholder proposal asking the Company to set out greenhouse gas emissions reduction goals. The proposal has been filed at the Company for several consecutive years, and last year received 27% shareholder support. A recommendation was also made to vote for a proposal asking Exxon to appoint an independent Chair.

Environmental Risk Management

LAPFF met with **Centrica** this quarter to develop a better understanding of the Company's views on the potential risks and benefits of developing a UK shale gas market. The discovery of shale gas in the UK has the potential to provide a stable source of energy that will help bring energy prices down and supply the UK with energy for 40 years or more. However there are a number of risks associated with the extraction process, which uses hydraulic fracturing. Centrica shared its views on the potential for large scale shale gas development in the UK, and how it believes the environmental and social risks can be managed.

TARGETING SOCIAL ISSUES

Employment Standards

Following the tragic factory collapse in Bangladesh, LAPFF wrote to **Associated British Foods (ABF)** to seek a meeting to discuss the Company's response. ABF and LAPFF have a history of engagement concerning overseas supply chains, and had discussions on this issue several times between 2005 and 2011. After several improvements in the Company's reporting and disclosure, LAPFF determined it was satisfied with the Company's progress. However following the tragedy in Bangladesh, clearly there was a need to re-initiate discussions in an effort to support the Company as it works collaboratively with other companies to improve overseas factory standards.

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In response to a complaint about labour practices filed by unions under the OECD multinational enterprises guidelines, LAPFF held a conference call with the head of investor relations at **Deutsche Post DHL**. The company agreed that employment practices in some markets, such as Turkey, had fallen short of its expectations, and it was looking to roll out global standards across the group. Dialogue will continue once the response to the OECD is clear.

As part of its continuing engagement with **National Express** over employment issues in its US schoolsbus business, LAPFF signed a statement calling on the company to improve oversight and reporting of human capital issues. LAPFF issued an Alert ahead of the AGM, and vice-chair Ian Greenwood attended and spoke at the meeting. The company continues to defend its stance and has offered a further meeting with the LAPFF chair.

The Forum held a meeting with **Tesco** to discuss the announced review of its US business Fresh & Easy. LAPFF had previously engaged with Tesco over employment issues, and the former chair met with Fresh & Easy employees in the US, at which point it became clear that the business was in difficulties and a further meeting was sought. LAPFF asked whether the company had learned lessons from the US experience and could have engaged with employee concerns earlier. The company agreed that earlier engagement may have been beneficial and said that lessons had been learned, but that there had also been benefits to the US experience.

CONSULTATIONS & PUBLIC POLICY

CONSULTATION RESPONSES

The Forum submitted several consultation responses this quarter. We expressed support for the **Financial Reporting Council's (FRC)** proposed reforms to require the auditor's report to address risks of material misstatement, materiality and a summary of the audit scope. LAPFF also issued a response to **The Sharman Inquiry** on Going Concern. In its paper, LAPFF highlighted that assessing going concern requires prudent accounting policies, and that this assessment is not consistent with IFRS in several material respects. LAPFF co-signed a paper to the **UK Competition Commission** to advocate in favour of mandatory audit rotation, and backed a letter to the **Financial Conduct Authority (FCA)** raising concerns regarding the failure of the listing regime to provide basic corporate governance protections for investors.

NETWORKS & EVENTS

Representatives of LAPFF regularly attend conferences and events on behalf of members. A list of recent events is listed below.

- **Barclays annual meeting**
- **National Express annual meeting**
- **Unburnable carbon** - UKSIF sponsored event
- **Commodities trading** – UKSIF sponsored event
- **30% Club Seminar** – hosted by Bloomberg
- **RI Europe Conference** – hosted by responsible-investor.com
- **Investors and Diversity Panel** – hosted by BNY Mellon
- **Board effectiveness** - Centre for Financial Innovation roundtable
- **Access to Nutrition Index** – hosted by F&C

COMPANY PROGRESS REPORT

Company	Topics	Outcome
Anglo American	Remuneration	Satisfactory Response
Associated British Foods	Employment Standards, Social Risk	Satisfactory Response
AstraZeneca	Remuneration	No Improvement
Aviva plc	Remuneration	No Improvement
BAE Systems	Remuneration	No Improvement
Barclays	Finance & Accounting	Awaiting Response
British American Tobacco	Social Risk	Satisfactory Response
British Sky Broadcasting	Remuneration	Awaiting Response
Burberry	Remuneration, Board Composition	Dialogue
Carnival Corp	Remuneration	Awaiting Response
Centrica	Environmental Risk, Social Risk	Satisfactory Response
Comcast Corp	Board Composition	No Improvement
Deutsche Post	Employment Standards	Dialogue
Dunelm Mill	Remuneration	Satisfactory Response
Enterprise Inns	Remuneration	Satisfactory Response
ExxonMobil	Environmental Risk, Board Composition	No Improvement
Freeport McMoran	Board Composition	Moderate Improvement
Fresnillo	Remuneration	Satisfactory Response
Glencore International	Remuneration	Awaiting Response
Hays	Remuneration	Satisfactory Response
HSBC	Finance & Accounting	Awaiting Response
Imagination Technologies	Remuneration	Awaiting Response
Imperial Tobacco	Social Risk, Reputational Risk	Satisfactory Response
JP Morgan	Board Composition	No Improvement
Laird PLC	Remuneration	Satisfactory Response
Land Securities	Remuneration	Satisfactory Response
Legal & General	Remuneration	Substantial Improvement
Lloyds	Finance & Accounting	Awaiting Response
Meggitt	Remuneration	Satisfactory Response
Melrose plc	Remuneration	Satisfactory Response
National Express	Employment Standards	No Improvement
National Grid	Remuneration	Dialogue
Petra Diamonds	Remuneration	Satisfactory Response
Prudential	Remuneration	No Improvement
Resolution Ltd	Remuneration	Awaiting Response
Rio Tinto	Environmental Risk	Change in Process
Royal Bank of Scotland	Finance & Accounting	No Improvement
SABMiller	Remuneration	Awaiting Response
Smith & Nephew	Remuneration	Awaiting Response
Société Générale	Remuneration	Substantial Improvement

Company	Topics	Outcome
Standard Chartered	Board Composition, Remuneration	Satisfactory Response
Tesco	Employment Standards	Change in Process
Trinity Mirror	Reputational Risk, Social risk	Dialogue
Vesuvius (formerly Cookson)	Remuneration	Awaiting Response
Weir Group	Remuneration	Satisfactory Response
WM Morrison Supermarkets	Remuneration	Substantial Improvement
WPP	Remuneration	No Improvement

Local Authority Pension Fund Forum

The Local Authority Pension Fund Forum was established in 1991 and is a voluntary association of local authority pension funds based in the UK. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which its members invest. The Forum's members currently have combined assets of over £115 billion.

Report prepared by PIRC Ltd. for the Local Authority Pension Fund Forum

PIRC

www.lapfforum.org

Aberdeen City Council
Avon Pension Fund
Bedfordshire Pension Fund
Camden LB
Cheshire Pension Fund
City of London Corporation
Clwyd Pension Fund
Croydon LB
Derbyshire CC
Devon CC
Dorset County Pension Fund
Dyfed Pension Fund
Ealing LB
East Riding of Yorkshire Council
Enfield
Falkirk Council
Greater Gwent Fund
Greater Manchester Pension Fund
Greenwich Pension Fund
Gwynedd Pension Fund
Hackney LB
Haringey LB
Harrow LB
Hillingdon LB
Hounslow LB
Islington LB
Lancashire County Pension Fund
Lewisham LB
Lincolnshire CC
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Newham LB
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire CC Pension Fund
Northamptonshire CC
NILGOSC
Nottinghamshire CC
Rhondda Cynon Taf
Shropshire Council
Somerset CC
South Yorkshire Integrated Transport Authority
South Yorkshire Pensions Authority
Southwark LB
Staffordshire Pension Fund
Surrey CC
Teesside Pension Fund
Tower Hamlets LB
Tyne and Wear Pension Fund
Waltham Forest LB
Warwickshire Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund
Wiltshire CC
Worcestershire CC