Pension Fund Committee

Date **Thursday 14 March 2019**
Time **10.00 am**
Venue **Committee Room 2 - County Hall, Durham**

Business

Part A

Items during which the Press and Public are welcome to attend. Members of the Public can ask questions with the Chairman's agreement.

1. Apologies for Absence
2. Declarations of interest (if any)
3. The Minutes of the Meeting held on 6 December 2018 (Pages 5 - 12)
4. Feedback from Local Pension Board
5. Overall Value of Pension Fund Investments to 31 December 2018 (Pages 13 - 18)
6. Performance Measurement of Pension Fund Investments to 31 December 2018 (Pages 19 - 32)
7. Short Term Investments for the Period Ended 31 December 2018 (Pages 33 - 34)
8. Investment of the Pension Fund's Cash Balances (Pages 35 - 40)
9. Pension Fund Policy Documents - Funding Strategy Statement and Investment Strategy Statement (Pages 41 - 90)
10. Agreement of Accounting Policies for Application in the 2018/19 Financial Statements of the Pension Fund (Pages 91 - 98)
11. Internal Audit Progress Report to 31 December 2018 (Pages 99 - 102)

12. Draft Audit Plan 2019/20 (Pages 103 - 106)
13. Local Government Pension Scheme (LGPS): Review of Pension Fund Risks (Pages 107 - 116)
14. Cost Management in the LGPS (Pages 117 - 124)
15. Such other business as, in the opinion of the Chairman of the Meeting is of sufficient urgency to warrant consideration
16. Any resolution relating to the exclusion of the public during the discussion of items containing exempt information

Part B

Items during which it is considered the meeting will not be open to the public (consideration of exempt or confidential information)

17. The Minutes of the Meeting held on 6 December 2018 (Pages 125 - 132)
18. Report of the Pension Fund Adviser (Pages 133 - 170)
19. Investment Strategy Review Update (Pages 171 - 220)
20. Investment Strategy - Implementation Considerations (Pages 221 - 222)
21. Report of Aberdeen Standard (Pages 223 - 248)
22. Report of AB (Pages 249 - 266)
23. Report of BlackRock (Pages 267 - 284)
24. Report of BNY Mellon (Walter Scott) (Pages 285 - 292)
25. Report of CBRE Global Investment Partners (Pages 293 - 306)
26. Report of Mondrian Investment Partners Ltd (Pages 307 - 314)
27. Report of Royal London (Pages 315 - 318)
28. Such other business as, in the opinion of the Chairman of the meeting, is of sufficient urgency to warrant consideration

Helen Lynch
Head of Legal and Democratic Services

County Hall
Durham
6 March 2019

To: The Members of the Pension Fund Committee

County Council Members:
Councillors M Davinson, O Temple, J Atkinson, C Carr, J Carr, J Lethbridge, S Hugill, B Kellett, J Shuttleworth, M Wilson and S Zair

Darlington Borough Council Members
Councillor S Harker
Councillor I G Haszeldine

Scheme Member Representatives
A Delandre and J Taylor

Further Education Colleges Representative
A Broadbent

Scheduled Bodies Representative
(vacant)

Admitted Bodies Representative
(vacant)

Advisers: County Council Officers

Chief Executive	T Collins
Corporate Director of Resources	J Hewitt
Head of Legal and Democratic Services	H Lynch
Pensions Manager	P Cooper
Finance Manager	B White

Independent Advisers
C Arbuckle – Mercer
S Dickson – Mercer
A Fletcher – MJ Hudson Allenbridge

Investment Managers
Aberdeen Standard
AB
BlackRock
BNY Mellon (Walter Scott)
CBRE Global Investment Partners
Mondrian Investment Partners Ltd
Royal London

Staff Observers

UNISON	N Hancock
GMB	D Clegg

Contact: Jill Errington **Tel: 03000 269703**

DURHAM COUNTY COUNCIL

PENSION FUND COMMITTEE

At a Meeting of **Pension Fund Committee** held in Committee Room 2 - County Hall, Durham on **Thursday 6 December 2018 at 10.00 am**

Present:

Councillor M Davinson (Chairman)

Members of the Committee:
Councillors O Temple (Vice-Chairman), J Atkinson, C Carr, B Kellett and M Wilson

Scheme Member Representatives
Anne Delandre and John Taylor

Further Education Colleges Representative
Andy Broadbent

Also Present:
Council Advisers:
John Hewitt – Corporate Director of Resources
Beverley White – Finance Manager – Corporate Finance

Independent Advisers:
Catrina Arbuckle and Sandy Dickson – Mercer

Observers:
Neville Hancock – UNISON and Local Pension Board member
Councillor Amanda Hopgood – Chair of Local Pension Board
Ian Densham – Local Pension Board member
Paul Cooper – newly appointed Pensions Manager

The Chairman announced the sad death of former County Councillor Andy Turner, who during his term of office had been a highly valued Chairman of the Pension Fund Committee.

1 Apologies for Absence

Apologies for absence were received from Councillors S Hugill and S Zair.

2 Declarations of interest

There were no declarations of interest.

3 Minutes

The Minutes of the meeting held on 6 September 2018 were agreed as a correct record and were signed by the Chairman.

Matter Arising from the Minutes

Pension Fund Committee Independent Investment Adviser
Beverley White provided an update regarding the procurement process for the appointment of an Independent Adviser which would hopefully be completed in January 2019. The Corporate Director of Resources was authorised, in consultation with the Chair and Vice-Chair of the Committee, to make the appointment and an update would be provided at the next meeting.

4 Overall Value of Pension Fund Investments to 30 September 2018

The Committee considered a report of the Corporate Director of Resources which provided an update on the overall value of the Pension Fund's investments at 30 September 2018, the movement in the cash balance during the last four quarters and the projected cash flow position up to 31 December 2019 (for copy see file of Minutes).

Resolved:

The information contained in the report be noted.

5 Performance Measurement of Pension Fund Investments to 30 September 2018

The Committee considered a report of the Corporate Director of Resources which provided an overview of the performance of the Fund to 30 September 2018 (for copy see file of Minutes).

Resolved:

That the information contained in the report produced by JP Morgan be noted.

6 Short Term Investments for the Period Ended 30 September 2018

The Committee considered a report of the Corporate Director of Resources which provided the Committee with information on the performance of the Pension Fund's short term investments as at 30 September 2018 (for copy see file of Minutes).

Resolved:

That the position at 30 September 2018 regarding the Pension Fund's short term investments where the Pension Fund's surplus cash holding was £32,948m and £38,822 net interest was earned in the three month period, be noted.

7 Internal Audit Progress Report to 30 September 2018

The Committee considered a report of the Chief Internal Auditor and Corporate Fraud Manager which outlined progress made in delivering the 2018/2019 internal audit plan relevant to the Pension Fund Committee (for copy see file of Minutes).

A summary of the approved audit plan with the status of each audit was included in the report, together with the scope of the final report issued in the quarter.

On behalf of the Committee, Councillor Temple congratulated Officers for the work undertaken by the Team during the year.

Resolved:

That the work undertaken by Internal Audit during the period ending 30 September 2018 be noted.

8 Feedback from Local Pension Board

Councillor Hopgood, the Chair of the Local Pension Board advised that there were no recommendations to report to the Pension Fund Committee. The Local Pension Board at its meeting later that day would consider its Work Programme for the next 2 years.

Resolved: That the information given be noted.

9 Any Other Business

BCPP Responsible Investment Policy and Corporate Governance and Voting Guidelines

Beverley White reported that BCPP had asked all partner funds to consider the Partnership's Responsible Investment Policy and Corporate Governance by the end of January 2019. Earlier versions of the documents had been presented to the Committee in December 2017, but the policies had been subject to a further review since then. Members were informed of key changes, and were invited to comment. John Hewitt noted that the Responsible Investment Policy was consistent with Durham's Investment Strategy Statement.

Resolved:

That the BCPP Responsible Investment Policy and Corporate Governance and Voting Guidelines be agreed.

BCPP National Conference 2018

The Committee was informed that Councillors J Atkinson and O Temple, John Taylor and Anne Delandre, and the Local Pension Board Chair Councillor A Hopgood had attended BCPP's National Conference in Leeds on 8/9 November 2018.

Members were invited to provide feedback from the Conference. Councillor Temple highlighted the need for financial modelling of Durham's Pension Fund, to consider how income is recycled into the Fund in the long-term, and to look at the maturity of the Fund going forward. As a Fund tracking indices was preferred but the Committee had a responsibility for responsible investment in ESG and passive investment may not therefore be appropriate. In terms of global equities, two externally managed BCPP global equity funds were proposed and one internally managed option. It appeared that a mix of investment in private equity and infrastructure would provide greater flexibility.

Catrina Arbuckle of Mercer referred to Councillor Temple's feedback and advised that passive investing did not mean that responsible investment was not possible, as long as a good passive Manager was used to manage investments.

Councillor Atkinson stated that the Responsible Investment Policy and Corporate Governance and Voting Guidelines addressed the matters that were considered at the Conference. There had been much discussion around voting procedures and also ethical investments which he considered would be a challenge.

Councillor Hopgood advised that a meeting of Local Pension Board Chairs had been held during the Conference which was a useful information sharing exercise. As a result of that meeting it was proposed that Chairs would meet twice-yearly to share best practice. The meeting had also highlighted the need for the Local Pension Board to produce an Annual Report.

All Members considered that the Conference was very useful and for the new Members of the Committee, John Taylor and Anne Delandre, they felt it had improved their knowledge and understanding of the BCPP.

10 Exclusion of the Public

Resolved:

That under Section 100(A)(4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involved the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act.

11 Minutes

The Minutes of the meeting held on 6 September 2018 were agreed as a correct record and were signed by the Chairman.

12 Report of the Pension Fund Adviser

The Committee considered a report of the Independent Adviser Sandy Dickson of Mercer (for copy see file of Minutes).

Resolved:

That the information given be noted.

13 Investment Strategy Review

The Committee considered a report and presentation from Mercer which included recommendations following their review of the Investment Strategy (for copy see file of Minutes).

Resolved:

That Mercer's proposal in relation to the review of the Investment Strategy be noted.

14 Border to Coast Pensions Partnership - Update

The Committee received a presentation from Andrew Stone and Daniel Booth of BCPP which included the following:-

Global Equity
Alternative Assets Platform
Private Equity
Infrastructure

Resolved:

a) that the update from BCPP be noted;

b) clarification be sought from BCPP with regard to the timescales for allocation to asset classes;

c) a Special meeting of the Committee be arranged following the appointment of the Independent Adviser to consider asset allocation.

15 Report of Aberdeen Standard

Consideration was given to a report from Aberdeen Standard which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

16 Report of Alliance Bernstein

Consideration was given to a report from Alliance Bernstein which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

17 Report of BlackRock

Consideration was given to a report from BlackRock which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

18 Report of BNY Mellon (Walter Scott)

Consideration was given to a report from BNY Mellon (Walter Scott) which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

19 Report of CBRE Global Investment Partners

Consideration was given to a report from CBRE which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

20 Report of Mondrian Investment Partners Ltd

Consideration was given to a report from Mondrian Investment Partners Ltd which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

21 Report of Royal London

Consideration was given to a report from Royal London which included:

a) Manager's views on the economy and investment strategy for the future
b) Investment Policy
c) List and valuation of investment holdings.

Resolved:

That the information given be noted.

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Pension Fund Committee

14 March 2019

Overall Value of Pension Fund Investments to 31 December 2018

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1. To provide an update to Members on the:

   (a) overall value of the Pension Fund's investments at 31 December 2018;
   (b) movement in the cash balance during the last four quarters;
   (c) projected cash flow position up to 31 March 2020.

Executive Summary

2. Appendix 1 details the working cash balance position of the Pension Fund and actual cash flow for the last four quarters. At 31 December 2018 the value of the Fund was £2.742 billion and the cash balance held in the Durham County Council Pension Fund bank account was £45.870 million. Fund Managers also held cash of £27.553 million at that date.

3. The cash flow forecast detailed in Appendix 2 indicates net cash outflows, excluding cash withdrawals from fund managers, in future quarters of between £10 million and £17 million. As fund rebalancing has been suspended whilst the strategic asset allocation is under review, a recovery of £20 million from Fund Managers in the quarters ending 30 June 2019 and 31 December 2019 has been included in the forecast.

Recommendation

4. Members are asked to note the information contained in this report.

Background

Value of the Pension Fund

5. Reports from the seven appointed Fund Managers, namely:

    - Aberdeen Standard
    - AB
    - BlackRock
    - Bank of New York Mellon (Walter Scott)
    - CB Richard Ellis
    - Mondrian
    - Royal London

    are included in other papers within this agenda.

6. The value of the Fund at 31 December 2018 was £2.742 billion compared to £2.883 billion at 30 September 2018. This is a decrease of £140.21 million (4.86%) in the third quarter of 2018/19.

Allocation of New Investment Money/ Withdrawal of Investment Money to Deal with Estimated Shortfall

7. New investment money is allocated to Fund Managers when the Pension Fund has cash which is not required to be available as a working cash balance, for example to pay pensioners or fees.

8. When it is estimated that the Pension Fund will not have sufficient cash available as a working cash balance, cash is withdrawn from Fund Managers.

9. Appendix 1 details the working cash balance position of the Pension Fund and actual cash flow for the last four quarters. As at 31 December 2018 the cash balance held in the Durham County Council Pension Fund bank account was £45.870 million. In addition to this, not included in this table, Fund Managers were holding cash of £27.553 million at 31 December 2018.

10. During the last quarter £26 million was returned from one fund manager who is expected to make capital calls on this sum as and when required.

Cash Flow Forecast 2018/19

11. Appendix 2 shows the projected cash flow for the Pension Fund for the period January 2019 to March 2020. It should be noted that this is only in respect of cash held in the Pension Fund bank account and that income earned from investments is currently retained by Managers.

12. The forecast includes the recovery of £20 million from Fund Managers in the quarters ending 30 June 2019 and 31 December 2019. Without the recovery of the aforementioned amounts, the Pension Fund is estimated to be in a cash negative position in all quarters to 31 March 2020.

13. The forecast indicates net cash outflows in future quarters of between £10 million and £17 million. The size of the outflows are exacerbated due to the early receipt of Durham County and Darlington Borough Councils' deficit contributions in April 2017, the impact of which is an apparent reduction in future contributions receivable of £6.598 million per quarter.

14. The following assumptions have been used in the cash flow forecast:

    (a) Annual dividend income receivable is estimated to be £28 million and profiled to be received as follows:

        (i) Quarter ended 31 March 2019 29%
        (ii) Quarter ended 30 June 2019 21%
        (iii) Quarter ended 30 September 2019 24%
        (iv) Quarter ended 31 December 2019 26%

    (b) Increases in contributions are included in line with the actuarial valuation.

    (c) Transfer values due in are estimated at £1.25 million per quarter. It is anticipated that transfers in will continue as the LGPS remains relatively attractive to employees.

    (d) Pensions increase was 3% with effect from 1 April 2018, and is forecasted to be 2.4% with effect from 1 April 2019.

    (e) Payroll paysheets (payments to pensioners) are forecast to increase by £0.25 million per quarter, from 1 April 2019. This figure will alter if there are large numbers of retirements from the employing authorities. It is anticipated however that the actual figure will not be materially different to the forecast since the

position of the County Council, being the largest employer in the Fund, has been taken into account.

(f) Payable paysheets are forecast on the basis of the previous year's profile and adjusted for known one-off payments, although this can be the most volatile figure as it includes payments of lump sums and fees to managers. This assumption errs on the side of prudence, in that this is an average figure taken from previous quarterly payments.

15. Appendix 2 provides an early indication of the likely impact on the Pension Fund's cash flow position over the next 15 months. It is continuously under review and is refined to take any new information into account as it becomes available.

Fund Rebalancing

16. Fund rebalancing is the mechanism by which the Pension Fund would ensure that the asset allocation to Investment Managers is maintained at the target levels previously agreed by the Pension Fund Committee and as set out in the Investment Strategy Statement. It is also the means by which cash is moved to or from managers as a consequence of the cash flow forecasts.

17. Due to the current suspension of fund rebalancing, there was no rebalancing exercise this quarter.

Contact: Beverley White Tel: 03000 261900

Appendix 1

Actual Cash Flow – For the period 1 January 2018 to 31 December 2018

Quarter Ended	**31.03.18**		**30.06.18**		**30.09.18**		**31.12.18**	
	Estimate	**Actual**	**Estimate**	**Actual**	**Estimate**	**Actual**	**Estimate**	**Actual**
	£	£	£	£	£	£	£	£
Cash Inflows								
Contributions - DCC	13,775,000	13,821,664	13,800,000	14,026,059	13,810,000	14,031,093	13,810,000	13,958,692
Contributions - Other	8,665,000	8,539,955	8,925,000	9,435,259	9,055,000	9,427,471	9,055,000	9,655,168
Unfunded pensions recharges	1,135,000	1,127,645	1,170,000	1,095,967	1,170,000	1,120,692	1,170,000	1,101,373
Transfer Values	1,000,000	1,127,398	1,250,000	1,505,702	1,250,000	808,619	1,250,000	1,024,338
Other income	2,000,000	3,309,977	2,000,000	1,280,190	2,000,000	2,028,874	2,000,000	1,126,820
Funds recovered from Managers	20,000,000	20,000,000	0	0	20,000,000	20,000,000	0	26,000,000
Interest on short term investments	30,000	23,166	30,000	46,562	40,000	38,822	50,000	65,169
Total Cash Inflow	46,605,000	47,949,804	27,175,000	27,389,739	47,325,000	47,455,569	27,335,000	52,931,560
Cash Outflows								
Payroll Paysheets	24,600,000	24,489,507	25,500,000	25,076,412	25,750,000	25,426,232	25,750,000	25,727,276
Payables Paysheets (incl. Managers' fees)	12,000,000	10,303,580	12,000,000	15,369,235	12,000,000	10,557,206	12,000,000	13,631,809
Funds transferred to Managers	0	0	0	0	0	0	0	0
Other Expenditure	1,000	1,808	1,000	4,439	1,000	785	1,000	790
Total Cash Outflows	36,601,000	34,794,895	37,501,000	40,450,085	37,751,000	35,984,223	37,751,000	39,359,875
Net Cash Inflow / (-) Outflow	10,004,000	13,154,910	-10,326,000	-13,060,346	9,574,000	11,471,347	-10,416,000	13,571,685
Balance at Bank (opening)		23,095,655		35,680,827		22,076,786		32,948,356
Balance at Bank (closing)		35,680,827		22,076,786		32,948,356		45,870,405

Appendix 2

Projected Cash Flow (including forecast dividends receivable by Fund Managers) - for the period 1 January 2019 to 31 March 2020

Quarter Ended	**31.03.19**	**30.06.19**	**30.09.19**	**31.12.19**	**31.03.20**
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£	**£**	**£**	**£**	**£**
Cash Inflows					
Contributions - DCC	13,950,000	13,950,000	13,950,000	13,950,000	13,950,000
Contributions - Other	9,600,000	9,760,000	9,850,000	9,850,000	9,850,000
Unfunded pensions recharges	1,120,000	1,140,000	1,140,000	1,140,000	1,140,000
Transfer Values	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000
Other income	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Funds recovered from Managers	0	20,000,000	0	20,000,000	0
Interest on short term investments	85,000	70,000	60,000	60,000	55,000
Total Cash Inflow	28,005,000	48,170,000	28,250,000	48,250,000	28,245,000
Cash Outflows					
Payroll Paysheets	26,000,000	26,850,000	27,100,000	27,350,000	27,600,000
Payables Paysheets (incl. Managers' fees)	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000
Funds transferred to Managers	5,600,000	5,900,000	0	0	0
Other Expenditure	1,000	1,000	1,000	1,000	1,000
Total Cash Outflows	43,601,000	44,751,000	39,101,000	39,351,000	39,601,000
Net Cash Inflow / (-) Outflow	-15,596,000	3,419,000	-10,851,000	8,899,000	-11,356,000
Balance at Bank (opening)	45,870,405	30,274,405	33,693,405	22,842,405	31,741,405
Balance at Bank (closing)	30,274,405	33,693,405	22,842,405	31,741,405	20,385,405
Dividends Received by Managers	8,070,000	5,740,000	6,830,000	7,360,000	8,070,000

Pension Fund Committee

14 March 2019

Performance Measurement of Pension Fund Investments to 31 December 2018

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 To provide an overview of the performance of the Pension Fund to 31 December 2018.

Recommendation

2 Members note the information contained in the attached report produced by the Fund's custodian, JP Morgan.

Background

3 The performance of the seven fund managers is measured against personalised benchmarks chosen at the inception of the fund. The attached report from JP Morgan shows:

(a) The fund managers' benchmarks;

(b) The total fund performance for the quarter to 31 December 2018, year to date and since inception;

(c) The managers' performance in absolute and relative terms against the relevant benchmarks, for the quarter to 31 December 2018, year to date and since inception;

(d) A portfolio comparison for the quarter ended 31 December 2018 and for the period since inception.

Contact: Beverley White Tel: 03000 261900

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J.P.Morgan

Durham Quarterly Report

Report Package

Published 30-Jan-2019 11:22:19

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Executive Summary

Durham CC (UK005)

As of December 2018

Gross of Fee

Total Fund Composite - Actual (0UK00501)

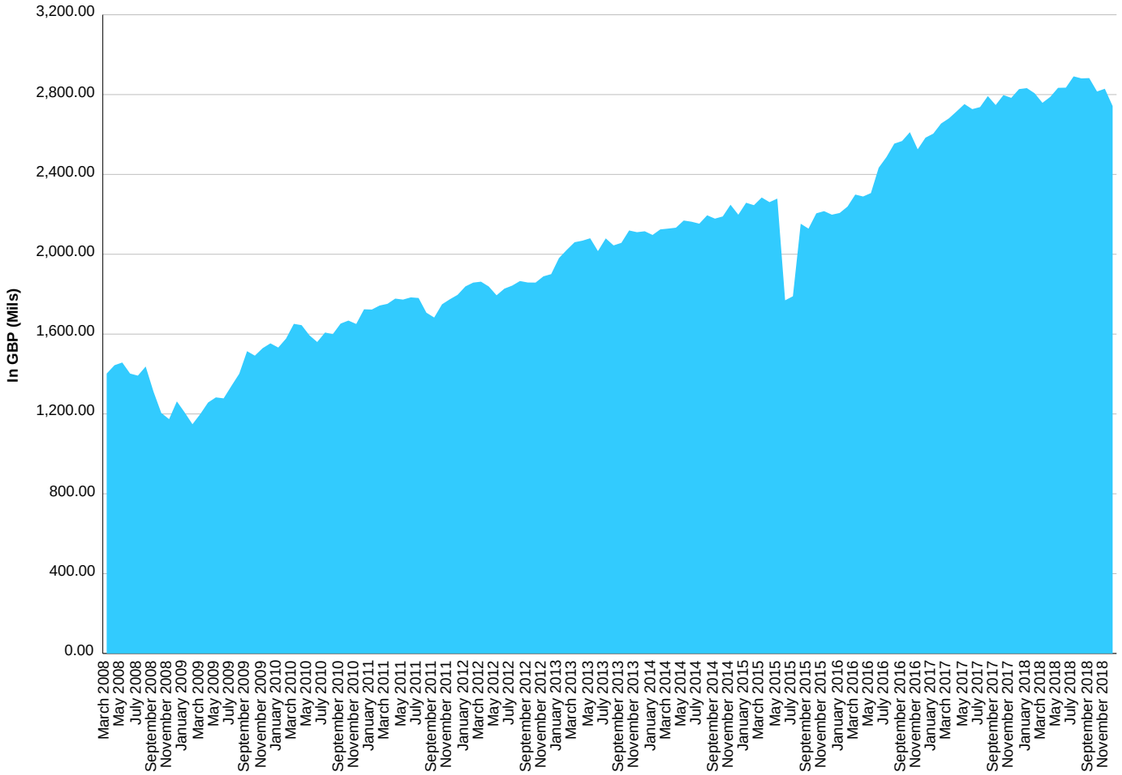
Market Value Overview

	In GBP (Mils)				
	December 2018	September 2018	June 2018	March 2018	December 2017
Market Value	2,742.48	2,882.68	2,834.64	2,758.82	2,827.45
Net Cash Flow	(26.00)	(20.00)	0.00	(20.00)	(14.98)
Net Income / Appreciation	(114.21)	68.05	75.82	(48.63)	94.79

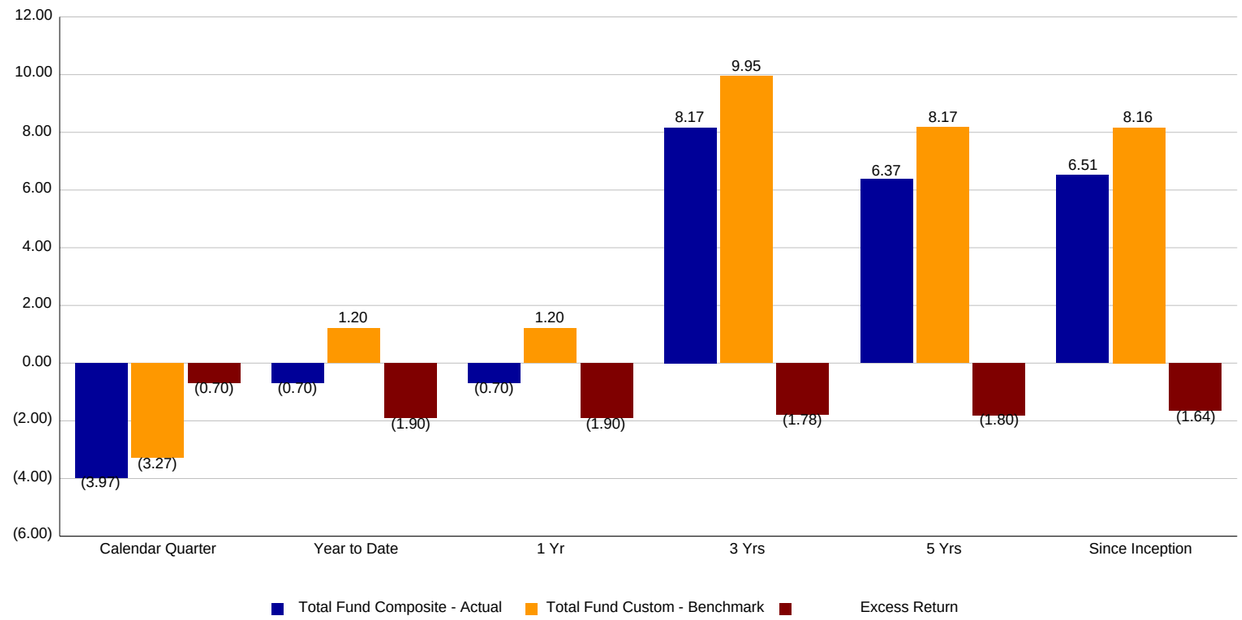
Performance Overview

	Performance (Annualised > 1 Year)					
	Calendar Quarter	Year to Date	1 Yr	3 Yrs	5 Yrs	Since Inception
Total Fund Composite - Actual	(3.97)	(0.70)	(0.70)	8.17	6.37	6.51
Total Fund Custom - Benchmark	(3.27)	1.20	1.20	9.95	8.17	8.16
Excess Return	(0.70)	(1.90)	(1.90)	(1.78)	(1.80)	(1.64)

Development of Market Value - Since Inception



Performance Returns



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Index and Benchmark Report - Monthly

Durham CC (UK005)

As at December 2018

Name	Month Return
Business Unit Indices	
Equities	
FT-All Share +3%	(3.51)
FTSE-Ftse All-Share (Gross)	(3.75)
FTSE-Ftse Aw Developed (Gross)	(7.27)
MSCI AC World Index (Gross) + 2.5%	(6.64)
MSCI AC World Index (Gross) + 3%	(6.60)
MSCI EM (Emerging Markets) (Net)	(2.48)
MSCI EM (Emerging Markets) (Net) + 2.5%	(2.28)
MSCI-Acwi (Gross)	(6.84)
MSCI-Em (Emerging Markets) (Gross) + 2.5%	(2.22)
MSCI-World (Gross)	(7.40)
Fixed Income	
British Gov Index Linked over 5 Yr + 0.5%	2.75
Cash And Cash Equivalent	
3 MONTH GBP LIBOR	0.08
3Month GBP Libor +4%	0.40
3Month libor in GBP plus 3%	0.32
GBP Zero Return Index	0.00
RPI + 5%	0.76
Retail Price Index (UK)	0.35

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Portfolio Comparison

Durham CC (UK005)
As of December 2018
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

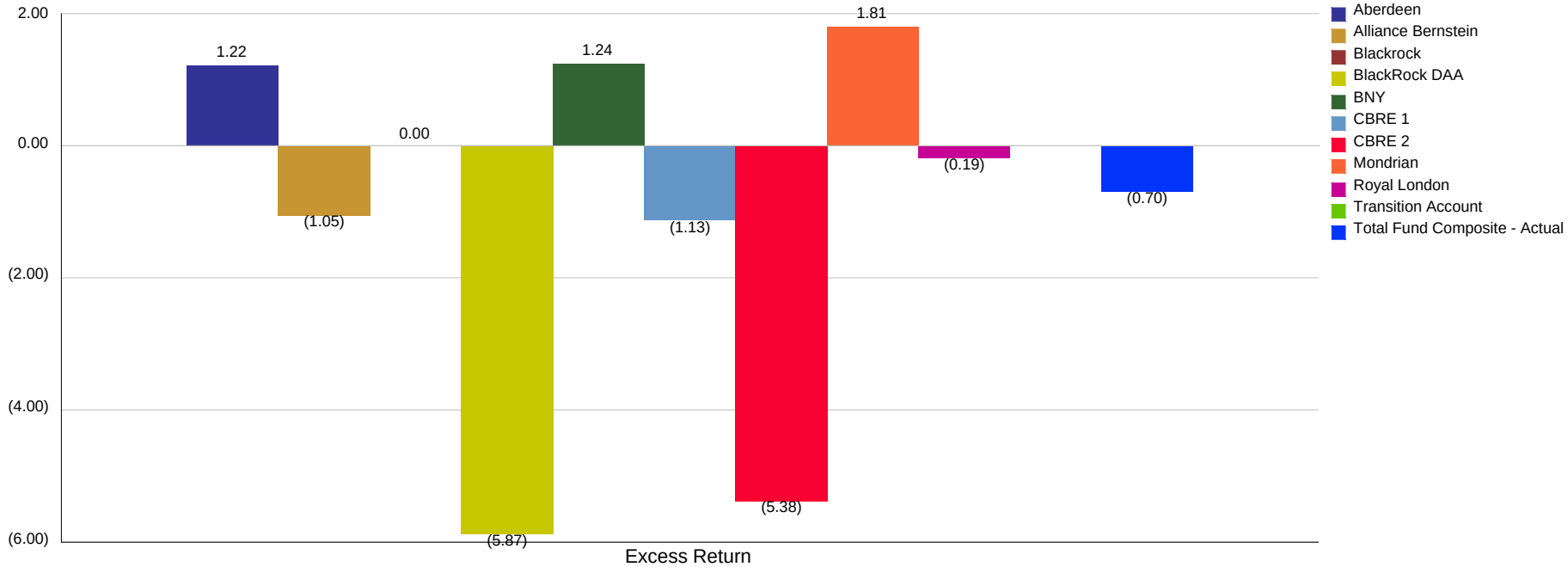
Manager	Benchmark	Market Value (mils)	Weight	Trailing 3 Months Return	Benchmark Trailing 3 Months Return	Excess Returns	Current Contribution to Return
Aberdeen	MSCI-Acwi (Gross) + 3%	444.11	16.19	(8.68)	(9.90)	1.22	(1.41)
Alliance Bernstein	3 Month Libor in GBP +3% pa	393.87	14.36	(0.09)	0.96	(1.05)	(0.01)
Blackrock	Zero Return - Historically FTSE All Share (Gross) +3% pa	0.01	0.00	0.00	0.00	0.00	0.00
BlackRock DAA	3 Month Libor in GBP +3% pa	450.28	16.42	(4.92)	0.96	(5.87)	(0.81)
BNY	MSCI World Index (Gross) + 2.5%	503.35	18.35	(9.44)	(10.69)	1.24	(1.73)
CBRE 1	Headline RPI +5% pa (CBRE1)	176.58	6.44	0.63	1.76	(1.13)	0.04
CBRE 2	Headline RPI +5% pa (CBRE2)	35.96	1.31	(3.62)	1.76	(5.38)	(0.05)
Mondrian	MSCI EM (Emerging Markets) (Gross) + 2.5%	200.46	7.31	(2.78)	(4.59)	1.81	(0.20)
Royal London	FTSE index Linked more than 5 years +0.5% pa	537.84	19.61	1.88	2.06	(0.19)	0.37
Transition Account	Not Applicable	0.02	0.00	0.00	-	-	0.00
Total Fund Composite - Actual	**Total Fund Custom - Benchmark**	**2,742.48**	**100.00**	**(3.97)**	**(3.27)**	**(0.70)**	**(3.97)**

J.P.Morgan

Portfolio Comparison

Durham CC (UK005)
As of December 2018
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Excess Returns - Trailing 3 Months



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Relative Performance

Durham CC (UK005)

For Period Ending December 2018

Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Total Fund Composite - Actual (0UK00501)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
00047880	Blackrock	10,317.74	0.00	0.00	0.00	0.00	0.00	0.11	4.10
	Zero Return - Historically FTSE All Share (Gross) +3% pa		0.00	0.00	0.00	0.00	0.00	0.03	5.45
	Excess Return		0.00	0.00	0.00	0.00	0.00	0.08	(1.35)
00047881	Royal London	537,839,854.15	2.70	1.88	(0.12)	(0.12)	9.42	9.51	8.33
	FTSE index Linked more than 5 years +0.5% pa		2.75	2.06	(0.37)	(0.37)	9.29	9.59	8.32
	Excess Return		(0.06)	(0.19)	0.26	0.26	0.13	(0.08)	0.02
00047882	Alliance Bernstein	393,868,560.27	0.28	(0.09)	(0.82)	(0.82)	2.37	2.38	3.46
	3 Month Libor in GBP +3% pa		0.32	0.96	3.74	3.74	3.51	3.53	4.06
	Excess Return		(0.05)	(1.05)	(4.56)	(4.56)	(1.14)	(1.15)	(0.61)
00047885	CBRE 1	176,579,971.55	(0.08)	0.63	7.35	7.35	6.70	8.73	4.08
	Headline RPI +5% pa (CBRE1)		0.76	1.76	7.82	7.82	8.24	7.54	7.95
	Excess Return		(0.84)	(1.13)	(0.47)	(0.47)	(1.54)	1.20	(3.86)
00051183	CBRE 2	35,960,713.46	(4.39)	(3.62)	(1.37)	(1.37)	5.47	7.82	5.47
	Headline RPI +5% pa (CBRE2)		0.76	1.76	7.82	7.82	8.24	7.54	7.95
	Excess Return		(5.15)	(5.38)	(9.19)	(9.19)	(2.77)	0.28	(2.47)
00082265	Transition Account	21,895.15	0.00	0.00	0.00	0.00	0.00	0.00	2.24
	Not Applicable		-	-	-	-	-	-	-
	Excess Return		-	-	-	-	-	-	-

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Relative Performance

Durham CC (UK005)

For Period Ending December 2018

Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Total Fund Composite - Actual (0UK00501)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
00301582	BlackRock DAA	450,282,995.12	(2.17)	(4.92)	(2.41)	(2.41)	1.91	-	1.59
	3 Month Libor in GBP +3% pa		0.32	0.96	3.74	3.74	3.59	-	3.81
	Excess Return		(2.49)	(5.87)	(6.16)	(6.16)	(1.68)	-	(2.22)
00301629	Mondrian	200,455,032.40	(1.47)	(2.78)	(5.11)	(5.11)	12.83	-	4.22
	MSCI EM (Emerging Markets) (Gross) + 2.5%		(2.22)	(4.59)	(6.62)	(6.62)	17.97	-	9.86
	Excess Return		0.75	1.81	1.51	1.51	(5.13)	-	(5.64)
00301630	Aberdeen	444,111,184.52	(5.79)	(8.68)	(6.18)	(6.18)	11.64	-	6.47
	MSCI-Acwi (Gross) + 3%		(6.60)	(9.90)	(0.37)	(0.37)	15.91	-	13.80
	Excess Return		0.81	1.22	(5.82)	(5.82)	(4.26)	-	(7.33)
00301691	BNY	503,347,707.07	(6.31)	(9.44)	4.64	4.64	14.78	-	12.90
	MSCI World Index (Gross) + 2.5%		(7.20)	(10.69)	0.28	0.28	15.78	-	13.66
	Excess Return		0.90	1.24	4.36	4.36	(1.00)	-	(0.77)
0UK00501	Total Fund Composite - Actual	2,742,478,231.43	(2.16)	(3.97)	(0.70)	(0.70)	8.17	6.37	6.51
	Total Fund Custom - Benchmark		(1.96)	(3.27)	1.20	1.20	9.95	8.17	8.16
	Excess Return		(0.19)	(0.70)	(1.90)	(1.90)	(1.78)	(1.80)	(1.64)

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Relative Performance

Durham CC (UK005)

For Period Ending December 2018

Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

CBRE Composite (0UK00502)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
00047885	CBRE 1	176,579,971.55	(0.08)	0.63	7.35	7.35	6.70	8.73	4.08
	Headline RPI +5% pa (CBRE1)		0.76	1.76	7.82	7.82	8.24	7.54	7.95
	Excess Return		(0.84)	(1.13)	(0.47)	(0.47)	(1.54)	1.20	(3.86)
00051183	CBRE 2	35,960,713.46	(4.39)	(3.62)	(1.37)	(1.37)	5.47	7.82	5.47
	Headline RPI +5% pa (CBRE2)		0.76	1.76	7.82	7.82	8.24	7.54	7.95
	Excess Return		(5.15)	(5.38)	(9.19)	(9.19)	(2.77)	0.28	(2.47)
0UK00502	CBRE Composite	212,540,685.01	(0.78)	(0.06)	5.91	5.91	6.57	8.60	4.67
	CBRE Composite Custom		0.76	1.76	7.82	7.82	8.24	7.54	7.95
	Excess Return		(1.54)	(1.82)	(1.91)	(1.91)	(1.68)	1.07	(3.28)

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Pension Fund Committee

14 March 2019

Short Term Investments for the period ended 31 December 2018

Ordinary Decision

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1. To provide the Committee with information on the performance of the Pension Fund's short-term investments as at 31 December 2018.

Recommendation

2. Members are asked to note the position at 31 December 2018 regarding the Pension Fund's short-term investments where the Pension Fund's surplus cash holding was £45.870 million and £65,169 net interest was earned in the three month period.

Short Term Investments

3. Durham County Council (the Council) invests the short-term cash balances on behalf of the Pension Fund; this is done in line with the Council's Treasury Management Policy and Annual Investment Strategy. This investment strategy sets out the maximum amounts and time limits in respect of deposits that can be placed with each financial institution.

4. The Pension Fund's surplus cash holding as at 31 December 2018 was £45.870 million, which was held in the institutions listed in the following table, alongside their credit rating at 31 December 2018.

Financial Institution	Short-term Rating	Amount Invested £m
Bank Deposit Accounts		
Handelsbanken	F1	0.471
Fixed Term Deposits		
Bank of Scotland	F1	7.704
Goldman Sachs	F1	1.712
Santander UK Plc	F1	5.136
UK Local Authorities	N/A	23.027
National Savings & Investments	N/A	0.171
Money Market Funds	N/A	7.649
Total		**45.870**

5. The following table provides information on the net interest earned during the three month period to 31 December 2018, the average daily investment balance and the average return earned in comparison to the average bank base rate. The interest paid to the Pension Fund is based upon the average three month rate of return earned by the Council and is net of the fees of £2,600 paid for the Council undertaking the Treasury Management function for the Pension Fund.

	Total
Net Interest Earned	£65,169
Average Return Earned	0.82%
Average Bank of England base rate	0.75%
Average Daily Balance of Investments	£32.759m

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee

14 March 2019

Investment of the Pension Fund's Cash Balances

John Hewitt, Corporate Director of Resources

Purpose of Report

1. To update the Committee of the Treasury Management service provided to the Pension Fund and to review the charges for the services and the calculation of interest on short term investments administered by Durham County Council (the Council) for 2019/20.

Executive Summary

2. As a result of changes to the Local Government Pension Scheme (Management and Investment of Funds) Regulations, in June 2010 the Pension Fund Committee agreed to invest the cash balances of the Pension Fund in line with the Council's Treasury Management Strategy and Annual Investment Strategy.

3. Since then the Council's Treasury Management team has continued to invest the balances of the Pension Fund on its behalf using approved counterparties in line with the Council's Treasury Management Strategy. This agreement is reviewed annually.

4. Quarterly reports on the return earned on short term investments are presented to the Pension Fund Committee.

Recommendations

5. It is recommended that, with effect from 1 April 2019:

   (a) the Pension Fund continues to invest its cash balances with the Council in line with the Council's Treasury Management Strategy;

   (b) interest be paid quarterly to the Pension Fund at a rate based on the daily cash balance and the 3 month rate of return earned by the Council on its own short term investments;

(c) an administration fee of £2,650 per quarter be paid to the Council for Treasury Management services; and

(d) in the event of the loss of an investment, the Pension Fund will bear the loss in proportion of the value of cash balances held at the time of the investment with Durham County Council.

Background

6. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the 2009 Regulations) introduced changes which ended the use of Pension Fund money by the administering authority. (The 2009 Regulations have since been superseded by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, however the same principle applies).

7. As a result of these regulations, a report was presented to the Pension Fund Committee in June 2010. At this meeting, the Committee gave its agreement to the Council continuing to invest the cash balances of the Pension Fund in line with the Council's Treasury Management Strategy and Annual Investment Strategy. This agreement is reviewed annually and the Council continues to invest the balances of the Pension Fund on its behalf.

8. The Council's Treasury Management Strategy (approved by Council annually each February) sets out the maximum amounts and time limits in respect of deposits which can be placed with each financial institution.

9. The Pension Fund's cash balances are invested along with the Council's cash balances at the most advantageous rate that can be achieved using approved counterparties.

10. Quarterly reports on the return earned on short term investments are presented to the Pension Fund Committee.

Administration of the Treasury Management Function

11. The Treasury Management team administer the cash balances of the Pension Fund in line with the Council's procedures.

12. The prime objective of the Council's investment strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are therefore the security of capital, liquidity of investments and, within those objectives, to secure optimum performance.

13. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

14. After this main principle, the Council will ensure that it:

(i) maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

(ii) has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

(iii) maintains a counterparty list in compliance with the CIPFA Treasury Management Code of Practice and credit rating information supplied by the Council's Treasury Management advisers and will revise the criteria and submit them to the Council for approval as necessary.

15. The treasury management team review and monitor the Council's Treasury Management Strategy on behalf of the Council and implement it on behalf of the Pension Fund. The team also update counterparties in line with information supplied by the Council's Treasury Management Advisers.

16. The Council's treasury management team monitors the cash, the bank account balances and the cash codes for the Council and the Pension Fund and actions the necessary transfers and coding adjustments. The Pension Fund balance is corrected for any incorrect banking of funds prior to calculation of the interest on the cash balance.

17. The treasury management team maintains full and accurate records in the performance of this service and makes them available for inspection by the Pension Fund Accounting Team, Internal and External Audit.

18. It is recommended that the charge for this service is increased slightly from £2,600 to the flat fee of £2,650 per quarter.

Calculation of Interest on Cash Balances

19. With effect from 1st April 2018 the interest paid to the Pension Fund in respect of its cash balances was based upon the average three month rate of return earned by the Council on its own short term investments. It is recommended that interest will continue to be paid to the Pension Fund using the average three month rate of return in 2019/20.

20. The choice of rate would however be subject to review by the Treasury Management team, to ensure an appropriate rate is applied.

Investments

21. It was also agreed by the Committee, that the Pension Fund's cash balances would be invested as part of the Council's overall investments.

22. As a result of this however, in the event of an investment being lost, for example due to the failure of a financial institution in which the cash is invested, the Council would be liable for the loss. This is due to the investment being in the name of the Council although the investment would include Pension Fund balances.

23. It was therefore agreed that the Pension Fund Committee share the risk of any investment in proportion to the value of cash balances at the time of investment. Any losses incurred as a result of impairment would then be split proportionately between the Council and the Pension Fund.

24. It is recommended that this arrangement continues.

Background Papers

(a) Pension Fund Committee - 21 June 2010 - The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

(b) Pension Fund Committee – 15 March 2018 - Investment of the Pension Fund's Cash Balances

(c) DCC's Treasury Management Strategy 2019/20 approved 20 February 2019.

(d) The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

Contact: Beverley White Tel: 03000 261900

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Pension Fund Committee

14 March 2019

Pension Fund Policy Documents – Funding Strategy Statement and Investment Strategy Statement

Ordinary Decision

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 To inform Members of the draft of the revised Investment Strategy Statement (ISS) which is currently out to consultation with Pension Fund employers.

Executive summary

2 In line with the Scheme Regulations, the Fund maintains both an ISS and Funding Strategy Statement (FSS). Due to proposed changes to the Fund's Strategic Asset Allocation, and the progress of asset pooling through Border to Coast Pension Partnership (BCPP) it has been necessary to update the ISS. The FSS will be updated following completion of the next triennial valuation of the Fund, as at 31 March 2019.

Recommendation(s)

3 Members are asked to

i) note the report and to advise of any comments they may have on the draft ISS set out in the appendices to this report, and;

ii) authorise the Corporate Director Resources to finalise the wording of the ISS, where appropriate taking into account any comments received from employers, and publish final versions by 31 March 2019.

Background

4 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 required administering authorities to prepare and review a written statement recording the investment policy of the Pension Fund – the 'Statement of Investment Principles' (SIP).

5 As reported at the December 2016 Pension Fund Committee meeting, these regulations were replaced by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ('the 2016 investment regulations'), which took effect from 1 November 2016 and require administering authorities, after taking proper advice, to prepare and publish a written statement setting out their investment strategy in relation to the Fund – the 'Investment Strategy Statement' (ISS).

6 Regulation 58 of the Local Government Pension Scheme Regulations 2013 ('the LGPS regulations') requires Local Government Pension Schemes (LGPS) administering authorities to prepare, maintain and publish a 'Funding Strategy Statement' (FSS).

7 The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Fund the Administering Authority will prepare and publish their funding strategy;
- In preparing the FSS, the Authority must have regard to:
  - the guidance issued by the Chartered Institute of Public Finance (CIPFA) for this purpose; and
  - their own Investment Strategy Statement
  - the FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the ISS

Investment Strategy Statement

8 The revisions to the ISS have been undertaken after taking advice from the Fund's investment consultants. The main revisions to the ISS are as follows:

- A revision to the Fund's Strategic Asset Allocation.
- An update to the section setting out how the council as administering authority to the Pension Fund will comply with the

requirement to pool assets with Border to Coast Pension Partnership.

- A section setting out BCPP's commitment to Responsible Investment.

Funding Strategy Statement

9 Following the most recent triennial valuation, as at 31 March 2016, the Pension Fund worked closely with the Actuary to update the FSS. Changes included:

- An additional section entitled 'Commencement of Employers' clarifying how (notional) asset transfers are calculated for new employers. This will be of particular relevance for new academy trusts.

- Reference was made to the role of the Local Pension Board in reviewing the valuation process.

- Reference is made to the LGPS regulations requirement for Funds to target long term cost efficiency as well as solvency.

- After discussions with, and advice from, the Pension Fund actuary the pooling of risks associated with payment of death in service lump sums was extended to include risks associated with payment of survivors' pensions on death in service and payment of ill health pensions. The effect of this is negligible for the larger Fund employers but for smaller employers will reduce contribution volatility and effectively self-insure what were previously significant risks.

10 The FSS will next be updated after the completion of the next triennial valuation of the Fund, as at 31 March 2019. The current FSS is included in the appendices for reference.

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APPENDIX 1

Pension Fund

Investment Strategy Statement

31 March 2019

1 Introduction

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ('the 2016 Investment Regulations') require administering authorities to formulate and to publish a statement of its investment strategy, in accordance with guidance issued from time to time by the Secretary of State.

This Investment Strategy Statement (ISS) has been designed to be a living document and is an important governance tool for the Durham County Council Pension Fund ('the Pension Fund'). This document sets out the investment strategy of the Pension Fund, provides transparency in relation to how the Pension Fund investments are managed, acts as a risk register, and has been kept as short in order to be read in as user-friendly manner as is possible. This document replaces the Pension Fund's Statement of Investment Principles.

This statement will be consulted on at least every three years and reviewed by the Pension Fund Committee ('the Committee') more frequently should any significant change occur.

2 Investment Responsibilities

The County Council, as Administering Authority for the Pension Fund, has delegated the investment arrangements of the Pension Fund to the Pension Fund Committee (the "Committee") who decide on the investment policy most suitable to meet the liabilities of the Pension Fund and the ultimate responsibility for the investment policy lies with it. The Committee is made up of elected representatives of the County Council, Darlington Borough Council, Further Education Colleges, Other Statutory Bodies, Admitted Bodies and Member Representatives.

The Committee has full delegated authority to make investment decisions.

2.1 The Pension Fund Committee has responsibility for:

- Determining overall investment strategy and strategic asset allocation and ensuring that investments are sufficiently diversified, are not over concentrated in any one type of investment, and that the Pension Fund is invested in suitable types of investments;
- Preparing policy documents including the ISS and Funding Strategy Statement (FSS). Monitoring compliance with the ISS and reviewing its contents following any strategic changes and at least every three years;
- Appointing the investment managers, and custodian until such time as all of the Fund's assets are transitioned to Border to Coast Pension Partnership Limited (BCPP);
- Appointing the Pension Fund actuary and any independent external advisers felt to be necessary for the good stewardship of the Pension Fund;
- Reviewing on a regular basis the investment managers' performance against established benchmarks, and satisfying themselves as to the investment managers' expertise and the quality of their internal systems and controls;
- Reviewing on a regular basis the performance of the independent external advisers;

- In cases of unsatisfactory performance of the investment managers and independent external advisers, taking appropriate action;
- Reviewing policy on social, environmental and ethical matters and on the exercise of rights, including voting rights; and
- Reviewing the funds allocated to investment managers on a regular basis to ensure that the strategic asset allocation is maintained (rebalancing).

2.2 The investment managers are responsible for:

- The investment of the Pension Fund assets in respect of which they are appointed in compliance with applicable rules and legislation, the constraints imposed by this document and the detailed Investment Management Agreement covering their portion of the Pension Fund's assets;
- Stock selection within asset classes;
- Preparation of quarterly reports, including a review of investment performance;
- Attending meetings of the Committee as requested;
- Where specifically instructed, voting in accordance with the Pension Fund's policy.

2.3 The Global Custodian is responsible for:

- Its own compliance with prevailing legislation;
- Providing the administering authority with quarterly valuations of the Pension Fund's assets and details of all transactions during the quarter;
- Collection of income, tax reclaims, exercising corporate administration and cash management;
- Such other services as the Pension Fund shall procure, for example, in connection with performance measurement and reporting or fund accounting.

2.4 The Investment Advisers are responsible for:

- Assisting the Corporate Director Resources and the Committee in determining the overall investment strategy, the strategic asset allocation and that the Pension Fund is invested in suitable types of investment, and ensuring that investments are sufficiently diversified.
- Assisting the Corporate Director Resources and the Committee in the preparation and review of Policy documents;
- Assisting the Corporate Director Resources and the Committee in their regular monitoring of the investment managers' performance;

- Assisting the Corporate Director Resources and the Committee, where required, in the selection and appointment of investment managers, custodians and Pension Fund Actuary;
- Advising and assisting the Corporate Director Resources and the Committee on other investment related issues, which may arise from time to time; and
- Providing continuing education and training to the Committee.

2.5 The Actuary is responsible for:

- Providing advice as to the structure of the Pension Fund's liabilities, the maturity of the Pension Fund and its funding level in order to aid the Committee in balancing the short term and long-term objectives of the Pension Fund.
- Carrying out its responsibilities as set out in the FSS.
- Undertaking the statutory triennial valuation of the Pension Fund's assets and liabilities.

2.6 The Corporate Director Resources is responsible for:

- Ensuring compliance with this document and bringing breaches thereof to the attention of the Committee;
- Ensuring that this document is regularly reviewed and updated in accordance with the 2016 Investment Regulations;
- Exercising delegated powers granted by the County Council to:
    - Administer the financial affairs in relation to the County Council's functions as a pension fund administering authority;
    - Exercise those discretions under the Local Government Pension Scheme Regulations 2013 as appear from time to time in Pension Fund Statements of Policy; and
    - Authorise, in cases of urgency, the taking of any action by an investment manager of the Pension Fund which is necessary to protect the interests of the Pension Fund.
- Managing the cash balances of the Pension Fund which the Investment Managers have not invested

3 Investment Beliefs and Objectives

The Pension Fund has the following investment beliefs which help to inform the investment strategy derived from the decision making process:

- Funding, investment strategy and contribution rates are linked

- The strategic asset allocation is the key factor in determining the risk and return profile of the Pension Fund's investments
- Investing over the long term provides opportunities to improve returns
- Diversification across asset classes can help to mitigate against adverse market conditions and assist the Pension Fund to produce a smoother return profile due to returns coming from a range of different sources
- Managing risk is a multi-dimensional and complex task but the overriding principle is to avoid taking more risk than is necessary to achieve the Pension Fund's objectives
- Environmental, Social and Governance are important factors for the sustainability of investment returns over the long term
- Value for money from investments is important, not just absolute costs.
- Asset pooling will help reduce costs whilst providing more choice of investments and will therefore be additive to Pension Fund returns
- High conviction active management can add value to returns

The Administering Authority's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term. The Solvency Target is the amount of assets which the Fund requires to hold to meet its objective of paying all benefits arising as they fall due.

3.1 Investment strategy and the process for ensuring suitability of investments.

The Pension Fund's objective is to pay benefits as they fall due. The Pension Fund is currently assessed to have a deficit in respect to previously accrued liabilities, and so the strategy is focused on recovering this deficit as well as maintaining affordable contributions for future benefit accrual, without taking undue risks. Having a thorough understanding of the risks facing the Pension Fund is crucial and these are covered later in the statement.

The Pension Fund's asset strategy, along with an overview of the role each asset plays is set out in the table below:

Asset class	Allocation %	Benchmark & Performance Target	Role (s) within the strategy
Global Equities	40.0	MSCI All Country World Index +2%	Long term growth in excess of inflation expected; Generate investment income i.e. dividends.
Emerging Market Equities	7.0	MSCI Emerging Markets Net Index +2.5%	

Asset class	Allocation %	Benchmark & Performance Target	Role (s) within the strategy
Index Linked Gilts	20.0	FTSE Over 5 Year Index-Linked Gilt Index +0.5%	Provide protection from changes in inflation both in terms of capital value and income
Global Bonds	15.0	UK 3-month LIBOR +3.0%	Diversified source of income and provides a degree of protection from changes in interest rates. Some growth above gilts expected
Dynamic Asset Allocation	0.0	UK 3-month LIBOR +3.0%	Diversification and Tactical Asset Allocation
Global Property	8.0	UK Retail Price Inflation +5.0%	Diversification; Generate investment income; Provide some inflation-sensitive exposure; Illiquidity premium
Private Markets	10.0	tbc	Long term growth in excess of inflation expected; Diversification; Illiquidity premium

The Committee is responsible for the Pension Fund's asset allocation which is determined via a triennial strategy review as part of the valuation process. The review is both qualitative and quantitative and is undertaken by the Committee in conjunction with the actuary, officers and investment adviser. The review considers:

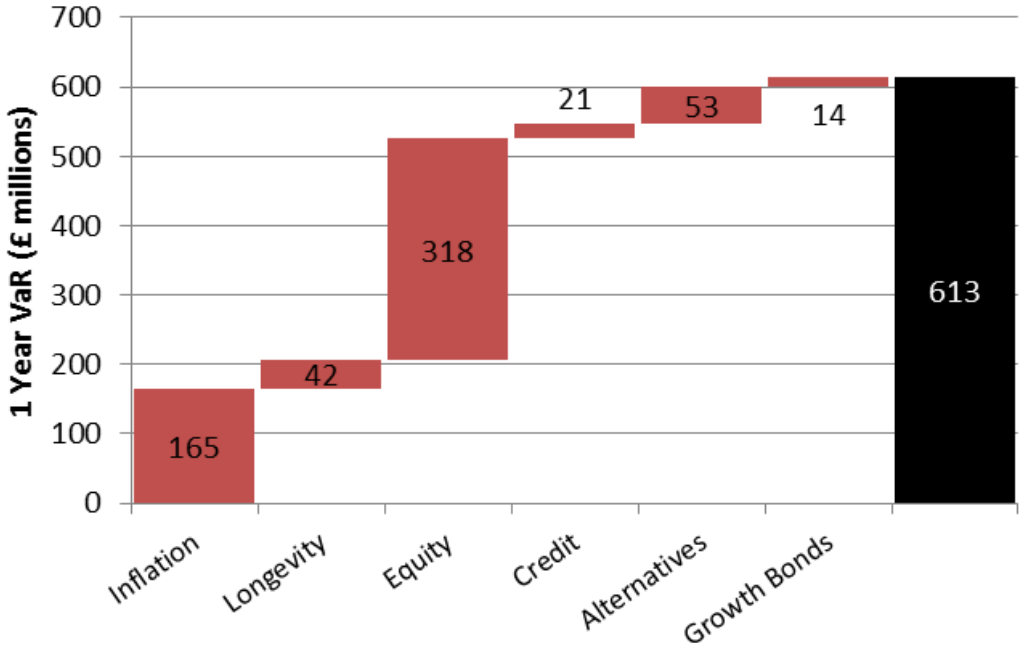
- The required level of return that will mean the Pension Fund can meet its future benefit obligations as they fall due
- The level of risk that the Pension Fund can tolerate in absolute terms, and in relation to its funding level and deficit
- An analysis of the order of magnitude of the various risks facing the Pension Fund is established in order that a priority order for mitigation can be determined
- The desire for diversification across asset class, region, sector, and type of security.

4 Risk measurement and management

The Committee assesses risks both qualitatively and quantitatively, with the starting point being the triennial strategy review. Risks are considered, understood and then prioritised accordingly.

(a) Investment risks

The Committee uses Risk Attribution Analysis to determine the order of magnitude of the main investment risks the Pension Fund is facing. The chart below shows the VaR (Value at Risk, essentially the minimum losses that would occur in a 1-in-20 event) facing the Pension Fund, split into major risk categories.



As an additional illustration of risk, the table below shows how a range of events (in isolation) could impact the Pension Fund:

Event	Event movement	Estimated Impact on Deficit
Fall in equity markets	30% fall in equities	£395m
Rise in Inflation	0.5% increase in inflation	£250m
Fall in discount rate	0.5% fall in the discount rate	£296m
Active Manager underperformance	3% underperformance from all active managers	£84m

As shown in both the Value-at-Risk attribution chart and the table above, the most significant risk that the Pension Fund is running is in relation to equities. Whilst not immaterial the risks being run by the use of active management is far smaller.

Equities

The largest risk that the Pension Fund is running is in relation to its equity holdings. Should equity market conditions deteriorate significantly this will have a negative impact on the funding level. The Pension Fund holds equities in order to provide the necessary returns to ensure that the Pension Fund remains affordable. The Committee believes that the extra returns that are expected to be generated by equities compensates the level of risk equities bring to the Pension Fund, but does believe in diversification, and looks to mitigate equity risk by investing significantly in bonds and alternatives. The Pension Fund is a long term investor but does require income over and above contributions received in order to pay pensions.

Inflation

Another significant risk that the Fund faces is in relation to inflation.The Pension Fund's liabilities are impacted by inflation both explicitly and implicitly. The Pension Fund will seek to invest in a range of assets that provide returns in excess of inflation and in some cases provide an inflation linked income, subject to a tolerable level of volatility.

Alternatives

The Pension Fund has a significant amount of assets allocated to a range of alternatives; previously via a dynamic asset allocation fund, but also through property. Going forward, the Fund will have a strategic allocation to Private Markets. The level of diversification these assets provide helps to reduce the Funds reliance on returns from equities. Illiquid assets such as property can also be a valuable source of income.

Active Manager Risk

Investment Managers are appointed to manage the Pension Fund's investments on its behalf, until such time as all of the Fund's assets are transitioned to BCPP. This risk is small relative to other risks; however the Pension Fund still addresses this risk. Extensive due diligence is used before managers are selected, with a number of different managers chosen to prevent concentration risk The investment managers are also monitored regularly by the Committee, Officers and by the Pension Fund's investment adviser.

The Pension Fund's portfolio is well diversified across asset classes, geography and asset managers. As different asset classes have varying correlations with other asset classes, the Pension Fund by investing in a range of different investments can minimise the level of risk run to a degree.

(b) Demographic Risks

The Pension Fund is subject to a range of demographic risks, but with particular reference to investment strategy, the Committee is aware of the potential for the Pension Fund to mature over time as the pensioner liability increases. A mature pension fund is likely to take less investment risk over time and this is considered at each strategy review. The more mature a pension fund, the more likely it is that disinvestments would need to be made to pay benefits. The Pension Fund is not in that situation at present as income from contributions and investments are greater than benefit payments. However, this situation is monitored regularly and formally as part of the actuarial valuation and strategy review.

(c) Cashflow Management Risks

The Pension Fund is becoming more mature and although it is cashflow positive after taking investment income into account, managing cashflow will become an increasingly important consideration in agreeing the investment strategy. Should this position change and cash outflows exceed cash inflows, mitigating actions would be taken such as investing in assets which produce cashflows.

(d) Governance Risks

The Pension Fund believes that there is a benefit to the Pension Fund to be gained from good governance in the form of either or both of an increased return and/or decreased risk. Poor governance could lead to opportunities and risks being missed, and have a detrimental effect on the funding level and deficit.

(e) Environmental, Social and Governance ('ESG') Risks

The Committee believes that ESG risks should be taken into account on an ongoing basis and are an integral part of the Pension Fund's strategy and objective of being a long term investor.

The Committee believes that engagement is key in relation to strong corporate governance, which in turn will enhance returns. Details of the Pension Fund's policies can be found later in this statement.

5 Approach to asset pooling

In order to satisfy the requirements of the Local Government Pension Scheme: Investment Reform and Guidance issued by the Department for Communities and Local Government (DCLG) in November 2015, the Administering Authority has elected to become a shareholder in BCPP Limited. BCPP was created in 2017 as a wholly owned private limited company registered in England and Wales, authorised and regulated by the Financial

Conduct Authority (FCA) as an alternative investment fund manager (AIFM). BCPP has 12 equal shareholders who are the administering bodies of the following 12 Funds:

- Bedfordshire Pension Fund
- Cumbria Pension Fund
- Durham Pension Fund
- East Riding Pension Fund
- Lincolnshire Pension Fund
- North Yorkshire Pension Fund
- Northumberland Pension Fund
- South Yorkshire Pension Fund
- South Yorkshire Passenger Transport Pension Fund
- Surrey Pension Fund
- Teesside Pension Fund
- Tyne and Wear Pension Fund
- Warwickshire Pension Fund

The partner Funds submitted their proposal to Government on 15th July 2016 and have received written confirmation from the Secretary of State to confirm that the proposal meets the criteria laid down in the guidance issued in November 2015 and set out below:

a) Asset pool(s) that achieve the benefits of scale;
b) Strong governance and decision making;
c) Reduced costs and excellent value for money; and
d) An improved capacity to invest in infrastructure.

5.1 Assets to be invested in BCPP Ltd

The Pension Fund's intention is to invest its assets via BCPP Ltd as and when suitable sub-funds become available. An indicative timetable for participating administering authorities to invest through BCPP Ltd was set out in the July 2016 submission to Government.

The key criteria for the Pension Fund's assessment of a BCPP Ltd sub-funds will be as follows:

- that the sub-fund enables access to an appropriate investment that meets the objectives and benchmark criteria set by the Pension Fund; and
- that there is financial benefit to the Pension Fund in investing in the sub-fund offered by BCPP Ltd.

The Fund's intention is to invest its assets through the BCPP pool as and when suitable investment solutions become available. At the time of preparing this statement, the Fund is planning to transition the first of its assets to BCPP. The first transition will be the Fund's investments in Global Equities. The Fund has also committed to develop a Private Market portfolio through BCPP. As the detailed parameters and objectives of BCPP sub funds are finalised, the Fund plans to transition further assets in line with the key criteria above.

Any assets not invested in BCPP Ltd will be reviewed at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money. The next such review will take place no later than 2020.

The Pension Fund will retain the decision making powers regarding asset allocation and will delegate the investment management function to BCPP Limited.

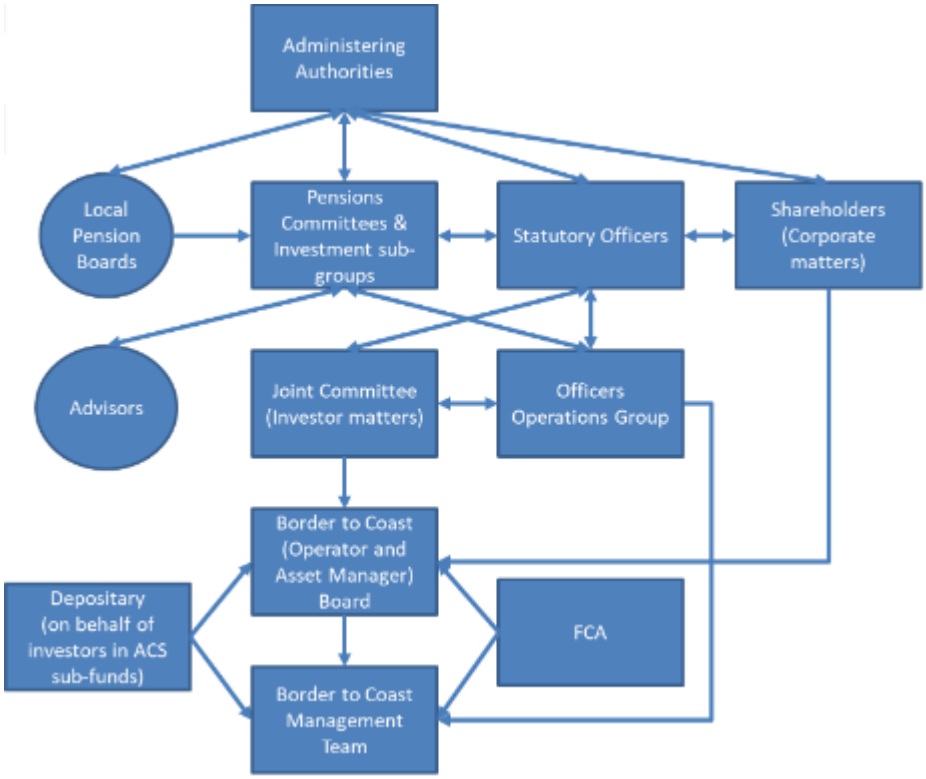
5.2 Structure and governance of BCPP Ltd

The 12 Partner Funds and BCPP work collaboratively to build the investment capabilities required to ensure that the Partner Funds are able to efficiently and effectively deliver their Strategic Asset Allocations in line with the following guiding principles:

- Meeting central Government's aims for governance, responsible investing, infrastructure and value for money
- One fund, one vote
- Funds retaining governance role and ownership of asset allocation
- Generating improved net-of-fees risk adjusted performance
- Border to Coast internal management capability
- Improved resilience and capacity over existing structures
- A shared team in one location

In order to hold BCPP to account, and to meet FCA requirements for a regulated asset manager, the Partner Funds stand at arms-length to Border to Coast during implementation and ongoing management of the sub-funds. The investment performance and capability of BCPP is overseen on a day to day basis by senior officers at each partner fund, and more formally on a quarterly basis by the Joint Committee, which is constituted of elected members from each partner fund. BCPP's performance as a company is overseen by shareholder representatives from the twelve administering authorities both on an ongoing basis and formally once a year at its AGM

The governance structure of BCPP is as follows:



The following groups support the governance of BCPP:

- **Joint Committee** – the Joint Committee is constituted from the 12 Pension Fund Chairs and will meet quarterly now that BCPP is established and functioning. It is the collaborative vehicle through which the individual Partner Funds provide collective oversight of the performance and direction of BCPP. Its remit includes oversight of progress towards the pooling of Partner Fund assets as a whole.
- **Officer Groups** - The Joint Committee is supported by the respective Authority s151 and Monitoring Officers and the Officer Operations Group (OOG), constituted from the 12 Senior Pension Fund Officers. These groups meet to discuss issues and give input to both Elected Members and BCPP as required. It is anticipated that the OOG will meet monthly, part of the meeting being attended by Border to Coast, part in closed session. The OOG work collaboratively together to ensure that due diligence over BCPP investment capabilities is carried out effectively on behalf of the Pension Committees.

- **Local Pension Boards** - In line with their role in other administrative and governance matters, the local pension boards provide support and challenge to the Pension Committee's decisions and decision-making process in relevant investment areas, and look to ensure appropriate governance is in place to provide effective monitoring.
- **Advisers** - Regulations require that Pension Funds take professional advice in respect of any investment decisions, and this is generally provided through Funds appointing Independent Investment Advisors and/or Investment Consultants. They will work with the Pension Committee and Officers to ensure that the strategic asset allocation can be effectively implemented through the use of the sub-funds available at BCPP.

6 Environmental, Social and Corporate Governance policy and policy of the exercise of rights (including voting rights) attaching to investments

The Committee must act with the best financial interests of the beneficiaries, present and future, in mind. The Committee believes that companies should be aware of the potential risks associated with adopting practices that are socially, environmentally or ethically unacceptable. As part of the investment decision-making process, Investment Managers are required to consider such practices and assess the extent to which this will detract from company performance and returns to shareholders.

Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. The quarterly report from investment managers should include details of voting activity.

The Pension Fund has never sought to implement a policy that explicitly excludes certain types of investments, companies or sectors except where they are barred by UK law. The Pension Fund believes that its influence as a shareholder is better deployed by engaging with companies, in order to influence behaviour and enhance shareholder value. The Pension Fund believes that this influence would be lost through a divestment or screening approach. The Pension Fund actively engages with companies through its investment managers.

Ultimately the Pension Fund will always retain the right to disinvest from certain companies or sectors in the event that all other approaches are unsuccessful and it is determined that the investment is no longer aligned with the interests of the Pension Fund or that the issue poses a material financial risk.

6.1 Myners Principles

Although not specifically referenced in the Regulations, the Committee feels that assessment of compliance with the Myners Principles is a valuable governance tool. A copy of the Pension Fund's Myners Compliance Statement can be found in Appendix 1.

7 Responsible Investing with BCPP

The purpose of BCPP is to make a difference to the investment outcomes for partner funds through pooling, by creating a stronger voice and investing responsibly now and into the future to enable sustainable performance. The LGPS (Management and Investment of Funds) 2016 regulations state that the responsibility for stewardship, which includes shareholder voting, remains with individual Funds. Stewardship, day-to-day administration and implementation is delegated by the Fund to BCPP for any assets managed by Border to Coast, with appropriate monitoring and challenge to ensure this continues to be in line with the Fund's requirements.

To leverage scale and for operational purposes, BCPP has, in conjunction with partner funds, developed an Responsible Investment Policy and accompanying Corporate Governance & Voting Guidelines to ensure clarity of approach on behalf of partner funds. The Pension Fund Committee and the committees of all 11 other partners in BCPP agreed to adopt BCPP's Responsible Investment (RI) Policy into their ISS. The policy is monitored with regular reports to BCPP's Chief Investment Officer (CIO), Investment Committee, Board, Joint Committee and partner funds. It is reviewed at least annually, or whenever revisions are proposed and updated as necessary.

BCPP believes that businesses that are governed well and run in a sustainable way are more resilient, able to survive shocks and have the potential to provide better financial returns for investors. ESG issues can have a material impact on the value of financial assets and on the long-term performance of investments, and therefore need to be considered across all asset classes in order to better manage risk and generate sustainable, long term returns. Well-managed companies with strong governance are more likely to be successful long-term investments.

BCPP is an active owner and steward of its investments, both internally and externally managed, across all asset classes. The commitment to RI is communicated in BCPP's UK Stewardship Code compliance statement. As a long-term investor and representative of asset owners, BCPP will therefore, hold companies and asset managers to account regarding ESG factors that have the potential to impact corporate value. BCPP will incorporate such factors into investment analysis and decision making, enabling long-term sustainable investment performance for partner funds. As a shareowner, BCPP has a

responsibility for effective stewardship of the companies it invests in, whether directly or indirectly through mandates with fund managers. It will practice active ownership through voting, monitoring companies, engagement and litigation.

BCPP's full approach to sustainability, including Voting and Engagement, Responsible Investment Policies, Collaborations, and Corporate Policies can be found online at https://www.bordertocoast.org.uk/sustainability/.

8 Advice Taken

In creating this statement, the Pension Fund has taken advice from its Investment Adviser. Also, in relation to each of the constituent parts, such as the asset allocation and risk mitigation, the Pension Fund has taken advice from its Investment Adviser, Mercer, and the Scheme Actuary, Aon Hewitt. In providing investment advice, Mercer is regulated by the Financial Conduct Authority.

Appendix 1 – Myners Principles

This appendix sets out the extent to which Durham County Council as the Administering Authority of the Durham County Council Pension Fund complies with the six principles of investment practice set out in the document published in November 2012 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012", in future, compliance with guidance given by the Secretary of State will be reported.

Principle 1 —Effective decision-making

Fully compliant: Investment decisions are made by those with the skill, information and resources necessary to take them effectively. A programme covering investment issues is being developed for new members joining the Committee and training is provided to all members.

Principle 2 –Clear objectives

Fully compliant: The overall investment objective for the Pension Fund is set out in the Funding Strategy Statement.

Principle 3 –Risk and Liabilities

Fully compliant: The overall investment objective is considered by the Pension Fund. The risks associated with the major asset classes in which the Pension Fund's assets are invested is regularly considered. A risk register has been completed for the Pension Fund and reports from Internal and External Audit are considered by the Committee.

Principle 4 –Performance Assessment

Partial compliance: Appropriate benchmarks have been set in consultation with the investment adviser and the actuary. Benchmarks are considered regularly as part of the review of the Strategic Asset Allocation. Performance against benchmarks is considered quarterly at the Committee. Investment Managers' performance is measured quarterly. Separate monitoring of Committee performance and investment adviser performance has yet to be established.

Principle 5 –Responsible Ownership

Partial compliance: The Pension Fund's policy for socially responsible investing is set out in the Statement of Investment Principles and (from April 2017) the Investment Strategy Statement. Explicit written mandates agreed with all investment managers. Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. Normal practice is to allow the Investment Managers to follow their in-house voting policy unless otherwise instructed by the Committee. The mandates do not specifically incorporate the principle of the US Department of Labor Interpretative Bulletin on activism.

Principle 6 –Transparency and Reporting

Fully compliant: The Committee acts in a transparent manner, communicating with its stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives through the publication of Committee reports and Minutes on the County Council website. The Funding Strategy Statement and the Statement of Investment Principles are also available on the internet and are included in the Pension Fund's Annual Report and Accounts. The Annual Report and Accounts includes the statutory documents that the Pension Fund is required to provide.

The Pension Fund provides regular communication to scheme members in a Newsletter and Annual Statements which are considered the most appropriate form.

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Pension Fund

Funding Strategy Statement

31 March 2017

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(A) STATUTORY BACKGROUND AND KEY ISSUES

1. The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 came into effect on 1 April 2004. They originally provided the statutory framework from which Local Government Pension Schemes (LGPS) administering authorities were required to prepare a Funding Strategy Statement (FSS) by 31 March 2005. The requirements at the date of writing this Statement are now set out under Regulation 58 of the Local Government Pension Scheme Regulations 2013 (the Regulations).

2. Key issues:

- After consultation with such persons as it considers appropriate (including officers and elected members and Fund employers), the administering authority is required to prepare and publish their funding strategy.

- In preparing the FSS, the administering authority has to have regard to:

  - guidance published by CIPFA in October 2012 entitled "Guidance on Preparing and Maintaining a Funding Strategy Statement and to the Fund's Statement of Investment Principles" and updated guidance published by CIPFA in September 2016.
  - its Investment Strategy Statement (ISS) or Statement of Investment Principles (SIP) published under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the Investment Regulations).

- The FSS must be revised and published whenever there is a material change in policy either on the matters set out in the FSS or the ISS or SIP.

- Each Fund Actuary must have regard to the FSS as part of the fund valuation process and the Fund Actuary has therefore been consulted on the contents of this FSS.

- The FSS addresses the issue of managing the need to fund benefits over the long term, whilst at the same time, allowing for scrutiny and accountability through improved transparency and disclosure.

- Until 1 April 2014, the Scheme was a defined benefit final salary scheme. From 1 April 2014, the Scheme is a defined benefit career average revalued earnings scheme. The benefits at the date of writing this Statement are specified in the

Regulations. Constraints on the levels of employee contributions are also specified in the Regulations.

- Employer contributions are determined in accordance with the Regulations, which require that an actuarial valuation is completed every three years by the Fund Actuary.

3. This Statement was reviewed as part of the triennial valuation as at 31 March 2016, and has been updated in March 2017.

(B) PURPOSE OF THE FUNDING STRATEGY STATEMENT

4. The purpose of this Funding Strategy Statement (FSS) is to document the processes by which the Administering Authority:

- establishes a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;

- supports the regulatory requirement of the desirability of maintaining as nearly constant a primary rate of employer contribution rates as possible;

- enables overall employer contributions to be kept as constant as possible and (subject to the Administering Authority not taking undue risks and ensuring that the regulatory requirements are met) at reasonable cost to the taxpayers, scheduled, designating and admitted bodies;

- ensures that the regulatory requirements to set contributions so as to ensure the solvency and long-term cost efficiency of the Fund are met; and

- takes a prudent longer-term view of funding the Fund's liabilities.

The intention is for this Strategy to apply comprehensively for the Fund as a whole to reflect its best interests, recognising that there will always be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the Statement, it must remain a single Strategy for the Administering Authority to implement and maintain.

(C) PURPOSE AND AIMS OF THE PENSION FUND

5. The purpose of the fund is to:

Invest monies in respect of contributions, transfer values and investment income to produce a Fund to pay Scheme benefits over the long term and in so doing to smooth out the contributions required from employers over the long term.

6. The aims of the fund are to:

- **Comply with Regulation 62 of the Regulations and specifically to adequately fund benefits to secure the Fund's solvency while taking account of the desirability of maintaining as nearly constant primary employer contribution rates as possible**

  The Administering Authority aims to keep employer contributions as nearly constant as possible, whilst taking account of:

  - the regulatory requirement to secure solvency and long term cost efficiency, which should be assessed in the light of the risk profile of the Fund and risk appetite of the Administering Authority and employers

  - the requirement to ensure that costs are reasonable to Scheduled Bodies, Admission Bodies, other bodies and to taxpayers (subject to not taking undue risks), and

  - maximising return from investments within reasonable risk parameters

  In order to achieve nearly constant employer contribution rates there may be a need to invest in assets that match the employer's liabilities. In this context, 'match' means assets which behave in a similar manner to the liabilities as economic conditions alter. For the liabilities represented by benefits payable by the Local Government Pension Scheme, such assets would tend to comprise gilt edged investments.

  The Administering Authority currently invests a large proportion of the Fund in equities, which are perceived as having higher long-term rates of return consistent with the requirement to maximise the returns from investments, within reasonable risk parameters. These assets are more risky in nature than fixed interest investments, and this can lead to more volatile returns in the short-term and a failure to deliver the anticipated returns in the long term.

  This can have an effect on employer contribution rates as the funding position of the Pension Fund is measured at the triennial valuations. The impact of this

can be reduced by smoothing adjustments at each actuarial valuation. Smoothing adjustments recognise that markets can rise and fall too far.

The Administering Authority recognises that there is a balance to be struck between the investment policy adopted, the smoothing mechanisms used at valuations, and the resultant stability of employer contribution rates from one valuation period to the next.

The Administering Authority also recognises that the position is potentially more volatile for admission bodies with short term contracts where utilisation of smoothing mechanisms is less appropriate.

- **Manage employers' liabilities effectively**

  The Administering Authority seeks to manage employers' liabilities effectively. In a funding context, this is achieved by seeking actuarial advice and regular monitoring of the investment of the Fund's assets through quarterly meetings of the Pension Fund Committee and appropriate segregation of employers for funding purposes.

- **Ensure that sufficient resources are available to meet all liabilities as they fall due**

  The Administering Authority recognises the need to ensure that the Fund has sufficient liquid assets to pay pensions, transfer values and other expenses. This position is continuously monitored and the cash available from contributions and cash held by Fund Managers is reviewed on a quarterly basis by the Pension Fund Committee.

- **Maximise the returns from investments within reasonable risk parameters.**

  The Administering Authority recognises the desirability of maximising returns from investments within reasonable risk parameters, through investment in unmatched investments. Investment returns higher than those of fixed interest and index-linked bonds are sought from investment in equities, property and other growth assets. The Administering Authority ensures that risk parameters are reasonable by:

  - ❖ Taking advice from its professional advisers, e.g. the Fund Actuary, Investment advisers and investment managers

- ❖ Controlling levels of investment in asset classes through the SIP or ISS

- ❖ Limiting default risk by restricting investment to asset classes recognised as appropriate for UK Pension Funds.

- ❖ Analysing the volatility and absolute return risks represented by those asset classes in collaboration with the Investment Adviser and Fund Managers, and ensuring that they remain consistent with the risk and return profiles anticipated in the funding strategy statement.

- ❖ Limiting concentration risk by developing a diversified investment strategy.

- ❖ Monitoring the mismatching risk, i.e. the risk that the investments do not move in line with the Fund's liabilities.

(D) RESPONSIBILITIES OF THE KEY PARTIES

7. Although a number of parties including investment fund managers and external auditors have responsibilities to the fund, the three parties whose responsibilities to the Fund are of particular relevance are the Administering Authority, the individual employers and the Fund Actuary:

8. The administering authority should:

- Administer the Fund

- Collect employer and employee contributions as set out in the Regulations

- Determine a schedule of due dates for the payment of contributions - Section 70(1)(a) of the Pensions Act 2004 suggests that Administering Authorities are now required to report breaches as defined in Section 70 (2) of the 2004 Act. This places monitoring of the date of receipt of employer contributions on the Administering Authority and therefore places a duty to report material late payments of contributions to the Pensions Regulator.

- Take action to recover assets from admission bodies whose Admission Agreement has ceased and other bodies whose participation in the Fund has ceased.

- Invest surplus monies in accordance with the Regulations.

- Pay from the Fund the relevant entitlements as set out in the Regulations.

- Ensure that cash is available to meet liabilities as and when they fall due.

- take measures as set out in the regulations to safeguard the fund against the consequences of employer default

- Manage the valuation process in consultation with the Fund's Actuary.

- Ensure effective communications with the Fund's Actuary to:

    - Ensure that the Fund Actuary is clear about the content of the Funding Strategy Statement;
    - Ensure reports are made available as required by guidance and regulation;
    - Agree timetables for the provision of information and valuation results;
    - Ensure provision of accurate data; and
    - Ensure that participating employers receive appropriate communications.

- Consider the appropriateness of interim valuations.

- Prepare and maintain an FSS and a SIP or ISS, both after proper consultation with interested parties, and

- Monitor all aspects of the fund's performance and funding and amend the FSS and SIP or ISS regularly as part of the on-going monitoring process.

- Effectively manage any potential conflicts of interest arising from its dual role as both Administering Authority and as a Scheme Employer.

- Enable the local Pension Board to review the valuation process as set out in their terms of reference

9. The individual employers should:

- Deduct contributions from employees' pay correctly.

- Pay all ongoing contributions, including their own as determined by the actuary, promptly by the due date.

- Pay any exit payments required in the event of their ceasing participation in the Fund.

- Develop a policy on certain discretions and exercise discretions within the regulatory framework, ensuring that the Administering Authority has copies of current policies covering those discretions.

- Make additional contributions in accordance with agreed arrangements in respect of, for example, additional membership or pension, augmentation of scheme benefits and early retirement strain, and

- Notify the administering authority promptly of all changes to membership, or as may be proposed, which affect future funding.

- Noting, and if desired responding to, any consultation regarding the Funding Strategy Statement, the Statement of Investment Principles, or other policies.

10. The fund actuary should:

- Prepare triennial valuations including the setting of employers' contribution rates at a level to ensure solvency and long term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and the Regulations.

- Prepare advice and calculations in connection with bulk transfers, the funding aspects of individual benefit-related matters, valuations of exiting employers and other forms of security for the Administering Authority against the financial effect on the Fund of the employer's default. Such advice will take account of the funding position and Funding Strategy Statement, as well as other relevant matters when instructed to do so.

- Assist the Administering Authority in assessing whether employer contributions need to be revised between actuarial valuations as required or permitted by the Regulations.

- In response to a request from the Administering Authority, assess the impact of Regulatory changes on costs.

- Ensure that the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the Administering Authority.

(E) FUNDING TARGETS, SOLVENCY AND EMPLOYER ASSET SHARES

Risk based approach

11. The Fund utilises a risk based approach to funding strategy.

12. A risk based approach entails carrying out the actuarial valuation on the basis of the assessed likelihood of meeting the funding objectives. In practice, three key decisions are required for the risk based approach:

    - what the Solvency Target should be (the funding objective - where the Administering Authority wants the Fund to get to),

    - the Trajectory Period (how quickly the Administering Authority wants the Fund wants to get there), and

    - the Probability of Funding Success (how likely the Administering Authority wants it to be now that the Fund will actually achieve the Solvency Target by the end of the Trajectory Period).

    These three choices, supported by complex risk modelling carried out by the Fund Actuary, define the discount rate and, by extension, the appropriate levels of contribution payable. Together they measure the riskiness of the funding strategy.

    These three terms are considered in more detail below.

Solvency and 'funding success'

13. The Administering Authority's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term. The Solvency Target is the amount of assets which the Fund wishes to hold at the end of the Trajectory Period (see later) to meet this aim.

14. The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target. The Administering Authority believes that its funding strategy will ensure the solvency of the Fund because employers

collectively have the financial capacity to increase employer contributions should future circumstances require, in order to continue to target a funding level of 100%

- For Scheduled Bodies, and certain other bodies, of sound covenant whose participation is indefinite in nature, appropriate actuarial methods and assumptions are taken to be measurement by use of the Projected Unit method of valuation, and using assumptions such that, if the Fund's financial position continued to be assessed by use of such methods and assumptions, and contributions were paid in accordance with those methods and assumptions, there would be a chance of at least 80% that the Fund would continue to be 100% funded over a time period considered appropriate at the time of assessment. The level of funding implied by this is the Solvency Target. For the purpose of this Statement, the required level of chance is defined as the Probability of Maintaining Solvency.

- For certain Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit, the required Probability of Maintaining Solvency will be set at a level higher than 80% dependent on circumstances. For most such bodies, the chance of achieving solvency will be set commensurate with assumed investment in an appropriate portfolio of Government index linked and fixed interest bonds after exit.

Probability of Funding Success

15. The Administering Authority deems funding success to have been achieved if the Fund, at the end of the Trajectory Period, has achieved the Solvency Target. The Probability of Funding Success is the assessed chance of this happening based on the level of contributions payable by members and employers.

16. Consistent with the aim of enabling employers' contribution rates to be kept as nearly constant as possible, the required chance of achieving the Solvency Target at the end of the relevant Trajectory Period for each employer or employer group can be altered at successive valuations within an overall envelope of acceptable risk. The Administering Authority will not permit contributions to be set following a valuation that have an unacceptably low chance of achieving the Solvency Target at the end of the relevant Trajectory Period.

17. At the 2016 valuation, the Trajectory Period used was 25 years, and the probability of Funding Success was set to be 67%.

Funding Target

18. In order to satisfy the legislative requirement to secure long term cost efficiency the Administering Authority's aim is for employer contributions to be set so as to make provision for the cost of benefit accrual, with an appropriate adjustment for any surplus or deficiency. This is achieved through the setting of a Funding Target.

19. The Funding Target is the amount of assets which the Fund needs to hold at the valuation date to pay the liabilities at that date as indicated by the chosen valuation method and assumptions. It is a product of the triennial actuarial valuation exercise and is not necessarily the same as the Solvency Target. It is instead the product of the data, chosen assumptions, and valuation method. The valuation method including the components of Funding Target, future service contributions and any adjustment for surplus or deficiency set the level of contributions payable, and dictate the chance of achieving the Solvency Target at the end of the Trajectory Period (defined below). The Funding Target will be the same as the Solvency Target only when the methods and assumptions used to set the Funding Target are the same as the appropriate funding methods and assumptions used to set the Solvency Target (see above).

20. Consistent with the aim of enabling employers' primary contribution rates to be kept as nearly constant as possible:

    - Contribution rates are set by use of the Projected Unit valuation method for most employers. The Projected Unit method is used in the actuarial valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the future service (primary) contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period.

    - For employers who no longer admit new members, the Attained Age valuation method is normally used. This means that the future service (primary) contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.

Application to different types of body

21. Some comments on the principles used to derive the Solvency and Funding Targets for different bodies in the Fund are set out below.

    - **Scheduled Bodies and certain other bodies of sound covenant**
      The Administering Authority will adopt a general approach in this regard of

assuming indefinite investment in a broad range of assets of higher risk than low risk assets for Scheduled Bodies and certain other bodies which are long term in nature.

- **Admission Bodies and certain other bodies whose participation is limited** For Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit the Administering Authority will have specific regard to the potential for participation to cease (or to have no contributing members), the potential timing of such exit, and any likely change in notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date of exit (i.e. whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities).

Full Funding and Solvency

22. The Fund is deemed to be fully funded when the assets held are equal to 100% of the Funding Target, where the funding target is assessed based on the sum of the appropriate funding targets across all the employers/groups of employers..

23. The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target.

Recovery Periods

24. The Recovery Period in relation to an employer is the period between the valuation date and the date on which solvency is targeted to be achieved.

25. Where a valuation shows the Fund to be in surplus or deficit against the Funding Target, employers' contribution rates will be adjusted to reach the solvent position over a number of years. The Recovery Period in relation to an employer or group of employers is therefore a period over which any adjustment to the level of contributions in respect of a surplus or deficiency relative to the Funding Target used in the valuation is payable.

26. The Recovery Period applicable for each employer is set by the Fund Actuary in consultation with the Administering Authority and the employer, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.

27. The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefits payments over a long period of time. For employers of sound covenant, the Administering Authority is therefore prepared to agree Recovery Periods that are longer than the average future working lifetime of the membership of that employer. In general for employers that are closed to new entrants and are of sufficient term, the Recovery Period is set to be the estimated future working lifetime of the active membership (i.e. the estimated period of time until the last active member leaves or retires). The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible.

28. However, the Administering Authority also recognises the risk involved in relying on long Recovery Periods and has agreed with the Actuary a maximum recovery period of 30 years for both, for employers which are assessed by the Administering Authority as being a long term secure employer. It is the intention of the Administering Authority to agree with employers a Recovery Period of as short a time as possible within this 30 year limit having regard to the affordability of the revised contribution rate in general taking into account the legislative requirements of securing solvency and maintaining as nearly a constant a contribution rate as possible. A period of 21 years has been used for Durham County Council at the 2016 valuation, the largest employer in the Fund. Recovery Periods for other employers or employer groups may be shorter and may not necessarily be the same as each other, in order to suitably balance risk to the Fund and cost to the employer.

29. For each individual employer the following will also be taken into account:

- covenant and strength of any guarantee relating to an employer and hence the risk of default
- length of participation in the Fund
- whether the employer is closed to new entrants or is likely to have a contraction in its membership of the Fund

Stepping

30. The Administering Authority will also consider at each valuation whether new contribution rates should be payable immediately or reached by being stepped over a number of years. Stepping is a generally accepted method of smoothing the impact of rate changes for local authority pension funds. In consultation with the Actuary, the Administering Authority accepts that long term employers may step up

to the new rates. This is in line with the aim of having contribution rates as nearly constant as possible. The Administering Authority usually allows a maximum of three steps however, in exceptional circumstances up to six steps may be used.

Grouping

31. In some circumstances it may be desirable to group employers within the Fund together for funding purposes (i.e. to calculate employer contribution rates). Reasons might include reduction of volatility of contribution rates for small employers, facilitating situations where employers have a common source of funding or accommodating employers who wish to share the risks related to their participation in the Fund.

32. The Administering Authority recognises that grouping can give rise to cross subsidies from one employer to another over time. Employers may be grouped entirely, such that all of the risks of participation are shared, or only partially grouped such that only specified risks are shared. The Administering Authority's policy is to consider the position carefully at initial grouping and at each valuation and to notify each employer that is grouped which other employers it is grouped with and details of the grouping method used. If the employer objects to this grouping, it will be set its own contribution rate.

33. Where employers are grouped together for funding purposes, this will only occur with the consent of the employers involved.

34. All employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service, and, from 1 April 2016, survivors pensions on death in service and payment of ill health pensions – in other words, the cost of such benefits is shared across the employers in the Fund. Such benefits can cause funding strains which could be significant for some of the smaller employers without insurance or sharing of risks. The Fund, in view of its size, does not see it as cost effective or necessary to insure these benefits externally and this is seen as a pragmatic and low cost approach to spreading the risk.

35. Where employers are pooled together for funding and contribution purposes, all risks are shared within the group and they have a single contribution rate.

Asset shares notionally allocated to employers

36. In order to establish contribution rates for individual employers or groups of employers it is convenient to notionally subdivide the Fund as a whole between the employers (or group of employers where grouping operates), as if each employer had its own asset share within the Fund.

37. This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, or ownership of any particular assets or groups of assets by any individual employer or group.

Roll-forward of asset shares

38. The asset share allocated to each employer will be rolled forward allowing for all cash flows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income. In general no allowance is made for the timing of contributions and cash flows for each year are assumed to be made half way through the year with investment returns assumed to be uniformly earned over that year. However, where significant one-off employer contributions have been paid, allowance is made for the timing of such contributions.

39. Further adjustments are made for:

- A notional deduction to meet the expenses paid from the Fund in line with the assumption used at the previous valuation.

- Allowance for any known material internal transfers in the Fund (cash flows will not exist for these transfers). The Fund Actuary will assume an estimated cash flow equal to the value of the liabilities determined consistent with the Funding Target transferred from one employer to the other unless some other approach has been agreed between the two employers.

- Allowance for lump sum death in service and other benefits shared across all employers in the Fund (see earlier).

- An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund which will take into account any gains or losses related to the orphan liabilities.

40. In some cases information available will not allow for such cash flow calculations. In such a circumstance:

- Where, in the opinion of the Fund Actuary, the cash flow data which is unavailable is of low materiality, estimated cash flows will be used.

- Where, in the opinion of the Fund Actuary, the cash flow data which is unavailable is material, the Fund Actuary will instead use an analysis of gains and losses to roll forward the asset share. Analysis of gains and losses methods are less precise than use of cash flows and involve calculation of gains and losses relative to the surplus or deficiency exhibited at the previous valuation. Having established an expected surplus or deficiency at this valuation, comparison of this with the liabilities evaluated at this valuation leads to an implied notional asset holding.

41. Analysis of gains and losses methods will also be used where the results of the cash flow approach appears to give unreliable results perhaps because of unknown internal transfers.

Fund maturity

42. To protect the Fund, and individual employers, from the risk of increasing maturity producing unacceptably volatile contribution adjustments as a percentage of pay the Administering Authority will normally require contributions as monetary amounts from employers in respect of any disclosed funding deficiency.

43. In certain circumstances, for secure employers considered by the Administering Authority as being long term in nature, contribution adjustments to correct for any disclosed deficiency may be set as a percentage of payroll. Such an approach carries an implicit assumption that the employer's payroll will increase at an assumed rate. If payroll fails to grow at this rate, or declines, insufficient corrective action will have been taken. To protect the Fund against this risk, the Administering Authority will monitor payrolls and where evidence is revealed of payrolls not increasing at the anticipated rate, the Administering Authority will consider requiring deficit contributions as monetary amounts rather than percentages of payroll.

(F) SPECIAL CIRCUMSTANCES RELATED TO CERTAIN EMPLOYERS

Interim reviews

44. Regulation 64 of the Regulations provides the Administering Authority with a power to carry out valuations in respect of employers who are likely to become an exiting employer, and for the Actuary to certify revised contribution rates, between triennial valuation dates.

45. The Administering Authority's overriding objective at all times in relation to employers is that, where possible, there is clarity over the Funding Target for that body, and that contribution rates payable are appropriate for that Funding Target. However, this is not always possible as any exit date may be unknown (for example, participation may be assumed at present to be indefinite), and also because market conditions change daily.

46. The Administering Authority's general approach in this area is as follows:

- Where the exit date is known, and is more than 3 years hence, or is unknown and assumed to be indefinite, the Administering Authority will generally not deem it necessary to carry out an interim valuation.

- For Admission Bodies admitted under paragraph 1(d) of Part 3, Schedule 2 of the Regulations falling into the above category, the Administering Authority sees it as the responsibility of the relevant Scheme Employer to instruct it if an interim valuation is required. Such an exercise would be at the expense of the relevant Scheme Employer unless otherwise agreed.

- A material change in circumstances, such as the exit date becoming known, material membership movements or material financial information coming to light may cause the Administering Authority to informally review the situation and subsequently formally request an interim valuation.

- For an employer whose participation is due to cease within the next 3 years, the Administering Authority will keep an eye on developments and may see fit to request an interim valuation at any time.

47. Notwithstanding the above guidelines, the Administering Authority reserves the right to request an interim valuation of any employer at any time if Regulation 64(4) of the Regulations applies.

Guarantors

48. Some employers may participate in the Fund by virtue of the existence of a Guarantor. The Administering Authority maintains a list of employers and their associated Guarantors. The Administering Authority, unless notified otherwise, sees the duty of a Guarantor to include the following:

- If an employer exits and defaults on any of its financial obligations to the Fund, the Guarantor is expected to provide finance to the Fund such that the Fund receives the amount certified by the Fund Actuary as due, including any interest payable thereon.
- If the Guarantor is an employer in the Fund and is judged to be of suitable covenant by the Administering Authority, the Guarantor may defray some of the financial liability by subsuming the residual liabilities into its own pool of Fund liabilities. In other words, it agrees to be a source of future funding in respect of those liabilities should future deficiencies emerge.

49. During the period of participation of the employer a Guarantor can at any time agree to the future subsumption of any residual liabilities of an employer. The effect of that action would be to reduce the Funding and Solvency Target for the employer, which would probably lead to reduced contribution requirements.

Bonds and other securitisation

50. Paragraph 6 of Part 3, Schedule 2 of the Regulations creates a requirement for a new Admission Body to carry out, to the satisfaction of the Administering Authority (and the Scheme Employer in the case of an Admission Body admitted under paragraph 1(d)(i) of that Part), an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.

51. Where the level of risk identified by the assessment is such as to require it, the admission body shall enter into an indemnity or bond with an appropriate party. Where it is not desirable for an Admission Body to enter into an indemnity or bond, the body is required to secure a guarantee in a form satisfactory to the Administering Authority from an organisation who either funds, owns or controls the functions of the admission body.

52. The Administering Authority's approach in this area is as follows:

- In the case of Admission Bodies admitted under Paragraph 1(d) of Part 3, Schedule 2 of the Regulations and other Admission Bodies with a Guarantor,

and so long as the Administering Authority judges the relevant Scheme Employer or Guarantor to be of sufficiently sound covenant, any bond exists purely to protect the relevant Scheme Employer on default of the Admission Body. As such, it is entirely the responsibility of the relevant Scheme Employer or Guarantor to arrange any risk assessments and decide the level of required bond. The Administering Authority will be pleased to supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer, but this should not be construed as advice to the relevant Scheme Employer on this matter. The Administering Authority notes that levels of required bond cover can fluctuate and recommends that relevant Scheme Employers review the required cover regularly, at least once a year.

- In the case of:
  - admission bodies admitted under paragraph 1(e) of Part 3, Schedule 2;
  - admission bodies admitted under paragraph 1(d) of Part 3, Schedule 2 where the administering authority does not judge the Scheme Employer to be of sufficiently strong covenant;
  - other admission bodies with no Guarantor or where the administering authority does not judge the Guarantor to be of sufficiently strong covenant;

the administering authority must be involved in the assessment of the required level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed the level of bond cover. The Administering Authority will supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer to form a view on what level of bond would be satisfactory. The Administering Authority will also on request supply this to the Admission Body or Guarantor. This should not be construed as advice to the Scheme Employer, Guarantor or Admission Body. The Administering Authority notes that levels of required bond cover can fluctuate and will recommend the relevant Scheme Employer to jointly review the required cover with it regularly, at least once a year.

Subsumed liabilities

53. Where an employer is exiting the Fund such that it will no longer have any contributing members, it is possible that another employer in the Fund agrees to provide a source of future funding in respect of any emerging deficiencies in respect of those liabilities.

54. In such circumstances the liabilities are known as subsumed liabilities (in that responsibility for them is taken on by the accepting employer). For such liabilities

the Administering Authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of the liabilities of the accepting employer. Generally this will mean assuming continued investment in more risky investments than Government bonds.

Orphan liabilities

55. Where an employer is exiting the Fund such that it will no longer have any contributing members, unless any residual liabilities are to become subsumed liabilities, the Administering Authority will act on the basis that it will have no further access for funding from that employer once any exit valuation, carried out in accordance with Regulation 64 of the Regulations, has been completed and any sums due have been paid. Residual liabilities of employers from whom no further funding can be obtained are known as orphan liabilities.

56. The Administering Authority will seek to minimise the risk to other employers in the Fund that any deficiency arises on the orphan liabilities such that this creates a cost for those other employers to make good the deficiency. To give effect to this, the Administering Authority will seek funding from the outgoing employer sufficient to enable it to match the liabilities with low risk investments, generally Government fixed interest and index linked bonds.

57. To the extent that the Administering Authority decides not to match these liabilities with Government bonds of appropriate term then any excess or deficient returns will be added to or deducted from the investment return to be attributed to the other employer's notional assets.

58. Liabilities in the Fund which are already orphaned will be assumed to be 100% funded on the appropriate funding target at each triennial valuation. This will be achieved by the Actuary notionally re-allocating assets within the Fund as required.

Commencement of Employers

59. When a new employer starts in the Fund, and members transfer from another employer in the Fund, a notional transfer of assets is needed from the original employer to the new employer. The approach used will depend on the circumstances surrounding the commencement of the new employer and some comments are set out below.

60. When a new admission body starts in the Fund due to an oursourcing event, they will usually start as fully funded on the Funding Target appropriate to the new employer. This means that any past service surplus or deficit for the members who are

transferring to the new employer remains with the original employer and does not transfer to the new employer.

61. For academies, a prioritised share of fund approach is followed. This involves fully funding the non-active members of the original employer at the previous triennial valuation, and using the residual assets to calculate the funding level applicable to the active members of the original employer. This is rolled forward in line with the progression of the overall funding level of the original employer during the period from the last valuation date to the date of commencement of the academy. The funding level applicable to the active members is then used to calculate the notional asset transfer to the new employer.

62. In other circumstances the notional asset transfer will often be subject to the agreement between the relevant parties and the Administering Authority (who will take advice from the Fund Actuary). In the event of any dispute the Administering Authority will take make the final decision having taken account of the issues related to the setting up of the new employer.

Cessation of participation

63. Where an employer becomes an exiting employer, an exit valuation will be carried out in accordance with Regulation 64 of the Regulations. That valuation will take account of any activity as a consequence of exit regarding any existing contributing members (for example any bulk transfer payments due) and the status of any liabilities that will remain in the Fund.

64. In particular, the exit valuation will distinguish between residual liabilities which will become orphan liabilities, and liabilities which will be subsumed by other employers.

- For orphan liabilities the Funding Target in the exit valuation will anticipate investment in low risk investments such as Government bonds.
- For subsumed liabilities the exit valuation will anticipate continued investment in assets similar to those held in respect of the subsuming employer's liabilities.

65. Regardless of whether the residual liabilities are orphan liabilities or subsumed liabilities, the departing employer will be expected to make good the funding position revealed in the exit valuation. In other words, the fact that liabilities may become subsumed liabilities does not remove the possibility of an exit payment being required.

(G) LINKS TO INVESTMENT POLICY SET OUT IN THE STATEMENT OF INVESTMENT PRINCIPLES OR INVESTMENT STRATEGY STATEMENT

66. The current investment strategy, as set out in the SIP or ISS, is summarised below:

General Principles and diversification

67. The Fund believes that the emphasis of investment over the long term should be on real assets, particularly equities and property. These are most likely to maximise the long term returns. The balance between UK and Overseas equities is, however, a matter of investment judgement. The Fund should also be diversified to include other real assets, such as Index-Linked and 'monetary' assets, such as Bonds and Cash.

68. The neutral benchmark proportions of the various asset classes have been determined by the Fund in consultation with the Investment Advisers and are reviewed at least once every three years to coincide with the Triennial Actuarial Valuation.

69. The active Investment managers are expected to adopt an active asset allocation policy to take advantage of the shorter term relative attractions of the various asset types.

70. The Administering Authority has produced this Funding Strategy Statement having taken a view on the level of risk inherent in the investment policy set out in the SIP or ISS and the funding policy set out in this document.

71. The SIP or ISS sets out the investment responsibilities and policies relevant to the Fund.

72. The Administering Authority will continue to review both documents to ensure that the overall risk profile remains appropriate.

(H) IDENTIFICATION OF RISKS AND COUNTER-MEASURES

73. The Administering Authority seeks to identify all risks to the Fund, will monitor the risks and take appropriate action to limit the impact of them wherever possible. The Administering Authority will ensure that funding risks are included within their overarching risk management framework and strategy, linking to their risk register and risk management policy as appropriate and includes defining a role for the Local Pension Board within this framework.

74. For ease of classification some of the key risks may be identified as follows:

75. Investment

These include:

- assets not delivering the required return (for whatever reason, including manager underperformance)
- systemic risk with the possibility of interlinked and simultaneous financial market volatility
- having insufficient funds to meet liabilities as they fall due
- inadequate, inappropriate or incomplete investment and actuarial advice is taken and acted upon
- counterparty failure

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income - yield curve, credit risks, duration risks and market risks
- alternative assets – liquidity risks, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risk
- macroeconomic risks

The Administering Authority reviews each investment manager's performance quarterly and annually considers the asset allocation of the Fund by carrying out an annual review meeting. The Administering Authority also annually reviews the effect of market movements on the Fund's overall funding position.

76. Employer

These include:

- the risk arising from ever changing mix of employers, from short term and exiting employers, and the potential for a shortfall in payments and / or orphaned liabilities.

The Administering Authority will put in place a Funding Strategy Statement which contains sufficient detail on how funding risks are managed in respect of the main categories of employer (e.g. scheduled and admission bodies) and other pension fund stakeholders.

The Administering Authority maintains a knowledge base on their employers, their basis of participation and their legal status and will use this information to set a funding strategy for the relevant employers

77. Liability

These include:

- Interest rates being lower than expected
- Pay increases being higher than expected
- Price inflation being higher than expected
- The longevity horizon continuing to expand
- Deteriorating patterns of early retirements

The Administering Authority will ensure that the Actuary investigates these matters at each valuation. Prudent management of the fund should ensure that sound policies and procedures are in place to manage, e.g. potential ill health or early retirements.

78. Regulatory

These include:

- Changes to general and LGPS specific regulations, e.g. more favourable benefits package, potential new entrants to the scheme, e.g. part-time employees
- Changes to national pension requirement and/or Inland Revenue rules

79. Liquidity and maturity

These include:

- An increased emphasis on outsourcing and alternative models for service delivery may result in active members leaving the LGPS
- Transfer of responsibility between different public sector bodies
- Scheme changes which might lead to increased opt-outs
- Spending cuts and their implications

All of these may result in workforce reductions that would reduce membership, reduce contributions and prematurely increase retirements in ways that may not have been taken into account in previous forecasts.

The Administering Authority's policy is to require regular communication between itself and employers and to ensure reviews of maturity at overall Fund and employer level where material issues are identified.

80. Governance

These include:

- Administering authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements)
- Administering authority not advised of an employer closing to new entrants
- An employer ceasing to exist with insufficient funding or adequacy of a bond

The Administering Authority requires regular communication with employers to ensure that it is made aware of any such changes in a timely manner.

81. Choice of Solvency and Funding Targets

The Administering Authority recognises that future experience and investment income cannot be predicted with certainty. Instead, there is a range of possible outcomes, and different assumed outcomes will lie at different places within that range.

The more optimistic the assumptions made in determining the Funding Target and Solvency Target, the more that outcome will sit towards the 'favourable' end of the range of possible outcomes, the lower will be the probability of experience actually matching or being more favourable than the assumed experience, and the lower will be the Funding Target and Solvency Target calculated by reference to those assumptions.

The Administering Authority will not adopt assumptions for Scheduled Bodies and certain other bodies which, in its judgement, and on the basis of actuarial advice received, are such that it is less than 55% likely that the strategy will deliver funding success (as defined earlier in this document). Where the probability of funding success is less than 65% the Administering Authority will not adopt assumptions which lead to a reduction in the aggregate employer contribution rate to the Fund.

The Administering Authority's policy will be to monitor the underlying position assuming no such excess returns are achieved to ensure that the funding target remains realistic relative to the low risk position.

82. Smoothing of Assets

These include:

- The utilisation of a smoothing adjustment in the solvency measurement introduces an element of risk, in that the smoothing adjustment may not provide a true measure of the underlying position

The Administering Authority’s policy is to review whether an approach is suitable and if so ensure the impact of this adjustment remains within acceptable limits.

83. Recovery Period

These include:

- Permitting surpluses or deficiencies to be eliminated over a recovery period rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements

The Administering Authority’s policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of Recovery Period where appropriate. Details of the Administering Authority's policy are set out earlier in this Statement.

84. Stepping

These include:

- Permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient in the early years of the process

The Administering Authority’s policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the number of permitted steps as appropriate. Details of the Administering Authority's Policy are set out earlier in this Statement.

(I) MONITORING AND REVIEW

85. The Administering Authority must keep the FSS under review and make appropriate revisions following a material change in policy. The triennial valuation exercise will establish contribution rates for all employers contributing to the fund within the framework provided by the strategy.

Pension Fund Committee

14 March 2019

Agreement of Accounting Policies for Application in the 2018/19 Financial Statements of the Pension Fund

John Hewitt, Corporate Director of Resources

Purpose of the Report

1. To update the Pension Fund Committee on the accounting policies to be applied in the preparation of the 2018/19 financial statements of the Pension Fund and to seek confirmation from the Committee that appropriate policies are being applied.

Executive summary

2. All of the accounting policies which were agreed by the Pension Fund Committee at its meeting in March 2018 and applied in the preparation of the 2017/18 Statement of Accounts remain appropriate for the preparation of 2018/19 Statement of Accounts.

3. The full list of accounting policies proposed for disclosure in the Pension Fund's Financial Statements for 2018/19 is detailed in Appendix 1.

Recommendations

4. The Committee is recommended to:

- review the accounting policies;
- approve their use in the preparation of the 2018/19 financial statements for the Pension Fund; and
- authorise the Corporate Director of Resources to revise the accounting policies as necessary and report any significant changes to the Committee.

Background

5. Although the Audit Committee has responsibility for the approval of Durham County Council's Statement of Accounts, which contains the Pension Fund Accounts, the Pension Fund Committee ought to approve the accounting policies to be used in the preparation of the Pension Fund accounts.

Accounting Policies

6. It is a requirement of the Local Government Act 2003 and the Accounts and Audit (England) Regulations 2015 for the Statement of Accounts to be produced in accordance with proper accounting practices. The 'Code of Practice on Local Authority Accounting 2018/19' (the Code) as published by the Chartered Institute of Public Finance and Accountancy (CIPFA) incorporates these requirements and therefore must be followed in completing the Accounts.

7. Accounting policies are defined in the Code as *"the specific principles bases, conventions, rules and practices applied by an authority in preparing and presenting financial statements"*.

8. Accounting policies need not be applied if the effect of applying them would be immaterial. Materiality is defined in the Code as it applies to omissions and misstatements:

   Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.

9. The accounting policies applicable to the Pension Fund, in the main, relate to the valuation of assets held and the recognition of the contributions and benefits.

10. The proposed accounting policies are in line with those used in the preparation of the 2017/18 accounts and there have been no changes to the Code necessitating a change for 2018/19.

11. The full list of accounting policies for the Pension Fund that it is proposed to disclose in the Statement of Accounts notes is detailed in Appendix 1.

Contact: Beverley White Tel: 03000 261900

Appendix 1: Accounting Policies for 2018/19

Significant accounting policies

The accounting policies set out below will be applied consistently to all periods presented in the accounts. The accounts will be prepared on the accruals basis of accounting (except individual transfer values to and from the scheme, which are accounted for on a cash basis).

FUND ACCOUNT

Contributions receivable
Contribution income is categorised and recognised as follows:

- normal contributions, from both members and employers, are accounted for on an accruals basis;
- employers' augmentation contributions are accounted for in the year in which they become due;
- employers' deficit funding contributions are accounted for in the year in which they become due in accordance with the Rates and Adjustment Certificate set by the actuary or on receipt, if earlier than the due date.

Transfers to and from other schemes
Transfer values represent amounts paid to or received from other local and public authorities, private, occupational or personal pension schemes in respect of pension rights already accumulated by employees transferring from or to the participating authorities.

Individual transfer values paid and received are accounted for on a cash basis as the amount payable or receivable is not determined until payment is made and accepted by the recipient. Bulk (Group) transfers, both out and in, are accounted for in full in the year in which the transfer value is agreed by Durham County Council Pension Fund.

Pension benefits payable
Pension benefits are recognised and recorded in the accounting records and reported in the financial statements as an expense in the period to which the benefit relates. Any amounts due, but yet to be paid, are disclosed in the Net Assets Statement as current liabilities.

Management expenses
All management expenses, which include administrative expenses, investment management expenses and oversight and governance costs, are accounted for on an accruals basis.

All staffing and overhead costs of the pensions administration team are allocated to the Pension Fund as administrative expenses.

Fees of the external Investment Managers and Custodian are agreed in the respective mandates governing their appointments. Note 12 provides further information regarding the basis of Investment Managers' Fees. Where an Investment Manager's fee note has not been received by the balance sheet date, an estimate based upon the market value of their mandate as at the end of the financial year is used for inclusion in the Fund Account.

Oversight and governance costs include costs relating to the pension fund accounting team, which are apportioned on the basis of staff time spent on the Fund and include all associated overheads, plus legal, actuarial and investments advisory services.

Investment income
Investment income is accounted for as follows:

- income from equities is recognised in the fund account on the date stocks are quoted ex-dividend;
- income from fixed interest and index-linked securities, cash and short-term deposits is accounted for on an accruals basis;
- interest income is recognised in the fund account as it accrues;
- income from other investments is accounted for on an accruals basis;
- income from overseas investments is recorded net of any withholding tax where this cannot be recovered;
- foreign income has been translated into sterling at the date of the transactions, when received during the year, or at the exchange rates applicable on the last working day in March, where amounts were still outstanding at the year-end;
- changes in the net market value of investments are recognised as income and comprise all realised and unrealised profits/ losses during the year.

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 would normally be accounted for as a fund expense as it arises, however when Investment Managers are not able to supply the necessary information, no taxation is separately disclosed in the Fund Account.

NET ASSETS STATEMENT

Valuation of Investments

Investments are included in the accounts at their fair value as at the reporting date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

All prices in foreign currency are translated into sterling at the prevailing rate on the last working day of March.

An investment asset is recognised in the Net Assets 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 to the fair value of the asset are recognised by the Fund.

The values of investments as shown in the Net Assets Statement have been determined as follows:

- Quoted equity securities, traded on an exchange, are accounted for on a bid market price basis, where Investment Managers provide valuations in this manner;

- Fixed interest securities, traded on an exchange, are accounted for at bid market price where Investment Managers provide valuations in this manner;

- Index linked securities are valued at bid market value where Investment Managers provide valuations in this manner;

- Unitised managed funds are valued at the closing bid price if bid and offer prices are reported by the relevant exchange and in the Investment Manager's valuation report. Single priced unitised managed funds are valued at the reported price;

- Unitised, unquoted managed property funds are valued at the net asset value adjusted for cash flows or a single price advised by the fund manager.

- Unquoted equity investments are accounted for on an estimated price of the investments held. Investment Managers use valuation techniques to establish a price at the year-end date based on an arm's length exchange given normal business considerations;

- Derivative contracts outstanding at the year-end are included in the Net Assets Statement at fair value (as provided by Investment Managers) and gains and losses arising are recognised in the Fund Account as at 31 March. The value of foreign currency contracts is based on market forward exchange rates at the reporting date; all other derivative contracts are valued using exchange prices at the reporting date. The value of all other derivative contracts is determined using exchange prices at the reporting date.

Where Investment Managers are unable to supply investment valuations in line with the above policies, valuations will be included as supplied by the Investment Manager, usually at mid-market price.

Cash and Cash Equivalents
Cash comprises cash in hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with insignificant risk of change in value.

Contingent Assets
A contingent asset arises where an event has taken place that gives a possible asset which will only be confirmed by the occurrence of uncertain future events not wholly within the control of the Pension Fund. Contingent assets are not recognised in the Net Assets Statement however details are disclosed in a Note within the accounts.

Investment transactions
Investment transactions arising up to 31 March but not settled until later are accrued in the accounts. All purchases and sales of investments in foreign currency are accounted for in sterling at the prevailing rate on the transaction date.

Acquisition costs of investments
Acquisition costs of investments are added to book cost at the time of purchase.

Financial liabilities
The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the Net Assets Statement on the date the Fund becomes party to the 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 actual present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary, in accordance with the requirements of IAS 19 and relevant actuarial standards. As permitted under IAS 26 the Pension Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the accounts.

Additional Voluntary Contributions (AVCs)
The Fund provides an additional voluntary contribution (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. In accordance with LGPS Regulations, AVCs are not recognised as income or assets in the Pension Fund Accounts, however a summary of the scheme and transactions are disclosed in a note to the accounts.

If, however, AVCs are used to purchase extra years' service from the Pension Fund, this is recognised as contribution income in the Fund's accounts on an accruals basis. Amounts received in this way can be found in a note in the accounts as additional contributions from members.

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Pension Fund Committee

14 March 2019

Internal Audit Progress Report to 31 December 2018

Report of Paul Bradley, Chief Internal Auditor and Corporate Fraud Manager

Electoral division(s) affected:

Countywide.

Purpose of the Report

1 To inform Members of the work that has been carried out by Internal Audit during the period 1 April 2018 to 31 December 2018 as part of the 2018/2019 Internal Audit Plan

Executive Summary

2 The report provides Members with the progress that has been made in achieving the Pension Fund Internal Audit Plan for 2018/2019 up to 31 December 2018 and aims to:

(a) Provide a high level of assurance, or otherwise, on internal control systems operated in the areas that have been subject to audit;

(b) Advise on any significant issues where controls need to improve in order to effectively manage risks;

(c) Advising of any other types of audit work carried out, such as consultancy reviews where an assurance opinion on the control environment may not be applicable;

(d) Advise of any unplanned work carried out or due to be carried out and any changes to the audit process.

Recommendation

3 Members are asked to note the work undertaken by Internal Audit during the period ending 31 December 2018.

Background

4 As an independent consultancy service, the Internal Audit Team strives to continue to add value and improve the organisation's operations as well as providing objective assurance to service managers and the Pension Fund Committee.

5 The Annual Internal Audit Plan, covering the period 01 April 2018 to 31 March 2019, was approved by the Pension Fund Committee on 15 March 2018.

Progress against 2018/19 planned work:

6 A summary of the approved audit plan, with the status of each audit, is shown below:

Audit Title	Audit Type	Status	Opinion
Audits brought forward from 2017/18			
Payroll	Assurance	Final Report	Substantial
Bank Reconciliation	Assurance	Final Report	Substantial
2018/19 audits			
Pension System ICT Controls, Data Quality and Performance	Assurance	In Progress	
Transfers in/out	Assurance	Final Report	Substantial
Additional Voluntary Contributions	Follow Up	Final Report	N/A
Governance Arrangements (of the Pool)	Assurance	Preparation	
Bank Reconciliation	Assurance	Final Report	Substantial
Debt Recovery	Assurance	Final Report	Substantial
National Fraud Initiative – Data matching to identify potential error/fraud	Counter Fraud	In Progress	N/A
Ad hoc advice & guidance	Advice/Consultancy	In Progress	N/A

7 The status shows that, of the eight reports planned to be completed in 2018/19, six final reports have been issued, three of which were issued in the third quarter.

8 A summary of the scope of the three final reports, issued in the quarter, is given over the page.

Audit Area	Brief Scope	Assurance Opinion
Transfers in/out	Assurance review of the arrangements in place to mitigate against the risks of; - Transfer values out calculations are inaccurate and not carried out promptly; - Transfer values in are not received or not accurately accounted for in a timely manner.	Substantial
Debt Recovery	Assurance review of the arrangements in place to mitigate against the risks of; - Failure to collect or recover income; - Invoices are raised incorrectly.	Substantial
Bank Reconciliation	Assurance review of the arrangements in place to mitigate against the risks of; - Material errors or fraudulent activities within the bank account or the General Ledger are not identified and corrected in a timely manner; - Theft or misuse of Pension Fund monies or bank accounts; - Transaction errors made by the bank go unnoticed; - Inaccurate or misleading financial information; - Performance not being properly managed or monitored.	Substantial

Conclusion

9 Delivery of the 2018/19 Internal Audit Plan is progressing, and, from the work carried out during the period, there are no significant control issues to bring to Members' attention.

Background papers

- Specific Internal Audit reports issued and working papers.

Other useful documents

- None

Contact: Paul Monaghan **Tel:** 03000 269662

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Pension Fund Committee

14 March 2019

Draft Audit Plan 2019/20

Report of Paul Bradley, Chief Internal Auditor and Corporate Fraud Manager

Electoral division(s) affected:

Countywide.

Purpose of the Report

1 To present the proposed Annual Audit Plan for 2019/20 for approval.

Recommendation

2 Members are asked to approve the proposed audit plan for 2019/20.

Background

3 The Public Sector Internal Audit Standards (PSIAS), which came into effect from April 2013, define internal audit as, “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

4 The agreed terms of reference for the internal audit service to fulfil this objective are detailed in the Internal Audit Charter.

2019/20 Audit Plan

5 The Audit Plan for 2019/20 has been developed following discussions between officers from Internal Audit and officers who have responsibility for the Pension Fund, using the strategic audit plan as the basis of the discussion. The proposed plan is shown in the table below.

Audit Title	Audit Type
Contributions	Assurance
Benefits	Assurance
Compliance with Breach Policy	Assurance
National Fraud Initiative – Identification of potential error/fraud	Counter Fraud
Management time and ad hoc advice	Advice and Consultancy

Background papers

- Strategic Internal Audit Plan

Other useful documents

- None

Contact: Paul Monaghan **Tel:** 03000 269662

Appendix 1: Implications

Legal Implications

There are no specific legal implications associated with this report. Internal Audit contribute to the effective governance of the Council and provide relevant and appropriate challenge and oversight where necessary.

Finance

The audit fee for the 2019/20 internal audit plan, to be delivered by the DCC Internal Audit Service, which is chargeable direct to the Pension Fund, remains the same as 2018/19 at £19,500.

Consultation

All Corporate Directors, the Director of Transformation and Partnerships and all Heads of Service.

Equality and Diversity / Public Sector Equality Duty

None.

Human Rights

None.

Crime and Disorder

None.

Staffing

None.

Accommodation

None.

Risk

The key risk is that actions agreed in audit reports to improve the control environment and assist the Council in achieving its objectives are not implemented. To mitigate this risk, a defined process exists within the Service to gain assurance that all actions agreed have been implemented on a timely basis. Such assurance is reflected in reports to the Committee.

Procurement

None.

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Pension Fund Committee

14 March 2019

Local Government Pension Scheme (LGPS): Review of Pension Fund Risks

Ordinary Decision

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 To update members on the revisions to the LGPS Pension Fund risk register, following a review with the Principal Risk and Governance Officer in February 2019.

Executive summary

2 The review of the risk register was undertaken in line with guidance in Managing Risk in the Local Government Pension Scheme 2018 (by the Chartered Institute of Public Finance & Accountancy), an extract from which is attached as Appendix 1.

3 As at 28 February 2019, there were 14 risks on the Pension Fund risk register, which is attached as Appendix 2.

Recommendation(s)

4 Members are requested to confirm that this report provides assurance that the Pension Fund risks are being effectively managed within the risk management framework across the Council.

Background

5 The introduction of new governance requirements in the LGPS in 2015, specifically the Pensions Regulator's new role and the establishment of local pension boards, reflects the increasing importance of risk management. It also reinforces the need for administering authorities to focus their risk management activities on all areas of scheme management and not just investment, noting of course that management of investment risk is rightly a fundamental concern.

6 The Chartered Institute of Public Finance and Accountancy (CIPFA) publication, *Managing Risk in the Local Government Pension Scheme 2018*, includes guidance on managing risks in LGPS financial management and administration. It states that, as part of their governance processes, funds should regularly report risks to committee and local pension boards, embedding a robust risk management. An extract from the CIPFA guidance is attached as Appendix 1.

7 The Pension Fund risk register follows the council's corporate risk management methodology and is reviewed by officers twice each year. In accordance with its terms of reference, the Pension Fund Committee will also review and monitor the Pension Fund risk register annually.

Risk Update

8 As at February 2019, there were 14 risks on the Pension Fund risk register, which is attached as Appendix 2.

Contact: Paul Cooper Tel: 03000 269798

Appendix 1: Extract from *Managing Risk in the LGPS* (CIPFA, 2018)

Effective risk management stands at the heart of sound corporate governance across all organisations and functions and the Local Government Pension Scheme (LGPS) is no exception. Using established risk management techniques, risks can be identified, analysed and managed effectively.

As part of their governance processes funds should be regularly reporting all risks to committee and the local pension board, embedding a robust risk management approach and processes which link to all key strategic documents as well as recording risks and progress on an active risk register.

Effective risk management will lead to substantial financial and non-financial benefits and should be an integral part of both committee and local pension board meetings.

The need for effective risk management is reflected throughout LGPS regulation and guidance, including:

- Regulation 7 of the LGPS (Management and Investment of Funds) Regulations 2016.
- The Pensions Regulator's Code of Practice 14 (which includes a section on internal controls and managing risks).
- The CIPFA Publication Delivering Good Governance in Local Government: Framework (2016 Edition) based upon the CIPFA/SOLACE Code of Corporate Governance.
- Statutory guidance under Regulation 58 of the LGPS Regulations 2013.
- Preparing and Maintaining a Funding Strategy Statement in the LGPS, 2016 Edition.
- CIPFA's guidance on Investment Pooling and Governance Principles, published in 2016.

Overall responsibility for risk management falls to the body with delegated responsibility for managing the fund, and the legal requirements relating to internal controls apply equally where schemes outsource services connected with the running of the scheme. However, the local pension board and officers advising the committee and assisting in the running of the fund should also have a role in relation to risk management.

The Pensions Regulator's Code of Practice 14 states that scheme managers must establish and operate internal controls. The risk management process should use a risk-based approach and ensure that sufficient time and attention is spent in:

- identifying, evaluating and managing risks
- developing and monitoring appropriate controls.

Appendix 2: Pension Fund Risk Register

Notes on the Risk Register
1. The full Pension Fund Risk Register is set out in the table below. 2. Risk assessment criteria are shown in the table on the right. 3. Significant changes to the risk register are highlighted in the column on the far right along with any outstanding actions to mitigate the risk.

Factor & Description		Financial impact	Likelihood
5	Critical	Over £15m	Highly Probable – more than once a year
4	Major	£5m - £15m	Probable – once a year
3	Moderate	£1m - £5m	Possible – every 1-3 years
2	Minor	£0.5m - £1m	Unlikely – every 3-5 years
1	Insignificant	£0.5m	Remote – over 5 years

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
1	The pension fund assets may fail to grow in line with the developing cost of pension fund liabilities, leading to an adverse financial impact on the pension fund (Asset & Investment Risk).	Financial	5	5	25	1. Professional advice. 2. Performance monitoring. 3. Investment Strategy Statement (ISS) Approach to Risk. 4. ISS Approach to Risk and Counterparty Risk Acceptability 5. High level of compliance with Myners Principles (of Investment Decision Making and Disclosure). 6. Diversified allocation of investments. 7. Significant investment in bonds, and allocation to alternatives. 8. Extensive due diligence is used before managers are selected. 9. A number of different managers chosen to prevent concentration of risk. 10. Regular monitoring to ensure that funding objectives are achieved. 11. Investment Advisor reports to Pension Fund Committee on a quarterly basis. 12. Quarterly performance figures of the IMs are reported and challenged at the Pension Fund Committee. 13. Investment advisor reviews the portfolios of the investment managers on a regular basis. 14. Local pension board reviews activity of pension committee.	5	2	10
2	A counterparty may default in meeting its obligations, leading to an adverse financial impact on the pension fund (Asset & Investment Risk).	Financial	5	3	15	Spreading of investments across different counter parties reduces risk of defaults being material.	5	1	5

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
3	Inappropriate investment in breach of the Council's environmental, social or governance principles, leading to reputational damage (Asset & Investment Risk).	Financial and reputational	5	3	15	1. Environmental, Social & Governance Policy through the fund's Investment Strategy Statement. 2. Environmental, Social & Governance factors forming part of asset manager selection rationale. 3. Reporting from investment managers includes details of voting activity. 4. Responsible Investment Policy agreed with BCPP and jointly owned with partner funds.	5	1	5
4	Risk that the amount of money needed to meet the fund's liabilities turns out to be greater than expected, leading to an adverse financial impact on the pension fund (Liability Risk).	Financial	5	3	12	1. Investment in a range of assets. 2. Inflation linked income, subject to a tolerable level of volatility. 3. Actuary takes a long-term view. 4. Ongoing liaison with the actuary. 5. Regular liaison with affected employers. 6. Mitigating actions would be taken such as investing in assets which produce cashflows or withdrawing cash from fund managers. 7. Regular cashflow monitoring. 8. Quarterly reporting to PFC.	5	1	5

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
5	Scheme employers may not meet their contribution requirements as they fall due, leading to an adverse financial impact on the pension fund (Employer Risk).	Financial	3	3	9	1. Reconciliation performed between bank account, cashbook and GL but only as part of annual accounts prep. 2. Annual returns reconciled to monthly payments. 3. As part of the process for the actuary's triennial valuation, bodies have opportunity to discuss funding. 4. Use of bonds and guarantees 5. Pension Fund Committee discuss admittance of admitted bodies where there is a choice (e.g. non-TUPE ones covered by LGPS Regulations) 6. Actuary calculation of the bond options (with DCC making final choice)	3	2	6
6	Scheme employers may fail to administer the scheme efficiently, leading to disruption to the discharge of administering authority functions (Employer Risk). Includes potential data quality issues.	Service delivery	1	4	4	1. Clear communication of requirements to scheme employers. 2. Electronic processing offered to all employers improving efficiency and ease of administration. 3. As part of the process for the actuary's triennial valuation, bodies have opportunity to discuss funding. 4. Pension Fund Committee discuss admittance of admitted bodies where there is a choice (e.g. non-TUPE ones covered by LGPS Regulations).	1	3	3
7	Potential lack of resources / skills, leading to disruption to the discharge of administering authority functions (Resource and Skill Risk).	Service delivery	2	3	6	1. Training for Pension Fund Committee and Local Pension Board. 2. Appropriately qualified staff in key roles. 3. Segregation of duties among pensions staff. 4. Fit for purpose staffing structure in place. 5. Training budget in place.	2	2	4

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
8	Risks associated with asset pooling through the newly-formed BCPP Ltd (Administrative Risk).	Financial	5	3	15	1. BCPP Ltd is a Financial-Conduct-Authority-regulated operator and alternative investment fund manager. 2. Delay transition of assets during set-up period, until necessary conditions for investment are met. 3. Due diligence on sub-funds in conjunction with investment consultants. 4. Part owners/control – fund represented on BCPP Joint Committee, statutory officer groups, senior pension officer groups and AGM, .	5	2	10
9	A serious ICT failure, leading to disruption to the discharge of administering authority functions (Administrative Risk).	Service delivery	1	4	4	1. UPM computer database system and ResourceLink system (pension payments) are supported by DCC ICT service for systems security. 2. UPM computer database system and ResourceLink system (pension payments) are covered by the Resources BCP. 3. Back up data centre is in place.	1	2	2
10	Poor standards of data quality, leading to disruption to the discharge of administering authority functions (Administrative Risk).	Service delivery	3	4	12	1. Actuary gets annual reports and checks the figures against these. 2. Internal checking and validation procedures. 3. Checking and validation by the Actuary.	2	2	4

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
11	Serious breach of law regarding management of data/information, including an unauthorised release requiring notification to ICO, leading to disruption to the discharge of administering authority functions (Administrative Risk).	Service delivery	2	5	10	1. Corporate Information Governance Group oversees policies, procedures & activities. 2. Comprehensive training to officers and members. 3. Data breach procedure in place. 4. Formal appointment of Senior Information Risk Owner to provide senior authority on information governance. 5. Assurance obtained from third party suppliers & contractors on compliance with relevant legislation. 6. Data Protection Officer appointed as required by the GDPR legislation. 7. Access levels in system set up for individual users.	2	3	6
12	A serious cyberattack, leading to disruption to the discharge of administering authority functions (Administrative Risk).	Service delivery	2	4	8	1. Software support agreements in place for all key systems as this is a requirement of PSN. 2. Business Continuity plans reviewed periodically to ensure alignment to current IT capabilities and accurate planning assumptions. 3. Continual programme of user awareness training and information governance training taken up by all staff and members.	2	2	4
13	Serious incident of fraud / corruption in the administration function, leading to an adverse financial impact on the pension fund (Administrative Risk).	Financial	5	3	15	1. Segregation of duties among administering authority staff. 2. Monthly reconciliations. 3. Fraud awareness training 4. Participate in National Fraud Initiative data matching exercises. 5. Rigorous checks of supporting documentation (e.g. death certificate)... 6. Pre-employment checks.	5	1	5

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
14	Non-compliance with some elements of pensions legislation may result in specific penalties or sanctions, leading to an adverse financial impact on the pension fund (Regulatory and Compliance).	Financial and reputational	2	3	6	1 Participation in regional Pension Officer forums. 2 Subscription to Local Government Association circulars. 3 Professional advice taken from the Fund's Actuary and investment consultants, as well as the admin authority's Legal team.	2	2	4

Pension Fund Committee

14 March 2019

Cost Management in the LGPS

Ordinary Decision

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 This report is intended to update Committee Members on the Cost Management mechanisms in the LGPS, and the current pause on the process.

Executive summary

2 The process to manage costs in public sector pension schemes, known as the cost cap mechanism, commenced for the first time in 2019. It appears that the cost cap floor has been breached across public sector schemes, including the LGPS. To return schemes to the target cost, the design of the schemes must be changed.

3 Before the cost cap mechanisms could be completed, however, the Government lost a Court of Appeal case relating to transitional protections for older scheme members in other public sector on the grounds of age discrimination. Because of the wider implications of the case, cost management processes across public service pensions have been paused.

Recommendation(s)

4 Members are asked to note the information contained in this report.

Background

5 In 2011 Lord Hutton concluded a fundamental review into public sector pension provision, with a stated aim to “ensure affordable and sustainable public sector pensions”. The report set out a number of recommendations that formed the basis for consultation with public sector workers, unions and others.

6 Following consultation, the Government legislated in the Public Service Pensions Act a framework for new public service pension schemes, which were introduced into local government in 2014 and the rest of the public sector in 2015.

7 In line with one of Lord Hutton’s recommendations, the Act provided for an employer cost cap with an objective of providing backstop protection for the taxpayer against unforeseen changes in scheme costs.

8 The provision in the Act requires public sector schemes to remain within a 2% margin either side of the employer cost cap, creating both a cost ceiling and floor. Where the cost of a public sector scheme goes beyond either of these margins, the legislation requires action to be taken to bring the scheme back to the target cost.

9 In the LGPS, there are two mechanisms to ensure that the scheme remains within the specified margins between the cost ceiling and floor. First, the LGPS Scheme Advisory Board (SAB) carries out a non-statutory assessment of the scheme intended to give an early warning of any cost changes. Following the SAB assessment, Her Majesty’s Treasury (HMT) will conduct a statutory evaluation of the cost cap.

10 This dual mechanism approach is unique to the funded LGPS. In the unfunded public sector schemes, Teachers, NHS, Police, Fire etc., there is no SAB process, with HMT’s statutory cost cap evaluation the only process to run.

11 The results from the HMT process for the unfunded schemes suggest that the cost cap floor has been breached across these schemes, which would result in the requirement for benefit improvements to return to the target cost.

12 Initial SAB assessment indicates that the LGPS has also breached the cost cap floor. A sub group of the Board, consisting of the Chair, Vice Chair and an employer representative agreed to consider a package of benefit improvements sufficient to return the scheme back to the cost target.

13 Before any proposed package of LGPS changes could be progressed, however, provisions relating to transitional protections for older scheme

members in other public sector schemes were found by the Court of Appeal to be unlawful on the grounds of age discrimination, and could not be justified (McCloud and Others v Ministry of Justice).

14 Although the case relates to Judges' and Firefighters' pension schemes, it is anticipated that the principles of the outcome could be accepted as applying to all public service schemes. Should the finding of the Court of Appeal stand, then significant changes to all public sector schemes may be required to remedy the age discrimination.

15 Because of this ruling, and subsequent changes to public service pensions that may be required, the cost cap process in the LGPS (and across the public sector) has been paused. A Q&A prepared by SAB is included in Appendix 1.

16 The Government has applied to the Supreme Court for permission to appeal the decision. Normally a decision on whether to grant permission is received within 3 months of the application, so by mid-April 2019 it should be clear whether the case will go through the Supreme Court, or whether the decision of the Court of Appeal stands.

17 Officers will continue to monitor the position, and update the Committee on the outcome of the legal case and the implications for Cost Management in the LGPS

Contact: Paul Cooper Tel: 03000 269798

Appendix 1: The McCloud case Q&A for administering authorities

McCloud Q&A

Print

The McCloud case Q&A for administering authorities

This Q&A outlines the potential timescales and possible outcomes of the McCloud case and its impact on the cost cap process. Throughout it will refer to the 'cost cap' which is the Government's Employer Cost Cap process as required under the Public Service Pensions Act 2013. There are also references to the SAB cost management process which is both separate and additional to the cost cap. Further information on both these processes can be found back on the Cost management page of this site.

At the end there is a question for administering authorities regarding the approach to the 2019 valuation. Please consider your view on this important matter and send your response to robert.holloway@local.gov.uk by Friday 1st March 2019.

What is the McCloud case?

The case concerns the transitional protections given to scheme members, who in 2012 were within 10 years of their normal retirement age, in the judges and firefighters schemes as part of public service pensions reform. Tapered protections were provided for those 3-4 years younger. On 20th December 2018 the Court of Appeal found that these protections were unlawful on the grounds of age discrimination and could not be justified.

What are the potential implications of the case?

If the protections are unlawful then those members who are found to have been discriminated against will need to be offered appropriate remedies to ensure they are placed in an equivalent position to the protected members. Such remedies will need to be ‘upwards’ - that is the benefits of unprotected members will need to be raised rather than the benefits of protected members being reduced.

If the case is about the judges and firefighters schemes why could it apply to all public service schemes?

Protections were applied to all members within 10 years of retirement in all public service schemes, with the form that protection took varying from scheme to scheme. Although the case only relates directly to two schemes it is anticipated that the principles of the outcome could be accepted as applying to all public service schemes.

Will there be a further appeal?

The Government has applied to the Supreme Court for permission to appeal. Normally a decision on whether to grant permission is received within 3 months of the application, so by mid-April 2019.

Why has the cost cap process been paused due to McCloud?

Should the finding of the Court of Appeal stand then significant changes to public service schemes may be required. Depending on extent and cost of these changes there could be a material impact on the outcome of the cost cap process.

What happens if the application to the Supreme Court is refused?

In this case the matter would be referred back to the Employment Tribunal for a remedy hearing. This would normally involve the submission of detailed evidence and could take 12 months or longer to reach a hearing. Once a Tribunal makes a finding on remedy, compensation will be awarded and the schemes amended as appropriate. Alternatively the parties might agree a remedy prior to any hearing and in any event we expect that the cost cap process will be re-run taking into account the remedy and any scheme amendments.

If the application for permission to appeal to the Supreme Court is successful when would a hearing be held?

In normal circumstances this would not be before the end of 2019. It is hoped given the implications of the case that an earlier hearing could be arranged. However, the hearing date is at the discretion of the Supreme Court and will depend on matters such as the priority it attaches to the case, the Court’s workload and the current cases timetable.

What happens if the Supreme Court upholds the findings of the Court of Appeal?

As with a rejection of the application for a hearing, the matter would be referred back to the Employment Tribunal for a remedy hearing. This would normally involve the submission of detailed evidence and could take 12 months or longer to reach a hearing. Once a Tribunal makes a finding on remedy, compensation will be awarded and the schemes amended as appropriate. Alternatively the parties might agree a remedy prior to any hearing and in any

event we expect that the cost cap process will be re-run taking into account the remedy and any scheme amendments.

What happens if the Supreme Court overturns the Court of Appeal judgment?

In this case we would expect the cost cap process to restart and result in a similar outcome to those at present.

When would any changes to schemes be effective from?

In the case of remedies, if the Court of Appeal judgement stands, these could be backdated to the commencement of existing protections in April 2015 (2014 for LGPS). For cost cap changes the Government has stated its intention to apply these from April 2019.

What LGPS protections could be in scope for McCloud?

Unlike other public service schemes the LGPS moved all members into the CARE scheme whatever their age. However those active members who were within 10 years of their 2008 scheme normal pension age on 31st March 2012 were protected via the statutory underpin. Protected members who meet the criteria for the underpin to apply, will receive the better of their CARE pension or one calculated under 2008 scheme rules.

What remedy could the Employment Tribunal process result in for the LGPS?

The remedy either agreed prior to or by the Employment Tribunal is designed to compensate those members found to have been discriminated against and may or may not be exactly in line with the benefits of protected members. It would therefore be premature to speculate on the form any remedy might take should the Court of Appeal judgement stand.

Would the SAB cost management process still run in the LGPS?

Yes in any outcome, it is the intention that the SAB cost management process (taking into account any remedies as a result of McCloud) would still run prior to the completion of the cost cap. At this point the SAB may choose to resubmit the existing proposals or review the package taking into account the cost of any remedy and the impact of backdating.

Will benefit changes have to be backdated to April 2019?

The SAB is committed to bring forward improvements to benefits costed on the assumption of an April 2019 effective date. However it is concerned about the confusion amongst scheme members which may be caused by the backdating of benefit changes over a potentially significant period and in particular the impact on those who will have left the scheme, voluntarily or otherwise, after April 2019 and prior to the implementation of any scheme changes. The SAB is also acutely aware of the enormous challenge that would be faced by administering authorities and employers in potentially backdating scheme changes over such a significant period. It is therefore currently exploring legal and actuarial options to mitigate these challenges while meeting its obligation to bring forward changes that reflect in full the cost of benefit improvements from April 2019.

Will any benefit changes from McCloud be taken into account in the 2019 LGPS valuations?

That will depend on when the timing of the various potential outcomes and the availability of a confirmed set of changes. Although such changes could potentially be taken account of up to March 2020, realistically October 2019 is the cut-off date given the need for employers to set budgets tor 2020-21. If the changes cannot be accounted for in the 2019 valuations, then depending on their extent and cost, an interim valuation may be needed to reset employer contribution certificates.

Question for LGPS administering authorities

With regards to the 2019 valuations would you prefer:-

A) To receive guidance from the SAB designed to promote a consistency of approach on how McCloud and/or cost management should be taken account of as part of the 2019 triennial valuation exercise. Such guidance would take the form that;

i. If there is no finalised outcome on McCloud/Cost cap (including a commitment by government to detailed benefit changes) by 31st August 2019 then the scheme benefit design used in the valuation should be as set out in current regulations.
ii. Each administering authority would then, with their Actuary, consider how they approach (and reflect in their FSS) the risk around this matter in the same way as they would for other financial, employer and

demographic risks.

iii. Once the outcome of McCloud is known and appropriate benefit changes are made administering authorities would, if they deem appropriate, re-visit employer contributions under such guidance or provision in regulation as may be available at that time.

iv. A consistent approach to delaying or method of estimating exit credits and payments

Or

B) To have no central guidance and instead leave it to each administering authority to determine their own approach to their valuation (including any potential cost from McCloud or cost cap) taking advice from their actuarial adviser.

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