

# Report of the Director, West Yorkshire Pension Fund, to the meeting of the Pension Board to be held on 19 November 2015.

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## Subject: Managing unquoted investments

### Summary statement:

This report has been prepared at the request of the Governance & Audit Committee following the review of the Audit Strategy Memorandum 2014/15.

The report provides the Pension Board with summary information on the management of unquoted investments. Investment in unquoted securities is valued at £855.70m 31 March 2015. This is 7.63% of total investments of £11,219.8m.

	Book Cost		Market Value 31/03/2015	
	£m		£m	
Quoted	6,421.10	91.06%	10,364.10	92.37%
Unquoted	630.10	8.94%	855.70	7.63%
<b>Total</b>	<b>7,051.20</b>		<b>11,219.80</b>	

In 2014/15 private equity made 21.3% return on investment for WYPF, and a 51% increase in cash distributions when compared to the previous year. All our investments are managed in house by investment managers employed directly by the fund. This sets us apart from the majority of pension funds, and means our costs are significantly lower than other pension funds. This lower cost also adds a few basis points to our performance figures.

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**Portfolio:**  
**Leader of Council & Strategic Regeneration**  
**Overview & Scrutiny Area: N/A**



The valuation of unquoted investments is reviewed by external and internal audit every year, and we have always received excellent audit reports. However, as the audit confirmation work takes place several weeks after the figures have been entered in the accounts, there is always a difference between the figure in the accounts and the later valuation by the auditors, which is then described by them as a mis-statement. It was after reviewing this difference that the Governance & Audit Committee requested that the Local Pension Board should consider this issue.

### **Recommendations**

That the management of unquoted investment report be considered by the Pension Board.



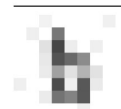
## 1.0 BACKGROUND

Investment in unquoted securities has grown steadily over the past years. Overall, investment in unquoted assets is controlled by our investment strategy. The Investment Advisory Panel (IAP) has set a strategy of increasing total unquoted investments to 10% of total investment. This means the year end share of 7.63% will increase by 2.37% to achieve the 10% strategy.

### 1.1 UNQUOTED INVESTMENTS

We invest in private equity, hedge funds, property, corporate bonds, unit trusts and fund of funds both in the UK and overseas. The table below shows the range and breakdown of WYPF unquoted investments, between asset classes as well as the UK and the rest of the world.

Unquoted Investments	Book Cost	Market Value	
	£m	£m	%
<b><u>UK Unquoted</u></b>			
UK Fixed Interest Corporate Bonds	18.60	23.40	0.20
UK Ordinary & Convertible Shares (Equities)	5.70	1.60	0.00
UK Cash Deposits	181.00	181.00	1.60
Uk Private Equity	119.70	181.30	1.60
Direct Property	6.40	6.00	0.10
<b>SUB TOTAL UK</b>	<b>331.40</b>	<b>393.30</b>	<b>3.50</b>
<b><u>Foreign Unquoted</u></b>			
Foreign Fixed Interest Corporate Bonds	3.10	3.70	0.00
Foreign Ordinary & Convertible Shares (Equities)	2.60	1.10	0.00
Foreign Private Equity	292.50	443.30	4.00
Foreign Unit Trusts	0.50	14.30	0.10
<b>SUB TOTAL FOREIGN</b>	<b>298.70</b>	<b>462.40</b>	<b>4.10</b>
<b>TOTAL UNQUOTED INVESTMENTS</b>	<b>630.10</b>	<b>855.70</b>	<b>100.00</b>



## 1.1 MANAGEMENT

WYPF portfolio of unquoted investments is managed by the Overseas Investment Team, day to day management is carried out by the Alternative Investment Manager and the Property Investment Manager. Both managers research, evaluate and select unquoted investments to be put forward for approval in principle by the IAP, after which the full due diligence is completed, and the final decision to invest made under delegated powers.

## 1.2 INVESTMENT ADVISORY PANEL

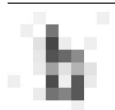
All investment in unquoted investments are approved in principle by the IAP. Investment managers report to the IAP every quarter to provide performance updates, present on new investments, and increased commitments in existing unquoted investments. The Alternative Investments Working Group of the IAP meets a number of private equity funds in London every year to assess manager performance. A separate meeting is also organised in Bradford for private equity regional managers.

## 1.3 INVESTMENT ADMINISTRATION AND CONTROL

The amount approved for investment with each manager is controlled by the investment strategy for that asset class, which is reviewed annually by the IAP, at the second meeting of the municipal year. The amount invested in each Fund or individual investment will be determined by the relevant internal manager, and in the case of private equity and infrastructure will normally have been considered by the IAP when giving its approval to the investment in principle. The payment of sums in settlement of the investment is controlled by the Investment Administration Team, the separation of duties providing the required control and cross checks.

Unquoted subscription documents are managed by the Investments Administration Team. Contract documentation is sealed by the Council Legal Team and a full schedule of amounts committed and invested on each contract is maintained.

All investments, quoted and unquoted, are processed by the Investment Administration Team, and all transactions are recorded on investment accounting systems. Summary transactions are processed on the Council's (CBMDC) SAP general ledger system. Transactions are balanced monthly between SAP and investment systems.



## 1.4 UNQUOTED INVESTMENT VALUATION

The majority of unquoted investments are valued using quarterly asset statements provided by asset managers. The quarterly asset statements gives the amount:

- 1.4.1 Committed
- 1.4.2 Drawdown to the end of the quarter,
- 1.4.3 Total value of assets and share of assets
- 1.4.4 Income distributed to date
- 1.4.5 Fees charged by asset managers
- 1.4.6 Total value of assets carried forward

We also receive the audited accounts for each unquoted investment organisation we invest in. The audited accounts are reviewed for consistency, any reduction in value and audit concerns, and where asset managers are involved we receive service assurance reports from their auditors.

## 2. TAXATION COMPLIANCE

Our tax exposure on unquoted investment is reviewed annually and we comply with all known tax requirements in all areas of our operations. We are supported in reviewing this annually by KPMG and their relevant overseas partners. All new investments made in unquoted investments are reviewed by KPMG, to ensure we can reclaim all taxes and also pay the necessary taxes where we are not exempt from tax.

## 3. LEGAL CONTRACT REVIEW

As part of our annual risk review we have identified the need to strengthen our access to expert legal support in this area of work. Our current management structure and legal support from CBMDC provides the essential legal support to comply with basic legal and management requirements for unquoted investment. In order to meet the legal demand of a growing complex world of unquoted investments, we will be looking at ways of increasing our access to specialised legal support for alternative investments.



#### **4. VERIFICATION OF ASSET VALUES**

- 4.1 Due to the fact that unquoted investments are not traded readily and asset statements provided by external asset managers are used to value unquoted investments, our auditors carry out extensive tests during their audit work. Each year in July and August they request independent confirmation of asset values from asset managers to verify the value of asset disclosed in the accounts. Because latest information is provided by asset managers, this independent verification of asset value results in a small undervaluation of asset in the balance sheet each year. This is classed as understatement of asset in audit terms. WYPF takes a strict prudent view of this type of understatement and we do not adjust for such, however we would adjust the account for any overstated asset values. The understatement is categorised as unadjusted mis-statement in the auditors' completion statement.
- 4.2 WYPF is not alone in this, and it is normal for organisations to take this prudent approach when valuing unquoted investment assets in their accounts. Equally auditors are obliged to report on this fact. It is an area of agreement with auditors, where audit process requires the auditors to report the fact, and the prudence concept supports WYPF approach on this issue.

#### **5. OTHER CONSIDERATIONS**

This is a report requested by the Pension Board and it is linked to "Report and Accounts 2014/15" and "Internal and external audit" reports being presented to the Board on 19 November 2015.

#### **6. RECOMMENDATION:**

That the management of unquoted investment report be considered by the Pension Board.

#### **7. APPENDICES**

None.

