



Extract from the report to the
Public Accounts Committee on
Lønmodtagernes Dyrtidsfond
(a public employees pension fund)

May
2008

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Introduction and Results

1. This report concerns LD (a public employees capital pension fund).
2. An amendment made to the act in 2004 entailed considerable changes for LD, as the account holders became entitled to transfer their deposits to other pension funds. At the same time, LD was provided with an opportunity to form partly owned subsidiaries, and subsequently – as the capital decreases - withdraw from said companies.
3. Rigsrevisionen considered it of importance to examine the financial results achieved by LD in the period 1997-2006, the establishment of LD's asset management companies, in particular "Kommanditselskabet LD Equity 1 K/S" (LDE 1), and the Ministry of Employment's supervision of LD. Upon the establishment of LDE 1, LD transferred some of its shares to the asset management company and they were subsequently sold to other investors. The other asset management companies were established on the basis of cash contributions made by LD and other investors.
4. The objective of the report is to assess LD's activities, in particular in the years following the amendment of the act in 2004.

The examination will answer the following questions:

- Is LD's financial performance satisfactory?
 - Did LD act appropriately in connection with the formation of the subsidiary LDE 1?
 - Has the Ministry of Employment's supervision of LD been satisfactory?
5. Rigsrevisionen began the examination on its own initiative in June 2007. The draft report has been presented to the Ministry of Employment and the Danish Financial Supervisory Authority, whose consultation responses have been incorporated in the report. The Ministry of Employment has obtained LD's comments and they are incorporated in the ministry's response.

RESULTS OF THE EXAMINATION

It is Rigsrevisionen's assessment that LD's financial performance is satisfactory compared with the results achieved by other investment managers. The return yielded on the account holders' deposits has been fair.

The board of LD did not act appropriately when the decision to form the subsidiary LDE 1 was made. Rigsrevisionen has attached special importance to the fact that LD did not secure the entire gain related to the divestment of three specific companies. To this should be added that the board should not have allowed the management to participate in the discussions when LDE 1 was formed, as the managing director could have a personal interest in the outcome of the decision.

In the future, the Ministry of Employment will strengthen its supervision of LD by monitoring the general development and results generated by the fund and assessing whether the return yielded by LD is satisfactory.

This overall assessment is based on:

LD's financial performance has been satisfactory. LD's return on investment is higher than the average return achieved by other investment managers, and the costs related to the administration of the accounts are lower than the other investment managers'. The return on the account holders' deposits is therefore considered fair.

- LD's return on investments is above the average return achieved by investment managers, but lower than the highest yields produced by the labour market pension funds.
- LD's costs for account administration are significantly lower than the average administration costs of other investment managers. Due to lack of data, Rigsrevisionen has not been able to compare LD's investment costs with other investment managers' costs.

LD's board did not act appropriately when the subsidiary LDE 1 was formed. Rigsrevisionen has attached special importance to the fact that LD did not secure the entire gain related to the divestment of three companies and the board did not increase the requirements of the data which provided the basis for the board's decision to form LDE 1.

- After the amendment of the act in 2004, LD established the asset investment company LDE 1 in order to generate sufficient available funds to counter the expected transfer of deposits to other investment managers.
- However, LD's cash position did not call for the formation of LDE 1 in March 2006, as the number of deposits being transferred was at this point decreasing, and LD had considerable cash resources deposited in various banks.
- The value of the asset transfers to LDE 1 was determined on the basis of generally accepted assessment methods. An auditing firm conducted an independent assessment on behalf of LD and LD also ensured that the assessment was updated to the time of divestment.
- Rigsrevisionen is of the opinion that the board should have responded to the variance of DKK 407 million between the independent assessment and the indicated purchase price for the three specific companies, and LD should have ensured that the entire gain related to the divestment of the companies went to LD. Rigsrevisionen has estimated that LD waived additional profits of approximately DKK 65 million, because the entire gain did not go to LD.
- The Ministry of Employment has noted that LD – according to the information presented to the ministry – has not conducted an analysis of whether the transaction was of maximum benefit to the account holders. However, the ministry is not of the opinion – based on the information provided – that it can be concluded that a more advantageous result could have been achieved.

- The Danish Financial Supervisory Authority has pointed out that the documentation available to the board of LD was not extensive enough to allow the board to determine whether LD has secured the best possible profits in connection with the formation of LDE 1.
- The formation of LDE 1 represented a potential conflict of interest to the management.

The Danish Financial Supervisory Authority has formed the opinion that if the managing director could have a personal interest in the outcome of a decision - as in the present case – then the board should increase the requirements to the information, providing the basis for the board's decision.

In continuation hereof, Rigsrevisionen finds that the board should not have allowed the management to present the basis of decision and participate in the discussions, because the legal capacity of the management should be beyond doubt.

Rigsrevisionen finds it satisfactory that the Ministry of Employment will strengthen its supervision of LD in the future by monitoring the general development and performance of the fund and assessing whether LD's return is satisfactory. The Ministry of Employment should consider whether the rules governing administration of the funds are clear, including also the rules governing the formation of LD's subsidiaries.

- The Ministry of Employment should during its ongoing supervision evaluate whether LD complies with the intent of the act and whether the board has aimed to ensure the best possible return. The Ministry of Employment should make its own assessment of whether the return generated by the fund is satisfactory for the account holders.
- LD is of the opinion that subsidiaries may be considered ordinary portfolio investments when the ownership changes. The Ministry of Employment has launched an analysis of the rules applying to LD. The analysis is not finished yet. In the opinion of Rigsrevisionen, the Ministry of Employment should consider a clarification of the rules governing the administration and investment of the funds after having evaluated the consequences of LD's application and interpretation of the act.
- Rigsrevisionen recommends the Ministry of Employment to lay down a strategy for the phasing out of the fund towards 2031. The strategy should be in place before the capital decreases to a size which makes it unprofitable for LD to run its own administration, but also to ensure that LD lives up to the intent of the act to ensure the best possible profits to and equal treatment of the account holders.