

## **SECTION 5 – CUMBRIA LOCAL GOVERNMENT PENSION SCHEME ACCOUNTS**

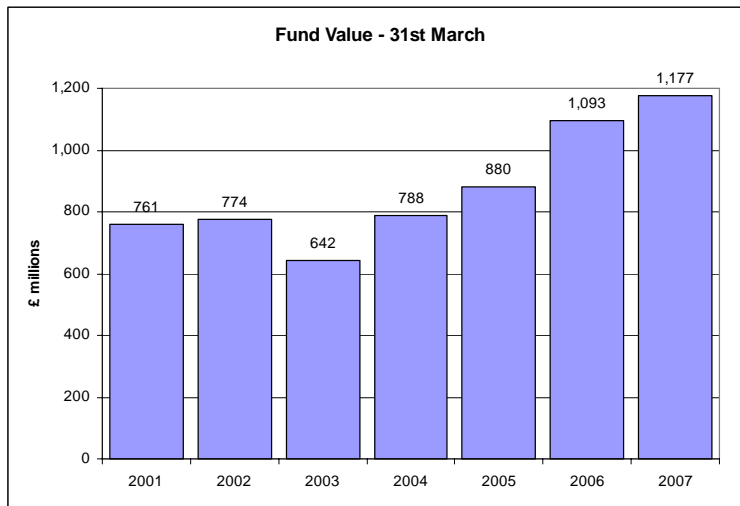
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## 5.0 CHAIRMAN'S INTRODUCTION

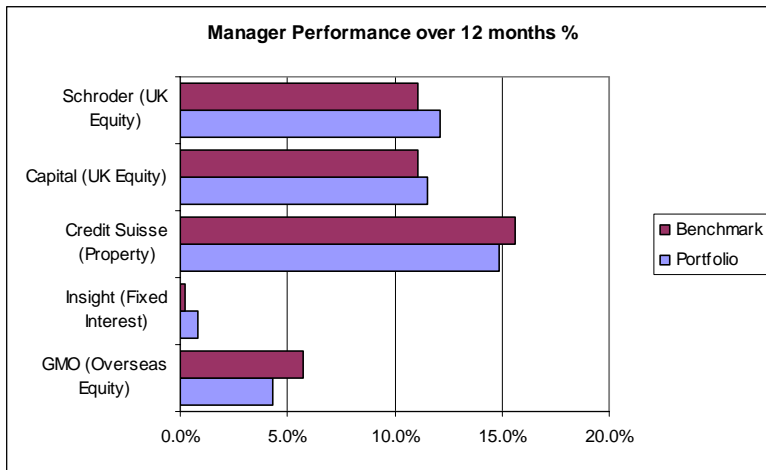
It is my pleasure to introduce the Cumbria Local Government Pension Scheme Annual Report for 2006/2007, on behalf of the Cumbria Pensions Committee.

This year has been one of steady growth which has seen the fund value increase to £1,177 million at 31<sup>st</sup> March 2007. The investment return achieved by the fund for the year was 6.7%, slightly above the scheme-specific benchmark of 6.4%. This was lower than the previous year's return of 22% but still ahead of the retail prices index increase of 4.8% to March 2007. The fund continues to rank well within the WM Local Authority Universe over the longer-term as the 10 year investment return is ranked 41<sup>st</sup> out of 100. The increase in fund value is shown in the table below.

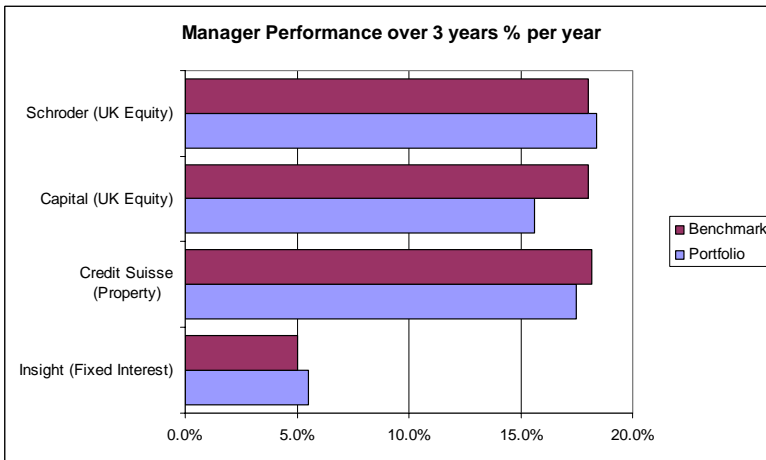


The increase in the Fund's assets has to be set alongside the growth in liabilities. For all pension funds, liabilities have been rising because interest rates are low. The net result since 2004, when the funding level was 76%, has been an overall improvement. Plans were set in place to restore the funding level to 100% over 25 years, although the County Council intends to eliminate the deficit in a shorter timescale of 20 years.

The performance of the investment managers for the year was mixed. The investment managers employed by the fund to manage UK equities and the bond manager outperformed their benchmarks for the year, whereas the overseas equity manager and the property manager underperformed.



Results for individual managers are reviewed over a number of years, so that one year's figures do not carry undue weight. The annualised performance of the active managers over the three-year period to 31<sup>st</sup> March 2007, against their individual benchmark, is shown in the table below. The overseas manager, GMO, has been in place for less than two years, and so is not included in the table.



The Pensions Committee decided in 2005 to undertake an investment strategy review. The result of the review was a resolution in May 2006 to restructure the fund by reducing the number of UK equity managers to one and to appoint three new active mandates for global equities, alternatives and foreign currency. At two special meetings of the Pension Committee in March 2007 the following three appointments were made; Newton Investment Management as Global Equities Manager; Mellon Global Investments as Currency Manager; and BlackRock Investment Management as the Alternatives Manager. Legal and General have been appointed to manage the transition of assets which is planned for the first quarter of 2007/08 and the new investment management structure should be fully in place by September 2007. The expectation is that the new structure will increase the investment efficiency of the fund by reducing some risks and investing in higher return assets.

In February 2007 the Pension Committee considered requests from three of the Fund's investment managers to adjust their investment guidelines to improve investment diversification and performance. The Committee agreed to a request by Schroders (UK equity) to move to their Diversified Opportunities product for UK equities and also agreed to a request from GMO (overseas equities) to invest in Canadian income trusts.

The target and benchmark for both these Managers remains unchanged and performance will continue to be closely monitored.

Another notable change during the first quarter of 2007 was the departure of the property team at Credit Suisse, led by Glenn Newson, who had been responsible for a long period of good returns for the Cumbria property portfolio. Credit Suisse moved quickly to put in place a new property team, the effectiveness of which is being closely monitored by the Committee.

The Pension Committee continues to be supported by Mr Bob Mather, the County Council's Deputy Chief Executive/Director of Finance and Central Services, and by officers from the County Council's Finance Department. I would like to take this opportunity to thank Mr Mather, the staff in Finance, Pensions, and all who participate in the management of the Fund for their work during the year.

The early part of 2007 has seen some new members join the Cumbria Pensions Committee, I would like to welcome them to the Committee and also express my thanks to all members, old and new for their valuable contributions throughout 2006/07.

Cllr. Simon A.J. Leyton  
Chairman

## **5.1 THE LOCAL GOVERNMENT PENSION SCHEME**

The Cumbria Local Government Pension scheme is part of the Local Government Pension Scheme. The scheme is a funded pension scheme, which means that funds are set aside to meet future retirement needs of scheme members. The scheme is a statutory pension scheme governed by the Superannuation Act 1972 and the Local Government Pension Scheme Regulations 1997. Under these regulations Cumbria County Council is required to provide an administration service for the scheme within the geographical area of Cumbria.

The County Council administers the pension scheme on behalf of 77 employers who are members of the scheme such as local authorities, further and higher education colleges and voluntary organisations. The fund includes a number of 'Admitted Bodies', i.e. organisations that have entered into an admission agreement with the County Council to participate in the Pension Fund. The Cumbria Pension Fund currently includes 41 admitted bodies such as charities and other non-profit making organisations.

The scheme is open to all local government employees within the County who are not covered by alternative pension arrangements. The main categories of employees covered by alternative arrangements are teachers, Fire Service uniformed personnel and police officers. Membership is also open to other eligible employees of employer members of the scheme. All local government employees (except casual workers) are automatically entered into the scheme, but they may opt out if they do not want to retain membership.

### **5.1.1 BENEFITS OF SCHEME MEMBERSHIP**

The Local Government Pension Scheme is a valuable benefit for staff. It is a final salary pension scheme where the pension is based on the final years pensionable pay and actual scheme membership. The scheme is contracted out of the State Second Pension and must, in general, provide benefits at least as good as most members would have received had they been members of the State Second Pension.

The scheme provides a comprehensive range of guaranteed benefits\* which include:

- A tax-free lump sum at retirement;
- A pension at retirement age that is fully inflation proofed once in payment;
- The ability to increase the pension by paying extra contributions;
- Enhanced benefits in cases where a member suffers permanent ill-health;
- Lump sum benefits payable upon death in service;
- Pensions for spouses and children in the event of death;

*\* The above is a summary only, intended to give an outline of the scheme. Specific queries should be referred to the Pensions Section, Capita Business Services, Kingmoor Business Park, Carlisle CA6 4SJ, telephone number 01228 673696, or consult the website [www.cumbriapensions.org.uk](http://www.cumbriapensions.org.uk).*

## **A New Scheme**

In November 2006, the Government announced a series of proposals to be introduced from April 2008 designed to change the look of the Local Government Pension Scheme. This followed consultation of scheme members, employers and trade unions over the summer of 2006. On 4 April 2007 the Government issued regulations confirming the benefits package for a New-Look LGPS in England and Wales from 1 April 2008. The LGPS (Benefits, Membership and Contributions) Regulations 2007 constitute the Government's definitive proposals to introduce the new scheme although these may be amended before the scheme is finally introduced.

The Scheme remains a final salary scheme but the accrual rate changes from 1/80<sup>th</sup> (1/64<sup>th</sup> taking lump sum into consideration) to 1/60<sup>th</sup>. The normal retirement age remains at 65, with transitional protections for some 'Rule of 85' qualifiers already in the Scheme before 1/10/2006. Earliest retirement age is changing from 50 to 55 from 2010, but will apply to new starters after 31/3/2008. The Death in Service tax free lump sum will be increased from 2 to 3 times salary. A two tier ill health retirement package is to be introduced which will provide a higher enhancement of benefits where the member is incapable of any other gainful employment before age 65, and a lower enhancement of benefits where the member is unlikely to be able to obtain gainful employment in a reasonable time but is likely to do so before age 65. Flexible retirement with employer consent, under specific circumstances, will be permitted from age 55, allowing Scheme members to draw some or all of their benefits while continuing to work. Transitional arrangements are to apply for employees who are 60 between 2016 and 2020 and who would meet the 'Rule of 85' (age plus service). The Government is currently consulting on these arrangements.

### **5.1.2 COST OF SCHEME MEMBERSHIP**

From April 2008, employee contribution rates for existing members who are currently paying 6% and for all new members will be tiered according to whole time equivalent pay in the previous year grouped in seven band ranges, the lowest contribution rate of 5.5% will apply to band one for salaries below £12,000 and the highest rate of 7.5% will apply band seven for salaries above £75,000. The contribution rates for existing members who are currently paying 5% will be increased on a phased basis, bringing their rate into line with all other scheme members from 1<sup>st</sup> April 2011.

The scheme employer pays the balance of the cost of providing the scheme's benefits after taking into account investment returns. Every three years an independent actuary calculates how much the employer has to contribute to the scheme. The Cumbria scheme currently employs Mercer Human Resource Consulting as scheme actuary.

The rate of employers' contribution varies from 7.4% to 30.4% as set in the actuarial valuation carried out as at 31 March 2004. The next triennial Actuarial Valuation will be carried out as at 31<sup>st</sup> March 2007. Results should be available by Autumn 2007 and revised contribution rates implemented from April 2008.

## **5.2 MANAGEMENT ARRANGEMENTS**

### **5.2.1 ADMINISTERING AUTHORITY**

Cumbria County Council

### **5.2.2 PENSIONS COMMITTEE MEMBERS 2006/07**

#### **County Council Elected Members**

Mr SAJ Leyton (Chair)  
Mr AL Barry  
Mr R Calvin  
Mr S Collins  
Mr J Garnett  
Mr N Clarkson/Mr C Kitchen  
Mr J Mallinson/Mr AP Richardson  
Mr ER Wilson

#### **District Council Elected Member**

Mr S Simpson

#### **Trades Union Non Voting Member**

Ms J Pennie

#### **Independent Advisers**

Mr DH Williams, retired Managing Director, Glasgow Investment Managers  
Mr TJA Gardener, Global Leader, Mercers Investment Consulting

### **5.2.3 OTHER MANAGEMENT ARRANGEMENTS**

#### **Fund Managers**

Capital International  
Schroder Investment Management  
GMO UK Limited (from 22<sup>nd</sup> April 2005)  
Insight Investments  
Credit Suisse Property Investment Management  
Legal and General Investment Management

#### **Custodian**

State Street Bank and Trust Company

#### **Actuary**

Mr. C. R. Hull FIA of Mercer Human Resource Consulting

## Bankers

National Westminster Bank PLC

## Auditor

The Audit Commission

## Legal Adviser

Cumbria County Council Legal Services

## Director of Finance

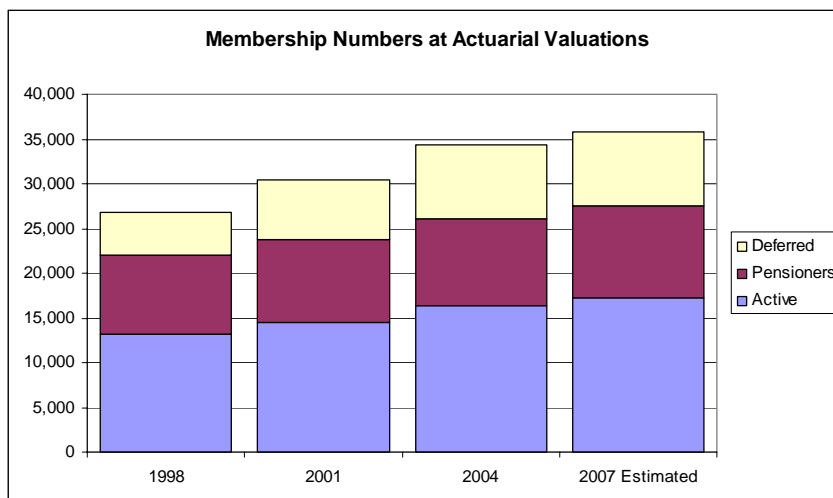
Mr. R. F. Mather - Deputy Chief Executive/Director of Finance and Central Services, Cumbria County Council

### 5.3 REPORT FROM THE CUMBRIA PENSIONS COMMITTEE

This report is prepared on behalf of Cumbria County Council, as beneficial owner of the assets of the scheme. The local government pension scheme, unlike private pension schemes, does not have trustees. The elected members who represent Cumbria County Council and the District Councils do perform duties that are similar to those of private trustees as members of the Pensions Committee. The County Council has the ultimate responsibility for paying benefits under the scheme.

The Pensions Committee normally meet five times a year and decide the investment strategy. It is advised by Independent Advisers, Mr Tim Gardener and Mr David Williams and by Council officers. Advice is also provided on specific issues by Investment Consultants.

At the 31<sup>st</sup> March 2004 valuation the Cumbria Local Government Pension Scheme had over 16,000 active members, close to 10,000 pensioners and dependants receiving benefits, and over 8,000 preserved pensions. There were 70 employer bodies in the Cumbria scheme at that time. A full list of the scheduled and admitted bodies currently in the Scheme is shown later in this report. The membership numbers at the time of the valuations have increased as follows:



The Cumbria Local Government Pension Scheme collects contributions from the scheme employers and employees. Six external fund managers invest these funds. The managers may invest in UK equities, overseas equities, index-linked securities, fixed interest securities, venture capital, managed funds (in particular unit and investment trusts), certain derivatives, direct property, cash and other assets as determined from time to time by the Pensions Committee. The return of the fund is to be achieved by the investment managers without exposing the Fund to excessive risk and with regard to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.

The Fund increased in value in the year to 31<sup>st</sup> March 2007 from £1,093 million (£1.1 billion) to £1,177 million (£1.2 billion), an increase of £84 million. The bulk of this increase came from an increase in the value of investments (£46.5 million) and investment income (£26.0 million net of tax) less the investment management expenses (£2.7 million). The net result of the daily running of the scheme (ie dealing with members) increased the value of the fund by £14.9 million.

Under the provisions of the Social Security Act 1986, all employees are entitled to make alternative arrangements for their retirement, within rules laid down by the government.

### 5.3.1 INVESTMENT PERFORMANCE

Details of fund managers' performance for the year to 31<sup>st</sup> March 2007 are as follows:

Manager	Asset Class	Portfolio Return %	Benchmark Return %	Excess Return %
Capital International	UK Equity Manager	11.5	11.1	0.4
Schroder Asset Management	UK Equity Manager	12.1	11.1	1.0
Insight Investments	Fixed Interest Manager	0.8	0.2	0.6
Credit Suisse Property	Property Manager	14.9	15.6	-0.7
GMO UK Limited	International Equity Manager	4.3	5.7	-1.4

Legal and General also manage around 38% of the funds assets on a passive basis, the mandate being to match various indices. Their investment funds have performed well showing small outperformances of the indices over three years, in particular 0.5% outperformance from the Asia Pacific ex Japan fund, and 0.4% outperformance from the Japan Equity fund.

In May 2006 the Pension Committee considered the results of the Investment Strategy Review carried out by Mercers Investment Consulting and resolved to reduce the number of UK equity managers to one, appoint a global fund manager, an 'alternatives' manager (i.e. hedge funds, private equity or absolute return), and an active foreign currency manager. The disappointing performance from Capital International combined with the results of the Investment Strategy Review, led the Pension Committee to retain Schrodgers for the management of UK equity.

The Pension Committee monitors fund managers' performance at its quarterly meetings. Fund managers present their reports twice yearly and where performance is below the benchmark, the Pension Committee may require fund managers to attend all quarterly meetings to present their performance reports.

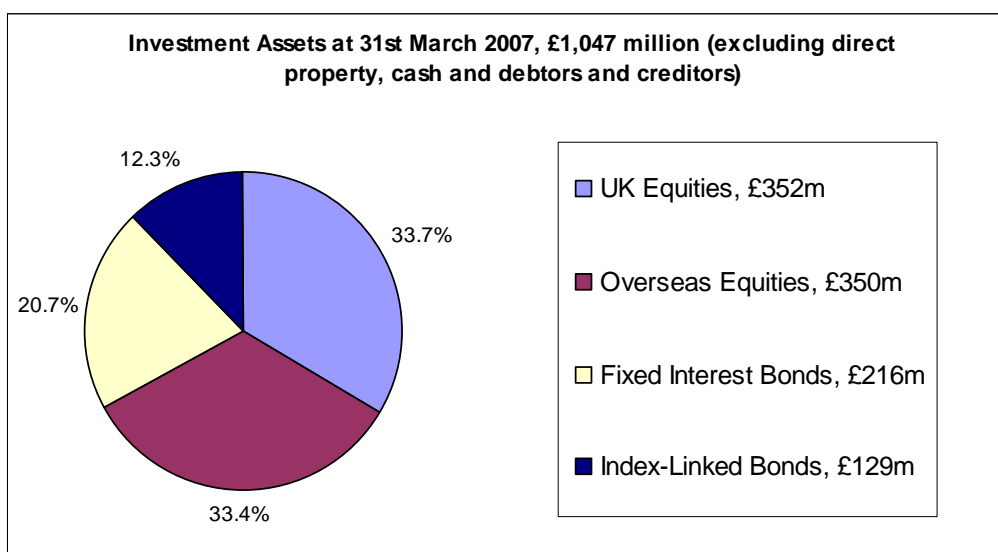
The Cumbria Fund currently performs in the local authority league table as follows:

	Year to 31st March 2007 %	3 Years to 31st March 2007 % per annum	5 Years to 31st March 2007 % per annum	10 Years to 31st March 2007 % per annum
Fund return	6.7	13.1	7.7	7.7
Cumbria's own benchmark	6.4	13.3	7.6	7.4
WM Local Authority Universe return	7.0	14.3	8.2	7.7
Ranking 1 to 100 in Local Authority Universe	57	85	58	41

After allowing for the Cumbria Fund's slightly more defensive asset structure (which limits both the downside in falling markets and the upside in rising markets), the recent review has reinforced the drive to obtain extra value from new investment areas.

### 5.3.2 INVESTING FUND MONEY

The Cumbria Fund has a diversified portfolio. This spreads the risk associated with any particular form of investment whilst facilitating the growth potential of the Fund. The scheme-specific weighting to the different asset classes was decided through an Investment Strategy Review during 2003/04. The scheme-specific benchmark was in place from 31<sup>st</sup> March 2004. The following table shows the distribution of the investment assets across the asset classes at the year end, excluding property of £99.5 million and cash of £23.4 million. The unitised insurance policy held by Legal and General has been segregated into the relevant asset class, per Note 5.7.1, as the manager uses unitised funds to maintain the Fund's total asset distribution close to the scheme-specific benchmark detailed in the Statement of Investment Principles.



The investment risks are spread further as a result of employing different fund managers and by using passive managed funds. The detailed selection and timing of investment purchases and sales is delegated to the Fund Managers.

Investment management fees are based on the value of funds under the management of each manager as set out in individual agreements, and as growth in the portfolio would lead to an increase in fee, this provides an element of performance incentive. The agreements also include the individual active managers' investment performance targets.

### 5.3.3 STATEMENT OF INVESTMENT PRINCIPLES

There is a statutory requirement for administering authorities to prepare and maintain a Statement of Investment Principles. The full Statement in place at the 31<sup>st</sup> March 2007 is shown at Appendix 2. This will be amended during 2007/08 for the new asset classes and manager structure.

The Scheme has a scheme-specific benchmark with long-term allocations to the various asset classes, excluding the direct property allocation, currently as follows:

ASSET CLASS	PERCENT AGE	INDEX	RANGES
UK Equities	32.5	FTSE All Share	30.5 – 34.5
Overseas Equities	32.5		30.5 – 34.5
North America	35.0	FTSE World North America	
Europe Ex UK	35.0	FTSE World Europe Ex UK	
Japan	12.5	FTSE World Japan	
Pacific Ex Japan	12.5	FTSE Developed Asia Pacific Ex Japan	
Emerging Markets	5.0	S&P IFC Investable Composite	
Fixed Interest	22.0		20.0 – 24.0
UK Fixed Interest	50.0	FTSE-A Govt (over 15 years)	
Corporate Bonds	50.0	IBOXX £ Non-Gilt	
Index-Linked	13.0	FTSE-A Index-Linked (over 5 years)	11.5 – 14.5
TOTAL	100.0		

Property has a monetary target held separately from the strategic benchmark and compared to the IPD Monthly Property Index.

### 5.3.4 FUNDING STRATEGY STATEMENT

There is a statutory requirement for administering authorities to prepare and publish a Funding Strategy Statement by 31<sup>st</sup> March 2005. The statement has been prepared in consultation with scheme employers and with advice from the actuary in light of the results from the 2004 Actuarial Valuation. At a meeting held on 23<sup>rd</sup> February 2005 the statement was approved by the Cumbria Pensions Committee. The full Statement is shown at Appendix 3.

### 5.3.5 GOVERNANCE POLICY STATEMENT

There is a new statutory requirement for administering authorities to prepare and publish a Governance Policy Statement by 6<sup>th</sup> April 2006. The statement was approved

by the Cumbria Pensions Committee at a meeting held on 14<sup>th</sup> February 2006. The full Statement is shown at Appendix 4.

#### **5.4 FINANCIAL STATEMENTS AND NOTES TO THE ACCOUNTS**

The Statement of Accounts for the Cumbria Local Government Pension Scheme is presented in its entirety and separately from the general fund in keeping with its significance and the fact that, although the County Council is the administering authority, the fund covers both County Council employees and those of other scheduled and admitted bodies.

## 5.4.1 PENSION FUND ACCOUNT

2005/06 £000's	FUND ACCOUNT FOR THE YEAR TO 31ST MARCH 2007		Notes	2006/07 £000's	2006/07 £000's
	<b>Dealing with Members, Employers and Others</b>				
	Contributions Receivable				
	From Employer's				
36,004		Normal		38,749	
3,283		Special		1,709	
1,503		Additional		2,328	
			5.6.1		42,786
	From Employees or Members				
13,895		Normal		14,503	
177		Additional		210	
			5.6.1		14,713
	Transfers In				
	Group transfers from other Schemes and Scheme mergers			628	
13,215		Individual transfers in from other Schemes		8,408	
					9,036
	Other Income				
275		Interest on Internal Cash			230
<b>68,352</b>		<b>Total Income</b>			<b>66,765</b>
	<b>Less:</b>				
	Benefits Payable				
34,901		Pensions	5.6.1	36,591	
5,194		Lump Sums	5.6.1	8,195	
					44,786
	Payments to and on account of leavers				
109		Refund of contributions		106	
		Group transfers out to other Schemes		1,579	
6,116		Individual transfers out to other Schemes		4,386	
					6,071
	Other payments				
0		Bad Debt Written Off			44
850		Administrative Expenses	5.4.6		944
<b>47,170</b>		<b>Total Expenditure</b>			<b>51,845</b>
<b>21,182</b>	<b>Net additions from dealing with Members</b>				<b>14,920</b>
	<b>Returns on Investments</b>				
24,664		Investment Income	5.4.8	26,266	
(667)		Less; Irrecoverable tax on dividends	5.4.8	(304)	
					25,962
170,384		Change in Market Value of Investments	5.4.7	46,538	
(2,437)		Less: Investment Management Expenses		(2,717)	
					43,821
<b>191,944</b>	<b>Net Return on Investments</b>				<b>69,783</b>
<b>213,126</b>	<b>Net Increase / (Decrease) in the Fund during the Year</b>				<b>84,703</b>
<b>879,755</b>	<b>Add: Opening Net Assets of the Scheme</b>				<b>1,092,881</b>
<b>1,092,881</b>	<b>Closing Net Assets of the Scheme</b>				<b>1,177,584</b>

## 5.4.2 NET ASSET STATEMENT

2005/06 £000's	NET ASSETS AS AT 31ST MARCH 2007	Notes	2006/07 £000's	2006/07 £000's
	<b>Investment Assets</b>			
	Fixed Interest Securities			
48,364	Public Sector	5.7.1	47,021	
62,124	Other	5.7.1	60,696	107,717
433,844	Equities (including convertible shares)	5.7.1		475,196
50,750	Index linked securities	5.7.1		52,062
	Pooled Investment Vehicles			
363,608	Unitised Insurance Policies	5.7.1	389,168	
25,528	Unit Trusts	5.7.1	23,030	412,198
	Property			
69,525	Freehold		79,205	
9,200	Long Leasehold		16,875	
3,250	Short Leasehold	5.7.1	3,450	99,530
19,802	Cash & Money Market Instruments	5.7.1		23,445
<b>1,085,995</b>	<b>Investment Assets managed by Fund Managers</b>	5.4.7 / 5.7.2		<b>1,170,148</b>
	Other Investment Balances			
7,098	External Manager Debtors	5.4.4	6,843	
(4,737)	External Manager Creditors	5.4.4	(3,590)	3,253
<b>1,088,356</b>	<b>Total Investment Assets</b>			<b>1,173,401</b>
	<b>Current Assets / Liabilities</b>			
3,140	Administering Authority Debtors	5.4.4	3,502	
(714)	Administering Authority Creditors	5.4.4	(794)	
2,099	Cash with Administering Authority		1,475	4,183
<b>4,525</b>	<b>Net Current Assets</b>			<b>4,183</b>
<b>1,092,881</b>	<b>TOTAL</b>			<b>1,177,584</b>

### 5.4.3 ACCOUNTING POLICIES

The general principles adopted in the preparation of the full Annual Report and Accounts are those recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA). They meet the requirements of the Local Government Pension Fund Regulations 1997 and the main recommendations of "The Financial Reports of Pension Schemes - A Statement of Recommended Practice" (the Pensions SORP) produced by the Pensions Research Accountants Group. The disclosure requirements for the summarised pension fund accounts are, however, limited to those recommended by the Local Authority SORP published by CIPFA.

### 5.4.4 BASIS OF INCLUSION OF DEBTORS AND CREDITORS

Revenue transactions are recorded on a system of receipts and payments. Payments during the year have been converted to an expenditure basis by the introduction of creditors, to record significant amounts owing at 31<sup>st</sup> March.

Debtors have been introduced in respect of major items of income due but not received at 31<sup>st</sup> March. The fund's financial statements do not take account of liabilities to pay pensions and other benefits after the financial year-end.

Debtors can be analysed as follows:

	2005/06 £000's	2006/07 £000's
<b>External Managers</b>		
Securities sold awaiting settlement	1,681	1,057
Investment Income Accrued	4,564	4,913
Credit Suisse Property Debtors	853	873
	<b>7,098</b>	<b>6,843</b>
<b>Administering Authority</b>		
Pension increase and additional lump sums	16	23
Contributions due	1,860	1,902
Long Term Debtors	454	207
Tax Reclaim		415
Miscellaneous	810	955
	<b>3,140</b>	<b>3,502</b>
<b>Total Debtors</b>	<b>10,238</b>	<b>10,345</b>

From April 1999 no allowance for non ill health early retirement is made in determining the actuarial valuation result ie the rate of employers' contribution. The costs of such retirements are charged to employers by additional lump sum charges. Long-term debtors are in respect of these charges. Employers are allowed to pay these additional contributions over a period of five years, although interest is added. Cumbria County Council also has a voluntary arrangement whereby part of the actuarial strain of ill health retirements is paid immediately.

Creditors can be analysed as follows:

	2005/06 £000's	2006/07 £000's
<b>External Managers</b>		
Purchases awaiting settlement	2,839	1,497
Property Creditors	1,898	2,093
	<b>4,737</b>	<b>3,590</b>
<b>Administering Authority</b>		
Investment Managers Fees	645	794
Tax Payable	27	0
Miscellaneous	42	0
	<b>714</b>	<b>794</b>
<b>Total Creditors</b>	<b>5,451</b>	<b>4,384</b>

#### 5.4.5 BASIS OF VALUATION OF INVESTMENTS

Investments are shown in the accounts at market value. The independent custodian, State Street Bank and Trust, values the assets other than direct property investments. This provides an extra level of security. Investments are valued on the basis of the market convention where they are primarily traded which is either last trade or middle market price. Pooled investment vehicles are stated at the mid point of the latest prices quoted by their managers at close of business on 30<sup>th</sup> March 2007.

State Street Bank and Trust value all overseas securities and foreign currency balances in local currency then convert to sterling using the WM Reuters 16 00 exchange rates.

Further details of the pricing policy are as follows:

##### **Equities**

Pricing accuracy on equities is ensured by a series of data quality verifications that occur on a daily basis. Prices are reviewed beginning at the vendor file level to ensure that the appropriate number of prices are received at the expected time. From there, all U.S. and Non-U.S. traded equity prices are reviewed by comparison to a second price source using a zero tolerance threshold. By verifying the prices from two major vendor sources, daily price exceptions can be accurately identified. All discrepancies are researched with the primary source and secondary sources for validation, and updated accordingly.

##### **Bonds**

Prices are received daily from vendors in electronic transmissions and posted to a centralized database. In order to be loaded to the price database, asset identifier information is verified versus State Street's security master file. As price file loading occurs, daily tolerance verification is completed at the security level. Each security is automatically compared to the previous day's price. Changes exceeding a percentage of 10% are posted to a tolerance exception report and verified via secondary sources. If price exceptions cannot be validated by a secondary source, a challenge will be submitted to the appropriate vendor. Prices proven to be invalid are manually updated by GPS. Additional tolerance exception reporting can also be completed at the holdings level.

Sources of Prices are Bear Stearns, Bloomberg, Bridge, Dataline, FRI, FT Interactive Data, Lehman Brothers, Reuters.

### Direct Property Investments

Direct property is valued annually at the 31st March by an independent valuer CB Richard Ellis, Chartered Surveyors, 77 Grosvenor Street, London. The valuation is prepared on the basis of "open market value" and represents the best price at which the sale of an interest in the property might reasonably be expected to have been completed unconditionally for cash consideration on the date of the valuation.

#### 5.4.6 ALLOCATION OF ADMINISTRATION EXPENSES

A proportion of relevant officers' salaries has been charged to the Pension Scheme. In addition the cost of maintaining the employee contribution records, paying benefits and provision of other services has also been charged to the Scheme. This accords with the government regulations on the management of local government pension schemes and with the practice adopted by other managers of Local Government Pension Schemes nationally. From 1<sup>st</sup> February 2001 the County Council bought in the pension administration service from Capita.

Further details are as follows:

	Basis of Allocation	2005/06 £000's	2006/07 £000's
Corporate Finance	Time recording system	129	142
Internal Audit	Time recording system	13	15
Bank Charges	Cash Flow of the Authority	13	8
Creditor Payments	Number of invoices	3	4
Debtors System	Number of accounts	1	4
Capita Pensions	Payment under contract	638	723
		797	896
Other Fees & Purchases		53	48
<b>Total Administration Expenses</b>		<b>850</b>	<b>944</b>

Investment management expenses are shown separately from scheme administration in the Fund Account and include the fees paid to the fund managers and custodian, actuarial fees, performance measurement and investment consultant fees.

#### 5.4.7 CHANGE IN VALUE OF INVESTMENTS

During the financial year the following purchases and sales of investments were made. Unit trusts are included in the relevant equity heading.

	Value at 1st April 2006 £000's	Purchases at Cost £000's	Sales Proceeds £000's	Change in Market Value £000's	Value at 31st March 2007 £000's
Fixed Interest Securities	110,488	220,733	(218,855)	(4,649)	107,717
Equities					
UK Equities	319,547	144,084	(139,137)	27,991	352,485
Overseas Equities	139,825	62,799	(59,956)	3,073	145,741
Total Equities	459,372	206,883	(199,093)	31,064	498,226
Index-Linked Securities	50,750	8,909	(7,813)	216	52,062
Pooled Investment Vehicles	363,608	17,000	(4,000)	12,560	389,168
Property	81,975	17,739	(8,196)	8,012	99,530
<b>Total excluding cash</b>	<b>1,066,193</b>	<b>471,264</b>	<b>(437,957)</b>	<b>47,203</b>	<b>1,146,703</b>
Cash Deposits	19,802				23,445
<b>Total Investments</b>	<b>1,085,995</b>				<b>1,170,148</b>
Change in Market Value of foreign currency				(665)	
				<b>46,538</b>	

#### 5.4.8 INVESTMENT INCOME

Investment income includes accruals for dividends and interest receivable, and the recoverable tax on dividends. The investment income of £26 million, net of irrecoverable tax on dividends, can be analysed as follows:

	2005/06 £000's	2005/06 %	2006/07 £000's	2006/07 %
Fixed Interest Securities	5,298	22.1%	5,470	21.1%
Equities				
UK Equities	9,661	40.3%	10,369	39.9%
Overseas Equities	2,823	11.8%	4,443	17.1%
Total Equities	12,484	52.0%	14,812	57.1%
Index-Linked Securities	1,168	4.9%	472	1.8%
Pooled Investment Vehicles		0.0%	0	0.0%
Property	4,730	19.7%	4,991	19.2%
Cash Deposits	317	1.3%	217	0.8%
	<b>23,997</b>	<b>100.0%</b>	<b>25,962</b>	<b>100.0%</b>

#### 5.4.9 STOCK LENDING

Stock lending is the loan of specific securities from one investor to another that entitles the lender to continue receiving income generated by the stock plus an additional payment by the borrower. Exposure to risk is reduced by the borrower providing high quality collateral (cash, securities or gilts). A programme began during April 2005 through the custodian, State Street Bank and Trust, to earn additional income for the scheme from stock lending.

Securities on loan at the 31<sup>st</sup> March 2007 of £81.1 million are included in the net asset statement to reflect the scheme's continuing economic interest in the securities, and consist of £35.4 million UK equities, £4.6 million overseas equities, and £41.1 million UK Treasury Gilts. The related collateral totalled £84.0 million.

For the year to 31st March 2007, the scheme earned additional income of £56,100 through stock lending of the various assets, included in 5.4.8 above.

#### **5.4.10 RELATED PARTIES**

In day-to-day operations the scheme has many transactions with Cumbria County Council as the administering authority of the scheme, including the internally invested cash balance and payments for administration. There are no material transactions in respect of related parties requiring separate reporting. There are of course normal transactions with all the employers who have members in the scheme, who may be regarded as related parties, but these transactions are reported as part of the normal financial statements. The fund does not invest for example in schemes of economic regeneration sponsored by any of the employing bodies including Cumbria County Council.

Eight of Cumbria County Council's Councillors form the membership of the Cumbria Pensions Committee together with one co-opted District Councillor representing the six District Councils in Cumbria and an employee representative as a non-voting member. An examination of the returns for 2006/07 reveals that there were no material transactions between the Council and the members/officers and their families affecting involvement with the Pension Fund.

Such transactions as have been identified are either non-material or are associated with the normal activities of the individuals in question.

#### **5.4.11 POST BALANCE SHEET EVENTS**

There is still uncertainty concerning the final details of the abolishing of the "Rule of 85". Currently if a qualifying member is 60 and would have satisfied the rule of 85, between 1 April 2016 and 2020, and chooses to retire at that age an actuarial reduction will apply on a tapered basis.

In response to representation by trades unions the government has given undertakings that provided an affordable and legal alternative to the current protection can be brought forward, new regulations will be issued.

#### **5.4.12 CONTINGENT LIABILITIES/ASSETS**

The active members of the Cumbria Magistrates Courts Committee transferred to the Department for Constitutional Affairs from 1 April 2005. There has been no transfer of assets to the receiving fund, but this is expected to happen in 2007. The pensioners retiring before March 2005 will, however, remain in the Cumbria Local Government Pension Scheme.

An equal pay claim has been awarded against the County Council. An earmarked reserve of £ 21.8 million has been set up in the County Council's accounts against this claim. Should the County Council's appeal fail a substantial payment will be payable into the Cumbria Local Government Pension Scheme as employers' and employees' contribution. There will also be an increase in pensions liabilities. The amount of these payments and liabilities are uncertain.

#### **5.4.13 ADDITIONAL VOLUNTARY CONTRIBUTIONS**

The administering authority operates an additional voluntary contribution scheme. Employees are allowed to pay voluntary contributions to one of two independent AVC

scheme providers. To comply with regulation 5(2) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 the transactions are treated separately to these accounts and do not form part of them.

The two providers offered are Standard Life and Scottish Widows. The authority gives no guarantee of investment performance of the providers and makes no contribution to the employees' funds. The previous scheme on offer to employees was the Equitable Life Assurance Society but in December 2000 it stopped writing new business. The Financial Statements of the two schemes for Cumbria LGPS, along with those of Equitable Life, are shown below:

	Standard Life	Scottish Widows	Equitable Life	TOTAL
Opening Net Assets	900	886	1,712	3,498
Income				
Contributions Received	118	66	32	216
Transfers In	25	55	0	80
Expenditure				
Retirement Benefits	(109)	(2)	(153)	(264)
Transfers Out	(25)	(40)	(37)	(102)
Change in Market Value	76	54	58	188
<b>Closing Net Assets</b>	<b>985</b>	<b>1,019</b>	<b>1,612</b>	<b>3,616</b>

Members have the option of contributing to the various funds offered by their chosen provider. The ultimate destination for the investment contributions paid by a member is the securing of a pension at retirement, usually by buying an annuity or transferring the investment into the main Scheme assets under Regulation 66. The investment could be realisable earlier in the event of a member's death before retirement.

## 5.5 ACTUARIAL POSITION OF THE FUND

Under statutory provisions, an actuarial valuation of the Fund must be carried out at three yearly intervals. The Fund actuary, Mercer, carried out an actuarial valuation as at 31<sup>st</sup> March 2004. The actuarial method used was the projected unit method. This method is consistent with the funding objective and is in common use for funding pension funds in the United Kingdom. The target funding level is set by the Government at 100%.

The valuation assessed the accrued liability of the Fund for future benefits to subscribers to the scheme, the adequacy of the Fund and future contribution levels to meet these promised benefits when due. The valuation at March 2004 showed assets covered 76% of liabilities (94% at March 2001). The value of the Fund as at 31<sup>st</sup> March 2004 had increased to £788 million from £761 million at 31<sup>st</sup> March 2001. The funding level of 76% was 11th highest of the 35 Society of County Treasurers survey members. The average funding level was 73%.

The valuation also showed that a common rate of contribution of 10.0% of pensionable pay per annum was required from employers compared to 11.3% per annum at the March 2001 valuation. 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.

The common rate is adjusted to have regard to the individual circumstances of each employer in determining their rate of appropriate contribution. As a result of the valuation contribution rates have been certified for the three years commencing 1st April 2005 for employers participating in the Fund. The Actuary's rates and adjustment certificate is shown at Appendix 1.

The funding plan is set out in the schemes Funding Strategy Statement (FSS), as prepared by the Administering Authority (Cumbria County Council). Individual employer funding plans, and the resulting certified contribution rates, have been determined in accordance with the FSS. Depending on individual circumstances, different approaches to the funding of benefits have been adopted, as part of the FSS consultation process. However for the majority of employers the two main features of the funding plan are that contribution rates should be assessed based on recovery of the deficit over a maximum period of 25 years, and that any increase in contributions to this required level can be phased in over a period of up to 3 years.

If the deficiency is recovered over this 25 year period then the average employer contribution rate emerging from the valuation is 15.6% of pensionable pay per annum. Disregarding the effect of phasing in increases and in the absence of any further reviews, this average contribution rate would be paid for 25 years from 1 April 2005, reverting to 10.0% of pensionable pay at the end of the period.

For the valuation it was assumed that the rule of 85 has been removed from service from April 2005 and that the earliest retirement date at which unreduced benefits become an entitlement would be 65 except for those members who have protected status under the transitional provisions.

At the 1998 valuation the method of funding early retirements before age 60, on grounds other than ill health, was also modified. No allowance has been made for such retirements after 1st April 1999 by the actuary as they are to be funded by additional capital payments by the employer as and when they occur.

The most significant financial assumptions at the March 2004 valuation were:

	<b>For past service liabilities</b>	<b>For future service liabilities</b>
Investment Return – pre retirement	6.6% per annum	6.5% per annum
Investment Return – post retirement	5.6% per annum	6.5% per annum
Rate of Pensionable Pay Inflation	4.55% per annum	4.25% per annum
Rate of Price inflation	2.8% per annum	2.5% per annum

The County Council adopted a more cautious approach and its contribution rate, which applied in full from April 2005, is expected to recover the deficit over 20 years. The County Council's contribution rate has been set at 16.4% and this can be compared to the average contribution rate for the English Shire Counties of 18.4%.

The Administering Authority monitors the progress of the funding strategy between full actuarial valuations. An interim review was carried out as at 31 March 2006 showing a further improvement in the funding level to 82% and an estimated deficit of £237 million. The next full Actuarial Valuation will take place as at 31<sup>st</sup> March 2007, the results of which will be known later in 2007/08.

## 5.6 PARTICIPATING EMPLOYERS OF THE SCHEME

As at 31<sup>st</sup> March 2007 the scheduled and admitted bodies covered by the Cumbria Local Government Pension Scheme are :

<u>County, Borough, City and District Councils - Scheduled Bodies</u>	<u>Admitted Bodies - Active Members</u>
Cumbria County Council Allerdale Borough Council Barrow Borough Council Carlisle City Council Copeland Borough Council Eden District Council South Lakeland District Council (County Council schools are not shown separately) <u>Other Scheduled Bodies - Active Members</u> Barrow Sixth Form College Brampton Parish Council Carlisle College Cleator Moor Town Council Cockermouth Town Council Cumbria Institute of the Arts Cumbria Police Authority Cumbria Probation Service Cumbria Waste Management Furness College Kendal College Further Educ Kendal Town Council Keswick Town Council Lake Dist. National Park Auth Lakes College West Cumbria South Lakeland Housing ALMO Valuation Tribunal Service (Cumbria Val Panel) Wigton Town Council <u>Other Scheduled Bodies - No current contributions</u> Charlotte Mason College Cumbria Primary Teacher Training Dept Constit Affairs (Cumbria Magistrates) Health Authority Henry Lonsdale Trust Millom Town Council Port of Workington Practical Alternatives Project Homeless Ulverston Town Council University of Central Lancashire Water Authority	Agilisys Amey Infrastructure Services Attendo Monitoring Limited Barrow & District Soc for Blind Barrow Citizens Advice Botcherby Community Centre Capita Business Services Carlisle Housing Association Carlisle Leisure Allerdale Carlisle Leisure Ltd Commission for Social Care Inspection Cumbria Cerebral Palsy Cumbria Deaf Association Cumbria Sea Fisheries Cumbria Tourism Cumbria Training Partnership * Cumbria Vision Renaissance Ltd Currock Community Centre Eden Housing Association Egremont & District Pool Trust * FOCSA Services Glenmore Trust Harraby Community Centre Home Group Ltd (Copeland) Kendal Brewery Arts Centre Trust Ltd Kendal Citizens Advice Lakeland Arts Trust Longtown Memorial Hall Community Centre Morton Community Centre * North Country Leisure (Copeland) Oaklea Trust South Lakeland Leisure West House Wigton Joint Burial Committee <u>Admitted Bodies - No current contributions</u> Cumbria Arts in Education Direct Training Services Lake District Cheshire Homes NRCS Ltd (Neighbourhood Revitalisation) Solway Rural Initiative Troutbeck Bridge Swim Pool Ltd West Cumbria Groundwork Trust
* Admitted during 2006-07	

## 5.6.1 ANALYSIS OF CONTRIBUTIONS AND BENEFITS

	2005/06 £000's	2006/07 £000's
<b>Contributions to the Fund</b>		
Cumbria County Council	29,566	31,907
Other Scheduled Bodies	20,402	20,350
Admitted Bodies	4,894	5,242
	<b>54,862</b>	<b>57,499</b>
<b>Net Pensions Paid</b>		
Cumbria County Council	19,244	20,069
Other Scheduled Bodies	14,953	15,572
Admitted Bodies	704	950
	<b>34,901</b>	<b>36,591</b>
<b>Net Lump Sums Paid</b>		
Cumbria County Council	2,465	3,969
Other Scheduled Bodies	2,066	3,000
Admitted Bodies	663	1,226
	<b>5,194</b>	<b>8,195</b>

## 5.6.2 ANALYSIS OF RETIREMENTS DURING THE YEAR

	2005/06 £000's	2005/06 %	2006/07 £000's	2006/07 %
<b>Type of Retirement</b>				
Normal	280	71%	408	76%
Ill Health	46	12%	60	11%
Redundancy & Early Retirement	69	17%	71	13%
	<b>395</b>	<b>100%</b>	<b>539</b>	<b>100%</b>

## 5.7 INVESTMENT ASSETS OF THE FUND

### 5.7.1 ASSETS SPLIT BETWEEN UK, OVERSEAS, QUOTED AND UNQUOTED

The fund holds significant amounts of unquoted securities. This is mainly due to the fact that the unitised insurance policy held by the passive manager, Legal and General, is invested in unquoted, unitised, index-tracking funds, used as an efficient low risk method of investing in the asset classes.

	Asset Value at 31st March 2006 £000's	Percentage at 31st March 2006 %	Asset Value at 31st March 2007 £000's	Percentage at 31st March 2007 %
<b>Fixed Interest Securities</b>				
Public Sector / Government				
UK Quoted	46,738	4.3%	37,801	3.2%
Overseas Quoted	1,626	0.1%	9,220	0.8%
	48,364	4.5%	47,021	4.0%
Corporate Bonds				
UK Quoted	59,507	5.5%	59,345	5.1%
Overseas Quoted	2,617	0.2%	1,351	0.1%
	62,124	5.7%	60,696	5.2%
<b>Total</b>	<b>110,488</b>	<b>10.2%</b>	<b>107,717</b>	<b>9.2%</b>
<b>Equities</b>				
UK Equities				
Quoted	303,773	28.0%	339,795	29.0%
Unquoted	709	0.1%	739	0.1%
	304,482	28.0%	340,534	29.1%
Overseas Equities				
Quoted	129,362	11.9%	134,662	11.5%
Unquoted		0.0%	0	0.0%
	129,362	11.9%	134,662	11.5%
<b>Total</b>	<b>433,844</b>	<b>39.9%</b>	<b>475,196</b>	<b>40.6%</b>
<b>Index-Linked Securities</b>				
UK Quoted	50,750	4.7%	52,062	4.4%
<b>Pooled Investment Vehicles</b>				
Unitised Insurance Policies - Unquoted				
Overseas Equity	190,031	17.5%	203,758	17.4%
Public Sector Bonds - UK	60,393	5.6%	65,303	5.6%
Corporate Bonds - UK	38,912	3.6%	43,326	3.7%
Index-Linked Securities - UK	74,272	6.8%	76,781	6.6%
	363,608	33.5%	389,168	33.3%
Unit Trusts - Quoted				
UK Equity	15,065	1.4%	11,951	1.0%
Overseas Equity	10,463	1.0%	11,079	0.9%
	25,528	2.4%	23,030	2.0%
<b>Total</b>	<b>389,136</b>	<b>35.8%</b>	<b>412,198</b>	<b>35.2%</b>
<b>Property</b>	81,975	7.5%	99,530	8.5%
<b>Cash &amp; Money Market Instruments</b>	19,802	1.8%	23,445	2.0%
	<b>1,085,995</b>	<b>100.0%</b>	<b>1,170,148</b>	<b>100.0%</b>

## 5.7.2 VALUATION OF ASSETS MANAGED BY FUND MANAGERS

The value of assets managed by each fund manager ignoring debtors and creditors was:

	Asset Value at 31st March 2006 £000's	Percentage at 31st March 2006 %	Asset Value at 31st March 2007 £000's	Percentage at 31st March 2007 %
<b>Manager</b>				
Legal & General	414,362	38.2%	441,237	37.7%
Schroders Investment Management	167,327	15.4%	187,571	16.0%
Capital International	157,576	14.5%	175,797	15.0%
GMO UK (from 22nd April 2005)	141,880	13.1%	148,046	12.7%
Insight Investments	110,974	10.2%	110,981	9.5%
Credit Suisse Property Management	93,754	8.6%	106,516	9.1%
Putnams (to 31st March 2005) residual holdings with State Street	122	0.0%	0	0.0%
<b>Total</b>	<b>1,085,995</b>	<b>100.0%</b>	<b>1,170,148</b>	<b>100.0%</b>

### 5.7.3 TOP 10 HOLDINGS

Holding	Manager	£ millions	% of Total
Unitised Insurance Policy	Legal & General	389.2	36.2%
Royal Dutch Shell	Capital / Schroders	25.5	2.4%
Treasury 5% 7th March 2025	Insight	20.1	1.9%
Astra Zeneca	Capital / Schroders	16.8	1.6%
Vodafone	Capital / Schroders	15.2	1.4%
Royal Bank of Scotland Group	Capital / Schroders	14.1	1.3%
Treasury 4.25% 7th March 2036	Insight	12.7	1.2%
Glaxo Smith Kline	Capital / Schroders	11.1	1.0%
Global Emerging Markets Index	GMO	11.1	1.0%
Treasury 2.5 Index-linked 26th July 2016	Legal & General	9.6	0.9%

### 5.7.4 INDIVIDUAL INVESTMENTS VALUED AT GREATER THAN 5% OF THE TOTAL SCHEME

The only individual investment with a market value greater than 5% of the fund value is the unitised insurance policy held with Legal and General.

## 5.8 GLOSSARY

**Active Management** – Approach to investment management which aims to outperform a particular market index or benchmark through asset allocation and/or stock selection decisions. (*Also see Passive Management*).

**Actuary** – An independent consultant who advises the Fund and every three years formally reviews the assets and liabilities of the Fund and produces a report on the Fund's financial position, known as the Actuarial Valuation.

**Benchmark** – A yardstick against which the investment policy or performance of a fund manager can be compared, usually the index relating to the particular assets held.

**Bonds** – Certificate of debt issued by a government or company, promising regular payments on a specified date or range of dates, usually with final capital payment at redemption.

**Custodian** – Organisation which is responsible for the safekeeping of asset, income collection and settlement of trades for a portfolio, independent from the asset management function.

**Derivative** – Financial instrument whose value is dependent on the value of an underlying index, currency, commodity or other asset.

**Emerging Markets** – Developing economies in Latin America, Africa, Asia and the Middle East as well as areas of Europe and the Far East. Investment returns within these markets tend to be more volatile than those in more established markets.

**Equities** – Ordinary shares in UK and overseas companies traded on a stock exchange. Shareholders have an interest in the profits of the company and are entitled to vote at shareholders' meetings.

**Fixed Interest Securities** – Investments mainly in government but also company stocks, which guarantee a fixed rate of interest. The securities represent loans which are repayable at a future date but which can be traded on a recognised stock exchange in the meantime.

**Funding Level** – The ratio of a pension fund's assets to its liabilities. Normally relates to defined benefit pension funds and used as a measure of the fund's ability to meet its future liabilities.

**Index-linked Gilts** – UK government stock where the interest payments and the final redemption proceeds are linked to the Retail Price Index. Such stocks provide protection against inflation.

**Index-Tracking Fund (Managed Fund)** – Pooled investment vehicle which aims to match the returns on a particular market index. The fund may hold all stocks in the index or select a sample that will perform closely to the index. Investors can buy and sell units of the fund on an on-going basis.

**Investment Strategy** – Investor's long-term distribution of assets among various asset classes taking into consideration, for example, goals of the investor, attitude to risk and timescale etc.

**Market Value** – The price at which an investment can be bought or sold at a given date.

**Myners Review** – Review carried out by Paul Myners on behalf of the Chancellor of the UK government. The review, published in March 2001, investigated the challenges facing institutional investment decision making.

**Passive Management** – Portfolio which aims to replicate a particular market index or benchmark and does not attempt to actively manage the portfolio. (*Also see Active Management*).

**Portfolio** – Block of assets generally managed under the same mandate.

**Private Equity** – Shares in unquoted companies. Usually high risk, high return in nature.

**Retail Price Index** – Measure of price inflation in the UK. A basket of representative goods in the market is priced on a regular basis to monitor the rate of inflation.

**Return** – Increase in value of an investment over a period of time, expressed as a percentage of the value of the investment at the start of the period.

**Risk** – Likelihood of a return different from that expected and the possible extent of the difference. Also used to indicate the volatility of different assets.

**Settlement** – Payment or collection of proceeds after trading a security. Settlement usually takes place some time after the deal and price are agreed.

**Statement of Investment Principles** – The SIP sets out details of the investment policy being followed by a pension scheme. Includes certain specific statements such as the kinds of investments held and the balance between them, risk and expected returns, realisations of investments, socially responsible investments and corporate governance policy.

**Stock Lending** – Lending of stock from one investor to another that entitles the lender to continue to receive income generated by the stock plus an additional payment by the borrower.

**Unit Trust** – A specific type of pooled investment fund.

**Venture Capital** – Investment in a company that is at a relatively early stage of development and is not listed on a stock exchange.