Pension Fund Committee

Date	**Thursday 12 March 2020**
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 5 December 2019 (Pages 5 - 12)
4. Feedback from Local Pension Board
5. Overall Value of Pension Fund Investments to 31 December 2019 (Pages 13 - 18)
6. Performance Measurement of Pension Fund Investments to 31 December 2019 (Pages 19 - 20)
7. Short Term Investments for the Period Ended 31 December 2019 (Pages 21 - 22)
8. Provision of Treasury Management Services to the Pension Fund for 2020/21 (Pages 23 - 26)
9. Internal Audit Progress Report to 31 December 2019 (Pages 27 - 28)
10. Draft Audit Plan 2020/2021 (Pages 29 - 32)
11. Pension Administration Report (Pages 33 - 44)

12. Governance Compliance Statement (Pages 45 - 62)
13. Pension Fund Policy Documents - Funding Strategy Statement (Pages 63 - 118)
14. Review of Pension Fund Risks (Pages 119 - 128)
15. Agreement of Accounting Policies for Application in the 2019/20 Financial Statements of the Pension Fund (Pages 129 - 136)
16. Such other business as, in the opinion of the Chairman of the Meeting is of sufficient urgency to warrant consideration
17. 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)

18. The Minutes of the Meeting held on 5 December 2019 (Pages 137 - 146)
19. Investment Strategy Review Update (Pages 147 - 198)
20. Report of the Pension Fund Adviser (Pages 199 - 236)
21. Report of the Pension Fund Independent Investment Adviser (Pages 237 - 258)
22. Report of Alliance Bernstein (Pages 259 - 276)
23. Report of BlackRock (Pages 277 - 292)
24. Report of Border to Coast Pensions Partnership (Pages 293 - 316)
25. Report of CBRE Global Investment Partners (Pages 317 - 332)
26. Report of Mondrian Investment Partners (Pages 333 - 338)
27. Report of Royal London (Pages 339 - 342)
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
4 March 2020

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, W Stelling and M Wilson

Darlington Borough Council Members
Councillors C Johnson and S Durham

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
T Collins, J Hewitt, H Lynch, P Cooper, B White

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

Investment Managers
Alliance Bernstein
BlackRock
BCPP
CBRE
Mondrian
Royal London

Staff Observers
Unison – N Hancock
GMB – L Timbey

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

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DURHAM COUNTY COUNCIL

PENSION FUND COMMITTEE

At a Meeting of **Pension Fund Committee** held in Main Hall, Town Hall, Durham on **Thursday 5 December 2019 at 10.00 am**

Present:

Councillor M Davinson (Chair)

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

Scheme Member Representatives
Anne Delandre and John Taylor

Also Present:
Council Advisers:
Paul Cooper – Pensions Manager
Beverley White – Finance Manager

Independent Advisers:
Sandy Dickson – Mercer
Anthony Fletcher – MJ Hudson

Observers
Les Timbey – GMB
Ian Densham – Local Pension Board

1 Apologies for Absence

Apologies for absence were received from Councillors J Atkinson and S Hugill, Darlington Borough Councillor C Johnson, Further Education Colleges Representative A Broadbent, and Local Pension Board Members N Hancock and Councillor A Hopgood.

2 Declarations of interest (if any)

There were no declarations of interest.

3 Minutes

The Minutes of the meeting held on 12 September 2019, and the Special meeting held on 4 October 2019 were agreed as a correct record and were signed by the Chair.

4 Feedback from Local Pension Board

There was no feedback from the Local Pension Board.

5 Overall Value of Pension Fund Investments to 30 September 2019

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 2019, the movement in the cash balance during the last four quarters and the projected cash flow position up to 31 December 2020 (for copy see file of Minutes).

Resolved:

That the information contained in the report be noted.

6 Performance Measurement of Pension Fund Investments to 30 September 2019

The Committee considered a report of the Corporate Director of Resources which provided an overview of the performance of the Pension Fund's assets, which were being held outside of Border to Coast Pensions Partnership to 30 September 2019 (for copy see file of Minutes).

Members were informed that the value of assets included in the Custodian's report did not include investment in private markets and assets transferred from BNY Mellon to BCPP.

Resolved:

That the information contained in the report produced by the Fund's custodian, JP Morgan be noted.

7 Short Term Investments for the Period Ended 30 September 2019

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 2019 (for copy see file of Minutes).

Resolved:

That the position at 30 September 2019 regarding the Pension Fund's short-term investments where the Pension Fund's surplus cash holding was £29.883m and £84,864 net interest was earned in the three month period, be noted.

8 Border to Coast Pensions Partnership Responsible Investment Policy

The Committee considered a report of the Corporate Director of Resources which provided an update on the approach to Responsible Investment (RI) at Border to Coast Pensions Partnership (BCPP) (for copy see file of Minutes).

Rachel Elwell, the Chief Executive of BCPP emphasised the importance the Partnership attached to Responsible Investment. BCPP was able to create specialist expertise to ensure it fulfilled its responsibility to hold to account the companies it invested in on behalf of the Partner Funds.

Councillor Temple referred to private markets and distressed debts, and expressed concern at the potential risk that ESG was not given due prominence. The Member asked how this would be addressed.

Rachel Elwell assured the Member that this was taken very seriously, and Responsible Investment was particularly important for private markets which were liquid, ensuring that Managers and companies were aware of the potential risks and were mitigating against those risks. A robust approach included the development of a detailed questionnaire which challenged the Managers' understanding of the RI Policy, and to ensure that they had a process in place to respond to future hot topics. The Managers were required to report quarterly to BCPP.

Resolved:

That the Responsible Investment Policy and Corporate Governance and Voting Guidelines Policy that BCPP would operate on behalf of the Pension Fund for assets transferred into the pool, be noted and approved.

9 Any Other Business

Member Training

Self-Assessment Questionnaires

Paul Cooper reported that the majority of training needs self-assessment questionnaires had now been returned, and he would ask those Members

who had not yet completed the forms to do so following the meeting. The questionnaires would be evaluated to focus training in the areas identified by Members.

Multi- Asset Credit

A training session had been held for the Committee on 2 December 2019 focusing on Multi-Asset Credit in advance of Members making an investment decision in March 2020. A further session for those Members who had been unable to attend would be arranged in advance of the March Committee.

BCPP Annual Conference 2019

John Taylor provided feedback from the BCPP Annual Conference held on 10 and 11 October 2019. He advised that although the venue was disappointing the content of the Conference was excellent and was a worthwhile event.

Rachel Elwell agreed with the views of the Member in respect of the venue and advised that the Conference would return to York for 2020, and she hoped to see more Members attending.

Resolved:

That the information be noted.

10 Exclusion of the Public

Resolved:

That under Section 100 (A)(4) of the Local Government Act 1972, the 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.

With the agreement of the Committee, the Chair advised of a change to the order of business to consider the presentation of attending Managers CBRE, before the update from BCPP.

11 Minutes

The Minutes of the meeting held on 12 September 2019, and the Special meeting held on 4 October 2019 were agreed as a correct record and were signed by the Chair.

12 Internal Audit Progress Report to 30 September 2019

The Committee considered a report of the Corporate Director of Resources which informed Members of the work that had been carried out by Internal Audit during the period 1 April 2019 to 30 September 2019 as part of the 2019/2020 Internal Audit Plan (for copy see file of Minutes).

Resolved:

That the work undertaken by Internal Audit during the period ending 30 September 2019, be noted.

13 Competition and Markets Authority Consultant Objectives

The Committee considered a report of the Corporate Director of Resources which provided Members with information regarding The Investment Consultancy and Fiduciary Management Market Investigation Order 2019 which took effect from 10 December 2019 (for copy see file of Minutes).

Resolved:

That the Corporate Director of Resources, in consultation with the Chair and Vice-Chair of the Committee, be authorised to agree formal Strategic Objectives with the Fund's Investment Consultants and to review performance against these Objectives within 12 months (for copy see file of Minutes).

14 Investment Strategy Review Update

The Committee considered a report of the Corporate Director of Resources which provided an update on progress made towards implementing asset allocation decisions (for copy see file of Minutes).

Resolved:

That the information be noted and investment in the MAC sub fund be supported in principle, subject to the final details of the offer.

15 Report of the Pension Fund Adviser

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

Resolved:

That the information given be noted.

16 Report of the Pension Fund Independent Investment Adviser

The Committee considered a report of Anthony Fletcher, the Independent Investment Adviser of MJ Hudson (for copy see file of Minutes).

Resolved:

That the information given be noted.

17 Report of CBRE

Consideration was given to a report of the Managers in attendance 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
d) Portfolio Transition Proposal

Resolved:

That the information given be noted.

18 Border to Coast Pensions Partnership Update

Rachel Elwell, the Chief Executive of BCPP provided an update to Members on progress with the Boarder to Coast Pensions Partnership (for copy see file of Minutes).

Resolved:

That the information given be noted. .

19 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.

20 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.

21 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.

22 Report of BNY Mellon (Walter Scott)

Consideration was given to a report from Walter Scott(BNY Mellon) 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.

23 Report of Mondrian

Consideration was given to a report from Mondrian 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.

24 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.

Pension Fund Committee

12 March 2020

Overall Value of Pension Fund Investments to 31 December 2019

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 2019;
   (b) movement in the cash balance during the last four quarters; and
   (c) projected cash flow position up to 31 March 2021.

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 2019 the value of the Fund was £3.104 billion and the cash balance held in the Durham County Council Pension Fund bank account was £39.426 million. Fund Managers also held cash of £32.044 million at that date.

3. The cash flow forecast detailed in Appendix 2 indicates net cash outflows in future quarters, excluding cash withdrawals from fund managers, of between £8 million and £10 million.

4. As the Pension Fund is expecting to receive Durham County Council's pension deficit contribution relating to 2020/21 to 2022/23 in one lump sum in April 2020, there have been no cash withdrawals from fund managers built in to the forecast over the next five quarters.

Recommendation

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

Background

Value of the Pension Fund

6. Reports from the six appointed fund managers, namely:
    - AB
    - BlackRock
    - BCPP
    - CB Richard Ellis
    - Mondrian
    - Royal London

    are included in Part B of today's agenda.

7. The value of the Fund at 31 December 2019 was £3.104 billion compared to £3.130 billion at 30 September 2019. This is a decrease of £25.572 million (or 0.83%) in the third quarter of 2019/20.

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

8. 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.

9. 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.

10. 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 2019 the cash balance held in the Durham County Council Pension Fund bank account was £39.426 million. In addition to this, not included in this table, fund managers were holding cash of £32.044 million at 31 December 2019.

11. During the quarter ending 31 December 2019, the third private equity drawdown of £0.079 million and the second and third infrastructure drawdowns totalling £0.803 million were made to BCPP.

Cash Flow Forecast

12. Appendix 2 shows the projected cash flow for the Pension Fund for the period 1 January 2020 to 31 March 2021. 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.

13. The forecast includes the anticipated early receipt of Durham County Council's pension deficit contribution in one lump sum in April 2020. Without this, the Fund will need to make cash withdrawals from fund managers to maintain sufficient working cash balances.

14. The forecast indicates net cash outflows in future quarters of between £8 million and £10 million.

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

    (a) Annual investment income receivable is estimated to be £26.5 million and profiled to be received as follows:

(i)	Quarter ended 31 March 2020	29%
(ii)	Quarter ended 30 June 2020	21%
(iii)	Quarter ended 30 September 2020	24%
(iv)	Quarter ended 30 September 2020	26%

    (b) DCC contributions have been increased in line with the latest triennial valuation results; the other employer's contributions will be updated as soon as the final actuarial valuation report is available.

    (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 applied is the estimated pension indexation rate of 1.7% for 2020/21 with effect from 1 April 2020.

    (e) Payroll paysheets (payments to pensioners) are forecast to increase by £0.25 million per quarter. 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.

16. 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

17. Fund rebalancing is the mechanism by which the Pension Fund would ensure that the asset allocation to fund 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.

18. 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 2019 to 31 December 2019

Quarter Ended	31.03.19		30.06.19		30.09.19		31.12.19	
	Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate	Actual
	£	£	£	£	£	£	£	£
Cash Inflows								
Contributions - DCC	13,950,000	14,096,247	13,950,000	14,914,521	15,100,000	15,268,926	15,250,000	15,254,601
Contributions - Other	9,600,000	9,821,075	9,760,000	10,469,144	9,950,000	10,480,363	10,480,000	10,510,402
Unfunded pensions recharges	1,120,000	1,124,595	1,140,000	1,007,809	1,080,000	1,220,458	1,080,000	440,628
Transfer Values	1,250,000	805,197	1,250,000	832,205	1,250,000	2,092,081	1,250,000	3,509,472
Other income	2,000,000	3,311,968	2,000,000	1,563,888	2,000,000	1,070,689	2,000,000	1,483,864
Funds recovered from Managers	0	0	20,000,000	20,000,000	0	0	20,000,000	20,122,522
Interest on short term investments	85,000	104,769	85,000	78,697	84,000	84,864	65,000	70,530
Total Cash Inflow	28,005,000	29,263,850	48,185,000	48,866,264	29,464,000	30,217,381	50,125,000	51,392,019
Cash Outflows								
Payroll Paysheets	26,000,000	25,824,012	26,850,000	26,499,473	27,100,000	26,802,176	27,350,000	27,102,239
Payables Paysheets (incl. Managers' fees)	12,000,000	11,429,632	12,000,000	12,642,023	12,000,000	14,159,792	12,000,000	13,142,293
Funds transferred to Managers	5,600,000	0	5,900,000	3,640,602	0	1,303,736	0	881,383
Other Expenditure	1,000	794	1,000	1,284	1,000	1,293	1,000	1,282
Total Cash Outflows	43,601,000	37,254,438	44,751,000	42,783,382	39,101,000	42,266,998	39,351,000	41,127,196
Net Cash Inflow / (-) Outflow	-15,596,000	-7,990,588	3,434,000	6,082,882	-9,637,000	-12,049,617	10,774,000	10,264,822
Balance at Bank (opening)		45,870,405		37,289,542		42,645,995		29,882,861
Balance at Bank (closing)		37,289,542		42,645,995		29,882,861		39,426,392

Appendix 2

Projected Cash Flow (including forecast dividends receivable by Fund Managers) - for the period 1 January 2020 to 31 March 2021

Quarter Ended	**31.03.20**	**30.06.20**	**30.09.20**	**31.12.20**	**31.03.21**
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£	**£**	**£**	**£**	**£**
Cash Inflows					
Contributions - DCC	15,250,000	46,070,000	16,900,000	16,900,000	16,900,000
Contributions - Other	10,480,000	10,480,000	10,480,000	10,480,000	10,480,000
Unfunded pensions recharges	1,080,000	1,080,000	1,080,000	1,080,000	1,080,000
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					
Interest on short term investments	65,000	75,000	85,000	70,000	55,000
Total Cash Inflow	30,125,000	60,955,000	31,795,000	31,780,000	31,765,000
Cash Outflows					
Payroll Paysheets	27,600,000	27,820,000	28,070,000	28,320,000	28,570,000
Payables Paysheets (incl. Managers' fees)	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000
Funds transferred to Managers	0	0	0	0	0
Other Expenditure	1,000	1,000	1,000	1,000	1,000
Total Cash Outflows	39,601,000	39,821,000	40,071,000	40,321,000	40,571,000
Net Cash Inflow / (-) Outflow	-9,476,000	21,134,000	-8,276,000	-8,541,000	-8,806,000
Balance at Bank (opening)	39,426,392	29,950,392	51,084,392	42,808,392	34,267,392
Balance at Bank (closing)	29,950,392	51,084,392	42,808,392	34,267,392	25,461,392
Investment Income Received by Managers	7,685,000	5,565,000	6,360,000	6,890,000	7,685,000

Pension Fund Committee

12 March 2020

Performance Measurement of Pension Fund Investments to 31 December 2019

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 To provide an overview of the performance of the Pension Fund's assets to 31 December 2019.

Recommendation

2 Members note the performance information contained in the report.

Total Fund and Manager Performance

3 The performance of the fund managers is measured against personalised benchmarks chosen at the inception of the fund. The tables below have been provided by Mercer, using JPMorgan performance reports, and show:

(a) The total fund performance for the quarter to 31 December 2019, the last year, last 3 years and 5 years:

	Quarter (%)	Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Total Fund	0.0	14.6	7.4	7.6
Benchmark	*-0.7*	*12.2*	*6.9*	*8.0*
Relative to Benchmark	0.7	2.4	0.5	-0.4
Objective	*-0.3*	*13.3*	*8.0*	*9.1*
Relative to Objective	0.3	1.3	-0.6	-1.5
Funding Target	*1.1*	*4.5*	*4.5*	*4.7*
Relative to Funding Target	***-1.1***	***10.1***	***2.9***	***2.9***

(b) The managers' performance against the relevant benchmarks, for the quarter to 31 December 2019, the last year and last 3 years:

Manager	Last Quarter		Last Year		Last Three Years	
	Fund (%)	Benchmark (%)	Fund (%)	Benchmark (%)	Fund (% p.a.)	Benchmark (% p.a.)
BCPP	4.9	4.3	-	-	-	-
Mondrian	4.7	4.0	15.2	13.9	8.8	9.9
BlackRock	3.6	0.9	11.9	3.9	6.0	3.6
Alliance Bernstein	0.4	0.9	5.1	3.9	2.4	3.6
Royal London	-8.8	-9.4	7.6	6.8	3.7	2.9
CBRE	-1.0	1.5	7.6	7.2	5.8	8.0

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee

12 March 2020

Short Term Investments for the period ended 31 December 2019

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 2019.

Recommendation

2. Members are asked to note the position at 31 December 2019 regarding the Pension Fund's short-term investments where the Pension Fund's surplus cash holding was £39.426 million and £70,530 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 2019 was £39.426 million, which was held in the institutions listed in the following table, alongside their credit rating at 31 December 2019.

Financial Institution	Short-term Rating	Amount Invested £m
Bank Deposit Accounts		
Handelsbanken	F1+	0.000
Fixed Term Deposits		
Bank of Scotland	F1	5.781
Close Brothers	F1	2.569
Goldman Sachs	F1	3.083
Landesbank Hessen Thueringen Girozentrale	F1+	1.285
Santander UK Plc	F1	6.423
UK Local Authorities	N/A	10.342
Building Societies	N/A	5.203
National Savings & Investments	N/A	0.128
Money Market Funds	N/A	4.612
Total		**39.426**

5. The following table provides information on the net interest earned during the three month period to 31 December 2019, 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 £2,650 paid for the Council undertaking the Treasury Management function for the Pension Fund.

	Total
Net Interest Earned	£70,530
Average Return Earned	0.79%
Average Bank of England base rate	0.75%
Average Daily Balance of Investments	£36.721m

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee

12 March 2020

Provision of Treasury Management Services to the Pension Fund for 2020/21

John Hewitt, Corporate Director of Resources

Purpose of Report

1. To update the Committee of the Treasury Management services 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 2020/21.

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 2020:

   (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 £2,715 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 reviews and monitors the Council's Treasury Management Strategy on behalf of the Council and implement it on behalf of the Pension Fund. The team also updates 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 Auditors.

18. It is recommended that the charge for this service is increased from £2,650 to the flat fee of £2,715 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 2020/21.

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 – 14 March 2019 - Investment of the Pension Fund's Cash Balances

(c) DCC's Treasury Management Strategy 2020/21 approved 26 February 2020.

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

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee

12 March 2020

Internal Audit Progress Report to 31 December 2019

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 2019 to 31 December 2019 as part of the 2019/2020 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 2019/2020 up to 31 December 2019 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 2019.

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 2019 to 31 March 2020, was approved by the Pension Fund Committee on 14 March 2019.

Progress against 2019/20 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 2018/19			
Pension System ICT Controls, Data Quality and Performance	Assurance	Final Report	Moderate
Governance Arrangements	Assurance	In Progress	
2019/20 audits			
Contributions	Assurance	Not yet started	
Benefits	Assurance	In Progress	
Compliance with Breach Policy	Assurance	Service request to defer to 2020/21	
National Fraud Initiative – Data matching to identify potential error/fraud	Counter Fraud	In Progress	
Management time and ad hoc advice & guidance	Advice/Consultancy	In Progress	

7 The status shows that, of the four assurance reviews now planned to be completed in 2019/20, one final report has been issued. However, no final reports were issued in the period.

Background papers

- Specific Internal Audit reports issued and working papers.

Other useful documents

- None

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

Pension Fund Committee

12 March 2020

Draft Audit Plan 2020/21

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 2020/21 for approval.

Recommendation

2 Members are asked to approve the proposed audit plan for 2020/21.

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.

2020/21 Audit Plan

5 The Audit Plan for 2020/21 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
Audits deferred from 2019/20	
Compliance with Breach Policy	Assurance
2020/21 audits	
Pensions Payroll	Assurance
Additional Voluntary Contributions	Assurance
Bank Reconciliation	Assurance
Debt Recovery	Assurance
Admission Bodies / Funding Risks	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.

Climate Change

There are no direct implications on climate change as a result of this report, however the Internal Audit Service ensures that it considers climate change and sustainability in the recommendations that are made.

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.

Pension Fund Committee

12 March 2020

Pension Administration Report

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 This report briefs the Committee on developments in both matters that are Local Government Pension Scheme (LGPS) specific as well as providing an update on non-LGPS specific matters which are of interest.

Executive summary

2 There are a number of developments that will potentially impact the requirements placed upon the Fund, both specific to the LGPS and more generally. This report seeks to keep the Committee updated with those developments

Recommendation(s)

3 Committee is asked to note the report.

Background

4 This report provides an update to Committee on important pensions administration and governance matters that are currently relevant. The report is split into 2 main sections:

(a) LGPS specific matters, and;

(b) Non-LGPS specific matters that are of interest to the Committee.

LGPS Specific Matters

MHCLG Consultation – LGPS: Fair Deal – Strengthening Pension Protection

5 In January 2019, MHCLG launched a consultation that would strengthen the pensions protections that apply when an employee of an LGPS employer is compulsorily transferred to the employment of a service provider. If the proposed amendments are introduced, the option for staff to be granted access to a Government Actuary's Department (GAD) certified broadly comparable scheme will be removed.

6 MHCLG are currently considering the responses received, with a consultation response expected in due course. Officers will continue to monitor the position.

MHCLG consultation – LGPS: Changes to the Local Valuation Cycle and the Management of Employer Risk

7 In May 2019 MHCLG consulted on a number of changes to the LGPS, encompassing the following areas:

- amendments to the local fund valuations from the current 3 year (triennial) to a 4-year (quadrennial) cycle
- a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle
- proposals for flexibility on exit payments
- proposals for further policy changes to exit credits
- proposals for changes to the employers required to offer local government pension scheme membership

8 On 27 February MHCLG published a partial response to the consultation, covering proposals on exit credits only. MHCLG confirmed their intention to amend the Regulations providing greater discretion to Administering Authorities over the amount of any exit credit. The Local Government Pension Scheme (Amendment) Regulations 2020 were subsequently laid before parliament, coming into force on 20 March 2020 with backdated effect to 18 May 2018.

9 Officers are taking advice on the impact of the Amendment Regulations and will continue to monitor the position regards the remainder of the Consultation. Committee will be updated accordingly.

Ongoing Consultation – Guaranteed Minimum Pensions (GMP)

10 In February 2017 the Treasury consulted on options for how the Guaranteed Minimum Pension (GMP) element of pensions paid to those members who will reach state pension age on or after 6th December 2018 should be indexed.

11 In January 2018 the Treasury published its response to this consultation, acknowledging that it is a complex area with more time required to identify a long-term solution. As a result, the existing interim solution was extended, covering those members of public service schemes reaching state pension age between 6th April 2016 and 5th December 2018 to those that reach state pension age on or before 5th April 2021. Further time will then be taken to identify a longer-term solution.

12 Further consultation is expected so that a long-term solution can be implemented. The Committee will be kept up to date on this matter.

LGPS Scheme Advisory Board (SAB)

SAB Review – Academies

13 In 2017 SAB instigated a review of the participation of existing academies and commissioned Price Waterhouse Coopers to investigate issues of academy participation in the LGPS and prepare a report for the Board. The report made no recommendations but set out three broad types of approach or mechanisms to try and resolve these issues. These are:

- non-regulatory measures within the LGPS
- regulatory measures within the scheme, and
- measures outside of the LGPS, including through primary legislation.

14 The SAB review has been split between a funding working group and an administration working group. Work on the administration working group was put on hold due to competing work pressures; however, this has now been lifted and work on this is to resume.

15 Officers will continue to monitor the position and update Committee accordingly.

SAB Review – Tier 3 Employers

16 In addition to the review of Academy participation, above, SAB also commissioned work in respect of 'Tier 3' employers participating in the LGPS. Broadly, Tier 3 employers are those employers which:

(i) have no tax raising powers,

(ii) are not backed by an employer with tax raising powers;

(iii) are not an academy.

17 SAB has established a small working group to review concerns expressed by Tier 3 employers and the ways in which they may be resolved. The working group is tasked with reporting back to the SAB with a set of recommendations for further consideration.

18 The Committee will be updated as this matter progresses.

SAB Review – Good Governance in the LGPS

19 SAB is currently examining the effectiveness of current LGPS governance models with a focus on standards, consistency, representation, conflict management, clarity of roles and cost. The Board will consider a detailed paper in May 2020 which will likely result in new statutory guidance on Governance Compliance, with consideration in particular likely to be given to:

(a) changes to the scheme's regulatory provisions on Governance Compliance Statements,

(b) revised statutory guidance on Governance Compliance Statements,

(c) independent assessment of Governance Compliance Statements, and;

(d) establishing a set of Key Performance Indicators (KPIs)

20 Officers will provide a more detailed update to Committee in June after SAB has considered the matter further in May, taking into

account The Pensions Regulator's own review on Governance and Administration Risks in Public Service Pension Schemes.

SAB Review – Responsible Investment Guidance

21 In November, SAB drafted guidance for Responsible Investment in the LGPS, to clarify the parameters within which investment decisions can be made with regard to the integration of ESG factors. Following feedback, SAB has decided to take stock until more is known about the government's position on the proposed climate change provisions in the Pension Schemes Bill and the implications of the Supreme Court's judgement involving the Palestine Solidarity Campaign.

22 Committee will be updated as the matter progresses.

Cost Management Review/McCloud

23 Committee has been informed previously of the Cost Management Review in the LGPS and how this was largely superseded by the anticipated implications of the Court of Appeal judgements in McCloud and Sargeant.

24 The Fund's position on McCloud has been discussed previously, with the Actuary outlining in detail at the Annual General Meeting how the issue will be reflected in the valuation. The Fund will add an additional 0.9% to the employer contribution rate for all employers at the 2019 valuation.

25 Committee will be updated on progress with both McCloud and Cost Management

Non- LGPS Specific Matters

Public Sector Exit Payments Cap

26 The Small Business, Enterprise and Employment Act 2015 introduced the concept of a 'public sector exit payments cap'. The legislation provides that exit payments to be paid to a person are not to exceed £95,000. The 2015 Act provided the overarching principles of how the exit cap was to operate, but the detail was to be prescribed in regulations that were expected to soon follow.

27 After a period of delay the Treasury launched a new consultation on this matter in April 2019. Included in the consultation were draft regulations called 'The Restriction of Public Sector Exit Payment

Regulations 2019' which provided detail on how the exit cap will operate from an employer's perspective.

28 Under the Regulations, it is proposed that the exit cap will be phased into the public sector, but local government is covered by phase 1. The exit payment cap is to remain at £95,000 and includes:

- redundancy payment(s);
- any payment to offset an actuarial reduction to a pension arising by virtue of early retirement (know as 'strain on the fund' or 'early release' cost);
- any payment made pursuant to an award of compensation under the ACAS arbitration scheme or a settlement or conciliation agreement;
- any severance payment or ex gratia payment;
- any payment in the form of shares or share options;
- any payment on voluntary exit;
- any payment in lieu of notice due under a contract of employment;
- any payment made to extinguish any liability under a fixed term contract;
- any other payment made, whether under a contract of employment or otherwise, in consequence of termination of employment of loss of office.

29 Most significantly for the LGPS, is the inclusion of the 'strain on the fund' costs are included towards the cap. These costs of allowing unreduced access to pension benefits for members over 55 can exceed £95,000 for scheme members with long periods of membership.

30 The Treasury is currently considering responses to the Consultation, and Officers will update the Committee as the matter progresses.

Changes to Retail Price Index (RPI)

31 Following discussions between the UK Statistics Authority (UKSA), HM Treasury and the House Lords Economic Affairs Committee (HLEAC), the Chancellor of the Exchequer proposed a 2020 consultation on the alignment of RPI with CPIH. As current

experience suggests CPIH is 1% lower than RPI, alignment will mean a lower than expected income from index-linked gilts

32 The Chancellor has confirmed that the government will launch a consultation at Budget 2020 to understand the impact of the potential changes and consult on what changes should be made to RPI and when these should come into force. Further information can be found in the Technical Bulletin included in Appendix 1.

33 More detail on the impact of this issue was included as part of training for members of the Pension Fund Committee, which at the time of writing was scheduled to take place on 6 March 2020.

UK Stewardship Code 2020

34 The UK Stewardship Code aims to enhance the quality of engagement between investors and companies to help improve long-term risk-adjusted returns to shareholders. The Fund has previously signed up the Code, and BCPP also publish a UK Stewardship Code compliance statement.

35 Due to the significant changes in the Investment Market since the introduction of the first Code, The UK Stewardship Code 2020 is now being introduced. This new Code expands on the previous requirements and compromises a set of 12 Principles which require reporting and disclosure on an 'apply and explain' basis.

36 The LGPS (Management and Investment of Funds) 2016 Regulations state that the responsibility for stewardship, which includes shareholder voting, remains with the Partner Funds. Stewardship, day-to-day administration and implementation have been delegated to Border to Coast by the Partner Funds, on assets managed by Border to Coast, with appropriate monitoring and challenge to ensure this continues to be in line with Partner Fund requirements. To leverage scale and for operational purposes, Border to Coast has, in conjunction with Partner Funds, developed a Responsible Investment Policy and accompanying Corporate Governance & Voting Guidelines to ensure clarity of approach on behalf of Partner Funds.

37 Officers are currently considering the new Code, and will work in conjunction with BCPP to ensure compliance. A more detailed report will be provided to the Committee in due course.

Author(s)

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Appendix 1: GAD Technical Bulletin on RPI

Government Actuary's Department

January 2020

Technical Bulletin

Following the Chancellor of the Exchequer's reply to the UK Statistics Authority, there is significant uncertainty around the future of the Retail Prices Index (RPI) – one of the key measures of inflation in the UK. This technical bulletin looks at what the issues are underlying this exchange of letters and what might happen next.

The many measures of inflation

Price inflation is the rate at which prices of goods and services increase over time. Measures of inflation provide indicators of the cost of living and relative spending power but are also frequently used in contracts to determine changes in contracted payments. For example, inflation measures influence changes in benefit payments, pensions, rail fares and repayments of student loans and government debt.

There are different ways in which inflation can be measured. The most common measures used in the UK are the Retail Prices Index (RPI), Consumer Prices Index (CPI) and Consumer Prices Index with Housing (CPIH). Each measures inflation slightly differently, and as a result report different levels of inflation. More details on the differences are in a previously published explanatory note.

Historically, RPI was the dominant inflation measure in the UK and is the reference inflation for many pension schemes, student loan repayments and repayments for index-linked gilts. There have been a number of issues identified in the way that RPI has been calculated and as a result RPI's status as a National Statistic was revoked in 2013 and in 2018 the government confirmed that it will not introduce new uses of RPI.

Proposed changes to RPI

As a result of the issues with RPI, there has been significant discussion between the UK Statistics Authority (UKSA), HM Treasury and the House of Lords Economic Affairs Committee on whether RPI should continue to be used in its current format. UKSA has offered 2 recommendations to the Chancellor. The first recommendation is to cease publication and promotion of the RPI figures. The Chancellor rejected this as it would have a material and detrimental effect to existing users of RPI, including holders of relevant index-linked gilts.

The second recommendation is for RPI to be aligned to CPIH. The Chancellor has decided that these will not be aligned until February 2025 at the earliest. After 2030 there will no longer be a need for approval from the Chancellor in order to make changes to RPI and current indications suggest that a move to CPIH will be enacted by UKSA by this point at the latest.

The Chancellor has confirmed that the government will launch a consultation at Budget 2020 to understand the impact of potential changes and consult on what changes should be made to RPI and when these should come into force.

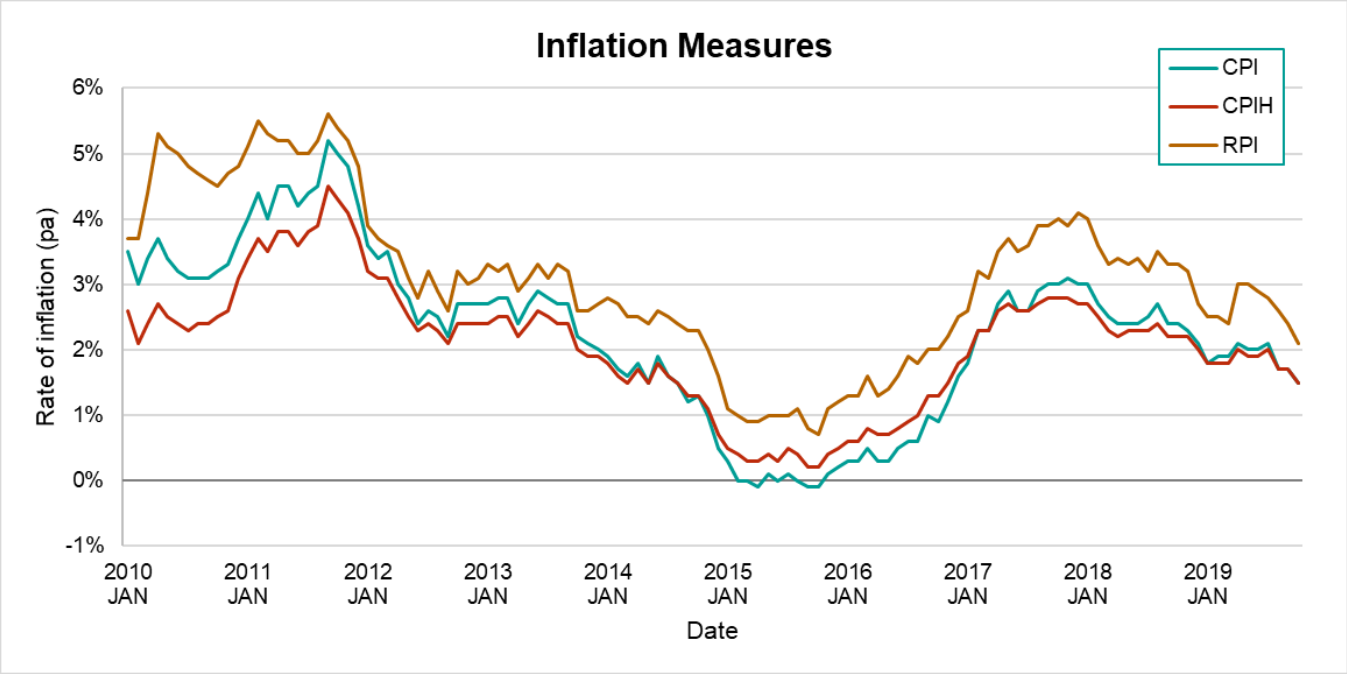
Differences between inflation measures

The levels of inflation reported by the various measures vary because of differences in:

- which goods and services are included in the measure – for example, CPI does not include any element of housing cost. Both RPI and CPIH do include measures of housing costs but in different ways
- the formula used to combine different prices into a single measure – for example, CPIH and CPI both use the same formula whereas RPI uses a different formula

The chart below shows the inflation figures under each measure since 2010 and shows that differences between the measures are not constant and do fluctuate.

Figure 1: The annual inflation for each measure (2010-Present)



Broadly speaking CPIH has moved relatively closely with CPI over the last 10 years. This reflects similarities in the indices and the fact that they only differ by the inclusion of residential rental price growth and council tax in the CPIH. In the long-term, one might assume rental price growth to cause CPIH to exceed CPI slightly – however, over the past 10 years CPIH has averaged 0.2% lower. This is because the rental price and council tax elements included in CPIH have grown less than general price inflation over the last 10 years.

Historically, the differences between RPI and CPI (and CPIH) have been larger – with RPI exceeding CPI by around 0.8% pa over the same period shown above. Similar differences are likely to persist before any reforms to RPI are made which, will be until at least 2025 but no later than 2030. Beyond this, it's expected that the differences between RPI and CPI will narrow and align to the differences between CPI and CPIH. As such, future expectations for RPI vary significantly depending on the time period of interest.

Impact of changes to RPI

As referred to in the Chancellor's reply to the UKSA, the full extent to which RPI is used, and the impact of a change to it, is somewhat unknown and supports the need for the forthcoming consultation. One area that is clearly and significantly impacted will be investors in index-linked gilts. With current experience suggesting that CPIH is approximately 1% lower than RPI, an alignment of RPI to CPIH will result in lower expected income from these investments.

While there was movement in the prices (and yields) of gilts following the September exchange of letters between the Chancellor and the UKSA, the fall has generally been lower than might have been expected given the differences between RPI and CPIH. Figure 2 illustrates this by showing the movement in break-even inflation – the difference between nominal and real index-linked yields which provide an indication of the market's inflation expectations.

Figure 2: Break-even inflation

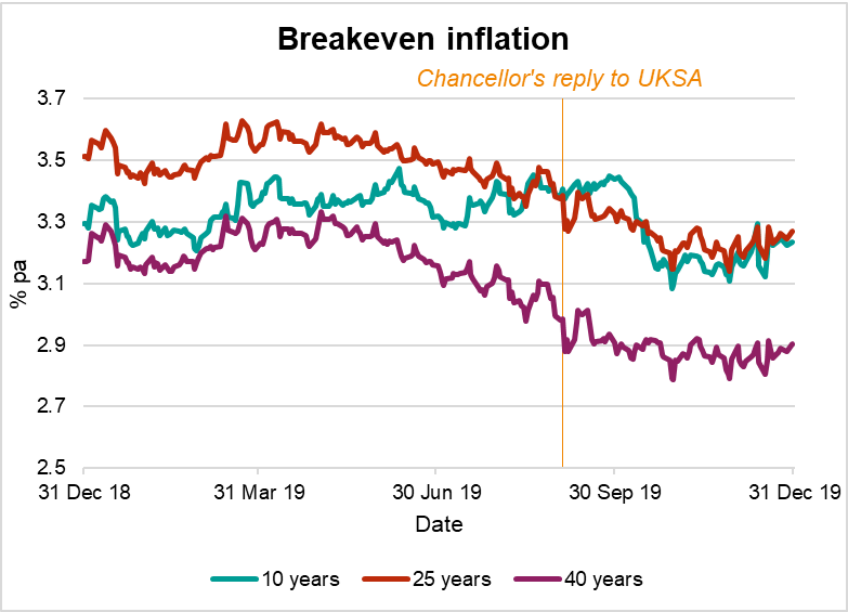


Figure 2 shows relatively little change in inflation expectations at shorter durations (10 years and less) following the Chancellor's response to the UKSA. This is consistent with the view that changes to RPI are unlikely to occur before 2030. There were more noticeable differences in inflation expectations over longer durations (25 and 40 years shown above). However these were generally relatively small – possibly reflecting either that the market was expecting changes to RPI and had already priced in the announcement, or reflecting that gilt holders expect that they might receive some form of compensation if there is any material change to RPI.

One major investor in index-linked gilts are pension schemes who invest to back inflation-linked pensions obligations. For schemes that revalue pensions in line with RPI, any changes to RPI will not only feed through to impacts on their index-linked gilt holdings but also impact the value of their liabilities. This is because changes to RPI are likely to mean that scheme members receive lower pension increases and so would reduce the present value of outstanding liabilities.

Reforms to RPI mean that index-linked gilts are likely to provide a closer match to scheme revaluation for schemes that revalue pensions in line with CPI. Therefore index-linked gilts are likely to be a more attractive hedging investment over the longer term. However, the scheme may already be holding RPI-linked instruments to hedge against CPI-linked pension increases and are

likely to have determined the level of investment in gilts based on the historical differences between RPI and CPI. Alignment of RPI to CPIH means that these schemes will have to revisit their hedging positions and are exposed to the risk of financial losses from the lower expected income from gilts.

Next steps

It is almost certain that RPI in its current format will not continue forever – however until the consultation has concluded, there remains significant uncertainty in how it might evolve. Given these uncertainties, when considering the outlook for future price inflation it is more important than ever to consider:

- which inflation measure is being used or referred to
- the time period over which a view on inflation is required as potential future changes are likely to significantly change the level of reported RPI inflation

If you would like to discuss any of these issues in more detail or have any questions then please email ashara.peiris@gad.gov.uk or get in touch with your usual GAD contact.

Pension Fund Committee

12 March 2020

Governance Compliance Statement

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 To update members on the revisions to the Pension Fund Committee Governance Compliance Statement, following a review with the MJ Hudson Allenbridge in February 2020.

Executive summary

2 The review of the Compliance Statement was undertaken in line with 2008 guidance issued by the Secretary of State for, at the time of issue, Communities and Local Government (CLG) and Regulation 55 of The Local Government Pension Scheme Regulations 2013.

Recommendation(s)

3 Members are asked to:

(a) note the report and to advise of any comments they may have on the Governance Compliance Statement set out in the appendices to this report,

(b) authorise the Corporate Director of Resources to publish details of training activity and attendance at Committee meetings, and;

(c) authorise the Corporate Director of Resources to finalise the wording of the Compliance Statement, taking into account where appropriate both professional advice as well as comments received from employers, and publish a final version by 31 March 2020.

Background

4 Under Regulation 55 of the Local Government Pension Scheme Regulations 2013 Durham County Council in its capacity as Administering Authority for the Pension Fund must prepare a written statement setting out “the extent to which a delegation, or the absence of a delegation, complies with guidance given by the Secretary of State and, to the extent that it does not so comply, the reasons for not complying”.

5 The written statement must be kept “under review, and make such revisions as are appropriate”. Following a review conducted with MJ Hudson Allenbridge, the Statement has been updated to reflect current requirements and practices. It is recommended as best practice that the Statement is augmented with a summary of training activity and attendance at Committee meetings.

6 The revised Statement will be shared with employers for comment, with the finalised version published on the council’s website and in the Fund’s Annual Report.

Good Governance Review

7 The Compliance Statement reflects the Fund’s approach to current governance requirements, but it should be noted that these requirements are currently under review by the LGPS Scheme Advisory Board (SAB).

8 SAB is currently examining the effectiveness of current LGPS governance models with a focus on standards, consistency, representation, conflict management, clarity of roles and cost. The Board will consider a detailed paper in May 2020 which will likely result in new statutory guidance on Governance Compliance.

Next Steps

9 The revised Governance Compliance Statement will be circulated to all Pension Fund employers for comment within two weeks. A Final version of the Statement for inclusion in the Annual Report will be published on 31 March 2020.

10 Officers will report back to Committee in June, with an update on the Good Governance Review, recommendations in light of any changing requirements, as well as a Training Plan informed by Member Self-Assessments.

Author(s)

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Appendix 1: Governance Compliance Statement

GOVERNANCE COMPLIANCE STATEMENT

Durham County Council is the Administering Authority for the Durham County Council Pension Fund.

The Council has delegated to the Pension Fund Committee various powers and duties in respect of its administration of the Fund.

This statement sets out the Fund's scheme of delegation and the terms of reference, structure and operational procedures of the delegation, and the extent of its compliance with 2008 statutory guidance issued by the Secretary of State (CLG) and the provisions of regulation 55 0f the Local Government Pension Scheme Regulations 2013.

The following sections set out the principles of governance as prescribed in the guidance and describe the Fund's current arrangements for compliance.

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

The constitution of the Council delegates to the **Pension Fund Committee** "powers and duties arising from Section 7 of the Superannuation Act 1972 and Regulations made thereunder" regarding the administration of the Scheme and investment of funds, including:

- Approval of applications from bodies seeking admission to the Local Government Pension Scheme;
- Appointment of external investment managers and advisers.

The following function is delegated to the **Corporate Director of Resources** by the Council:

> "To take all necessary actions of a routine nature to properly administer the financial affairs of the Council including … the Council's functions as a pension fund administering authority under the Superannuation Act 1972 and associated regulations."

The structure of the Pension Fund Committee was reviewed in December 2008 and revised with effect from 1 April 2009 to reflect the composition of Durham County Council as a unitary authority from that date. The structure of the Pension Fund Committee is as follows:

Body / category of bodies represented	**Number of Committee Members**
Durham County Council	11
Darlington Borough Council	2
Colleges	1
Scheduled Bodies	1
Admitted Bodies	1
Active Members	1
Pensioners	1
Total	**18**
(plus 2 non-voting union observers)	

The Terms of Reference of the Committee is available at www.durham.ogv.uk/lgps. A secondary committee or panel has not been established due to the full extent of representation on the Committee.

The Local Pension Board is established by Durham County Council and will be governed by Durham County Council's Constitution. The Board was established on 1 April 2015 under Regulations 105 to 109 of the Local Government Pension Scheme Regulations 2013 (as amended) and operates independently of the Pension Fund Committee.

The purpose of the Board is to assist the Administering Authority in its role as a scheme manager of the Scheme. Such assistance is to:

a) Secure compliance with the Regulations, any other legislation relating to the governance and administration of the Scheme, and requirements imposed by the Pensions Regulator in relation to the Scheme and;
b) To ensure the effective and efficient governance and administration of the Scheme.

The Board consists of six voting members of which three represent Scheme Members and three represent Scheme Employers, and there shall be an equal number of Member and Employer representatives. The Board appoints a chair from its membership.

All members of the Board must declare on appointment and at any such time as their circumstances change, any potential conflict of interest arising as a result of their position on the Board.

Knowledge and understanding must be considered in the light of the Board's purposes as set out above. The Board shall establish and maintain a record of training to address the knowledge and understanding requirements that apply to Board members under the Regulations.

The Board meets four times each year and may hold additional meetings if agreed by the Board. The quorum for each meeting is one Scheme Member representative and one Scheme Employer representative. A meeting that becomes inquorate may continue but any decisions will be non-binding.

The Chair shall agree with the Monitoring Officer (the 'Board Secretary') an agenda prior to each meeting which, together with supporting papers, will be issued at least five working days (where practicable) in advance of the meeting to all members of the Board. The Board meetings can be open to the general public.

The Administering Authority may meet the expenses of Board members as agreed by the Corporate Director of Resources in consultation with the Leader and Deputy Leader of the Council. The Administering Authority shall not pay allowances for Board members.

The Board should in the first instance report its requests, recommendations or concerns to the Pension Fund Committee. In support of this, any member of the Board may attend a Committee meeting as an observer.

The detailed terms of reference of the Local Pension Board may be found on the Council's website www.durham.gov.uk/article/6164/Durham-County-Council-Pension-Fund-Local-Pension-Board.

Principle B - Representation	Fully compliant

a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:
   i) employing authorities (including non-scheme employers e.g. admitted bodies);
   ii) scheme members (including deferred and pensioner scheme members),
   iii) where appropriate, independent professional observers,
   iv) expert advisers (on an ad-hoc basis).

b) That where lay members sit on a main or secondary committee they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.

The allocation of members to the Committee broadly reflects the number of active members, pensioners and deferred pensioners each of the larger employers has within the Fund.

The two Trade Union representatives are invited as observers.

The Committee does not consider it appropriate to appoint an independent professional observer to the Committee but these governance arrangements have been independently audited by Peter Scales of MJ Hudson Allenbridge on behalf of the Committee.

Investment Consultancy is provided to the Fund by Mercer, and the Committee has appointed Anthony Fletcher of MJ Hudson Allenbridge to provide independent investment advice.

All members of the Committee, union observers and independent advisers are given full access to papers and are allowed to participate in meetings.

Principle C - Selection and role of lay members	Fully compliant

a) That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.

b) That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.

The representatives from Durham County Council and Darlington Borough Council are appointed by decisions of the respective councils.

The representatives of the Colleges, other Statutory Bodies, and Admitted Bodies are selected by the Committee from nominations made by the employers and appointed for a period of 4 years.

The two scheme member representatives are selected by the Committee from applications received from the membership following advertisement in the newsletter - one from active scheme members and one from pensioner members.

All Committee members are made fully aware of their role and functions as set out in the terms of reference for the Committee and other documentation.

Applicants from the scheme membership are provided with an information pack setting out the duties and responsibilities of a Pension Fund Committee Member together with a description of the type of individual qualities and experience seen as essential or desirable for the role.

All members are also made aware that as well has having legal responsibilities for the prudent and effective stewardship of the Fund, in more general terms they have a clear fiduciary duty to participating employers, local tax payers and scheme beneficiaries in the performance of their responsibilities.

There is a standing agenda item at the start of each meeting inviting members to declare any financial or pecuniary interest related to specific matters on the agenda. The register of Members' interests is available online at www.durham.gov.uk.

Principle D - Voting	**Fully compliant**
a) The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	

All members appointed to the Committee have voting rights.

Union observers and advisers do not have voting rights as they do not act as formal members of the Committee.

Principle E - Training/Facility Time/Expenses	Fully compliant

a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.

b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.

c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.

The Committee has established a policy on training, facility time and reimbursement of expenses which applies to all members of the Committee.

Consideration has been given to the adoption of annual training plans and the maintenance of a log of all such training undertaken. The Committee receives specific training before making investment decisions. The training requirements of individual Committee Members is informed by Member self-assessment.

Principle F – Meetings (frequency/ quorum)	Fully compliant

a) That an administering authority's main committee or committees meet at least quarterly.

b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.

c) That an administering authority which does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.

The Pension Fund Committee meets four times a year and occasionally holds special meetings when required. The Pension Fund Committee also holds an Annual General Meeting each year to which all employers are invited.

The quorum for each regular meeting of the Committee is 5.

Principle G - Access	Fully compliant
a) That subject to any rules in the council's constitution all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	

All members of the Committee have equal access to committee papers, documents and advice to be considered at each meeting. Public documents are posted on the website.

Principle H - Scope	Fully compliant
a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	

As set out in the terms of reference, the Committee regularly considers "wider issues" and not just matters relating to the investment of the Fund.

Principle I - Publicity	Fully compliant
a) That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	

The Governance Compliance Statement is distributed to all employers, is reproduced in the Annual Report, and is published on the Council's website. The appointment of member representatives was advertised to all members for them to express an interest.

Appendix 2: Pension Fund Committee Terms of Reference

Pension Fund Committee – Terms of Reference

1. Objectives

1.1. The Pension Fund Committee's objective is to ensure effective stewardship of the Fund's affairs. The Pension Fund is governed by Local Government Pension Scheme Regulations and the Committee will ensure that the Pension Fund is run in accordance with the Regulations.

2. Authority

2.1 The Local Government Pension Scheme is a statutory scheme governed by Regulations. Durham County Council, acting as Administering Authority for the Pension Fund has determined to delegate all functions relating to the maintenance of the Pension Fund to the Pension Fund Committee for its governance, and for prudent and effective stewardship.

2.2 Members act as committee members and not as Trustees. There is no Trust Deed or Agreement as with Private Pension funds. Nonetheless, Members have fiduciary duties to participating employers and scheme members and take decisions with advice from Corporate Director Resources, officers and professional advisors, in accordance with the committee rules and voting procedures.

2.3 Under the terms of the County Council's Constitution, the Pension Fund Committee has been delegated the following terms of reference:

2.3.1. Powers and duties arising from Section 7 of the Superannuation Act 1972 and Regulations made thereunder including:

approval of applications from bodies seeking admission to the Local Government Pension Scheme;

appointment of external investment managers and advisers.

3. Composition

3.1. The Myners' first principle states that decisions should only be taken by persons or organisations with the skills, information and resources necessary to take them effectively. In order to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take. The Fund holds training sessions in advance

of decisions being taken, in particular when the investment strategy is considered, presentations on topical issues, related to possible choices of future investment. Further training in time for actuarial valuations is also undertaken.

3.2. The structure of the Pension Fund Committee is as follows:

Body/ category of bodies represented	Number of Committee Members
Durham County Council	11
Darlington Borough Council	2
Colleges	1
Other Statutory Bodies	1
Admitted Bodies	1
Member representatives	2
Total	**18**
plus non-voting union observers	*2*

3.3. The allocation of members to the Committee broadly reflects the number of active members, pensioners and deferred pensioners each of the larger employers has within the Fund. It has appropriate representation for the large employers within the Fund whilst maintaining a manageable governance framework for the size of the committee. The two trade union representatives are invited as observers.

3.4. The representatives from Durham County and Darlington Borough Councils are appointed by decisions of the respective councils. Representatives of the colleges, other statutory bodies, and admitted bodies are selected by the Committee from nominations made by the employers and are appointed for 4 years. The two scheme member representatives are selected by the Committee from applications received from the membership following advertisement in the newsletter: one from active scheme members and one from pensioner members.

3.5. All members of the Committee, union observers and independent advisers are given full access to papers and are allowed to participate in meetings.

3.6. All members appointed to the Committee have voting rights. Union observers and advisers do not have voting rights as they do not act as formal members of the Committee.

3.7. The Pension Fund Committee meets four times a year and occasionally holds special meetings when required.

3.8. The quorum for each regular meeting of the Committee is 5.

3.9. Minutes of the Committee are reported under the existing County Council Committee framework.

3.10. Detailed performance reports will remain confidential items on Committee agenda as will any other item deemed as such by the Chairman although the Committee will aim to operate as transparently as feasible.

4. Terms of Reference

Number	Term of Reference	Frequency of Reporting
	The Pension Fund Committee's objective is to ensure effective stewardship of the Fund's affairs. The Pension Fund is governed by Local Government Pension Scheme Regulations and the Committee will ensure that the Pension Fund is run in accordance with the Regulations.	
1	To prepare, monitor and undertake an annual review of policy documents including the: Funding Strategy Statement Statement of Investment Principles Governance Policy Communications Policy Administration Strategy (discretionary)	Annually
2	To review policy on social, environmental and ethical matters and on the exercise of rights, including voting rights.	Annually
3	To appoint and terminate, within the procurement and contract rules,: investment managers custodian actuary independent external advisers Additional Voluntary Contribution (AVC) providers, and other contracts related to the management of the Pension Fund	In line with contractual requirements and as and when required
4	To consider the appropriateness of the committee structure to deliver the outcomes required by the Terms of Reference, e.g the establishment of an investment sub-committee.	Annually

Number	Term of Reference	Frequency of Reporting
5	To be responsible for governance arrangements including regulatory compliance and implementation of audit recommendations	Quarterly
6	To approve the annual internal audit plan and monitor progress on it's delivery.	Annually and quarterly monitoring
7	To review and monitor the Pension Fund Risk Register.	Annually
8	To determine the overall investment strategy and strategic asset allocation, ensuring that investments are sufficiently diversified, not over concentrated in any one type of investment and that the pension fund is invested in suitable types of investments;	Minimum of 2 yearly reviews
9	To obtain, and have due regard to, professional advice from the fund managers, investment advisers, officers and the fund actuary as appropriate;	Quarterly and as and when required
10	To monitor and review the investment managers' performance against established benchmarks and to be satisfied of the investment managers' expertise and the quality of their internal systems and controls;	Quarterly
11	To take appropriate and timely action in cases of unsatisfactory performance of the investment managers and independent external advisers;	Quarterly and as and when required
12	To monitor the cash flow forecasts of the fund;	Quarterly
13	To review the resources allocated to investment managers on a regular basis;	Quarterly
14	Ensure appropriate arrangements are in place for the administration of benefits and contributions.	Annually

Number	Term of Reference	Frequency of Reporting
15	To approve, apply and decide upon employers joining and leaving the Fund. To consider, and if appropriate, approve applications of employers to become admitted bodies to the fund.	As and when required
16	To agree an accounting policy for the Fund consistent with IFRS and relevant authoritative guidance in order to prepare and publish a Pension Fund Annual Report including an abstract of accounts.	Annually
17	To review the Annual Report and Accounts of the Pension Fund and report its findings to the Audit Committee, where the Accounts are approved.	Annually
18	To consider all other relevant matters to the investment and administration of the fund.	As and when required
19	To establish constitutional documents, codes, policies, plans, frameworks and protocols connected with the establishment and operation of the Local Pension Board	As and when required

5. Meetings

5.1. The Pension Fund Committee meets four times a year and occasionally holds special meetings when required. The Pension Fund Committee also holds an Annual General Meeting to which all employers are invited. This maintains a manageable governance framework in terms of the frequency of meetings.

6. Programme of Work

6.1. An annual programme of work, cross referenced to the terms of reference, will be agreed annually by the Pension Fund Committee showing expected documents and reports to be presented and any training requirements.

7. Performance and Review

7.1. The Pension Fund Committee will carry out an annual self-assessment, including a review of these terms of reference, to evaluate its own performance and determine any action required to improve its effectiveness.

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Pension Fund Committee

12 March 2020

Pension Fund Policy Documents – Funding Strategy Statement

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

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

Executive summary

2 The Local Government Pension Scheme (LGPS) Regulations require the Fund to maintain and publish a Funding Strategy Statement (FSS). The FSS has been amended to reflect the approach taken to the current valuation.

Recommendation(s)

3 Members are asked to:

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

(b) authorise the Corporate Director of Resources to finalise the wording of the FSS, taking into account where appropriate both professional advice on the Local Government Pension Scheme (Amendment) Regulations 2020 as well as comments received from employers, and publish final versions by 31 March 2020.

Background

4 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).

5 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:
>
> i. the guidance issued by the Chartered Institute of Public Finance (CIPFA) for this purpose; and
> ii. their own Investment Strategy Statement (ISS)
> iii. 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

6 On 27 February 2020 the Local Government Pension Scheme (Amendment) Regulations 2020 were laid before parliament. They come into force on 20 March 2020, but have effect backdated to 18 May 2018. At the time of writing the Fund is taking professional advice on the impact of the changes.

7 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ('the 2016 investment regulations'), which took effect from 1 November 2016 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). The ISS needs to be prepared in accordance with guidance issued from time to time by the Secretary of State.

8 A revised draft FSS is included at Appendix 1 and the current ISS is included at Appendix 2 for information.

Funding Strategy Statement

9 The Pension Fund Actuary has been closely involved in the preparation of the revised FSS, which reflects the funding approach taken to the latest triennial valuation, as at 31 March 2019. Significant changes from the previous version of the FSS are as follows:

(a) Codifying the Fund's approach to Exiting Employers in light of the requirement to pay out exit credits

(b) Limiting asset transfers to academies to 100% of the liabilities

(c) Introducing an Intermediate Funding Target, for Colleges

(d) Further detail on the spreading of surplus and advance payment of deficit contributions

(e) Detailing the list of employers grouped on the Town and Parish Council rate for clarity

(f) Outlining the approach to the McCloud judgement

Next Steps

10 The draft FSS was sent to all Pension Fund employers week commencing 24 February 2020 with a request for comments within two weeks.

11 Final versions of the documents will be circulated by 31 March 2020. The ISS may need to be revised, if the Pension Fund's investment strategy changes. This will require necessitate further consultation with employers.

Author(s)

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Appendix 1: Funding Strategy Statement

Pension Fund

Funding Strategy Statement

TABLE OF CONTENTS

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 September 2016 entitled "Guidance on Preparing and Maintaining a Funding Strategy Statement and to the Fund's Statement of Investment Principles"
  - its Investment Strategy Statement (ISS) 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.

- 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 2019, and has been updated in March 2020.

(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 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 an ISS, both after proper consultation with interested parties, and

- Monitor all aspects of the fund's performance and funding and amend the FSS and 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 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 using appropriate actuarial methods and assumptions. 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 tax-raising Scheduled Bodies, and certain other bodies where a Scheme Employer of sound covenant has agreed to subsume its assets and liabilities following the exit of the employer from the Fund, the Solvency Target is set at a level advised by the Fund Actuary as a prudent long-term funding objective for the Fund to achieve at the end of the Trajectory Period, based on continued investment in a mix of growth and matching assets intended to deliver a return above the rate of increases to pensions and pension accounts.

- 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 chance of achieving solvency will be set commensurate with assumed investment in an appropriate portfolio of Government 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 modelling carried out by the Fund Actuary.

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 2019 valuation, the Trajectory Period used was 25 years, and the probability of Funding Success was set to be 75%.

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, assumptions and data. The valuation calculations, including 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).

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.

- **Tax-raising Scheduled Bodies and certain other bodies where a Scheme Employer of sound covenant has agreed to subsume its assets and liabilities following the exit of the Employer from the Fund**
  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. This is known as the Scheduled Body/Subsumption Funding Target.

- **Non tax-raising scheduled bodies (in particular colleges)**
  Whilst the Administering Authority will adopt a general approach of assuming indefinite investment in a broad range of assets of higher risk, a reduction will be made to the left service discount rate to reflect concerns about the covenant strength of Colleges. This is known as the Intermediate Funding Target

- **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). This is known as the Ongoing Orphan Funding Target.

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 employers which are assessed by the Administering Authority as being a long term secure employer.

- For employers who are less than 100% funded, 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.

- For employers who have a surplus, the Administering Authority will aim not to reduce the recovery period from that used at the previous valuation, noting that longer recovery periods lead to a smaller surplus reduction to the contribution rate.

- In line with the desirability of maintaining as nearly constant a contribution rate at this and future valuations, the Recovery Period shall not apply to any employer at a funding level of between 100% - 105%. Those employers will be required to pay the primary rate (i.e. the future service rate) in full, without any adjustment for a surplus. In respect of any employer at a funding level in excess of 105%, the Recovery Period shall only apply to any surplus above the 105% funding level.

A period of 18 years has been used for Durham County Council at the 2019 valuation, the largest employer in the Fund. Recovery Periods for other employers or employer groups may be shorter or longer 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 employers may step up (or down) to the new rates subject to this not introducing undue risk to the Fund. 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.

Advance Funding of Secondary Contributions

31. The Administering Authority may at its discretion, and after considering the advice of the Fund Actuary, permit particular employers to opt to pay early, in lump sum form, the secondary contributions designed to meet a deficit, that would otherwise be payable over the following year (or longer period not exceeding three years). An appropriate discount, as determined by the Fund Actuary, would be applied to the secondary contributions to reflect the early payment.

Grouping / Pooling

32. In some circumstances it may be desirable to group or pool 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 such as outsourcings which have been carried out on a 'pass-through' approach where it makes sense for the service provider to be given either the same primary contribution rate as the outsourcing body or the fixed contribution rate agreed contractually, or
    - employers have been grouped for practical or commercial reasons.

33. The Administering Authority recognises that grouping of employers 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.

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

35. All employers in the Fund are grouped together in respect of the risks associated with payment of survivors pensions and lump sum benefits 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.

36. There are a small number of different groups and approaches used and these are set out in the Appendix to this FSS.

Asset shares notionally allocated to employers

37. 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.

38. 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

39. 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.

40. 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 cash equivalent transfer value based on appropriate factors set by the Government Actuary's Department.

- Allowance for death in service and ill-health 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.

41. 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.

42. 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

43. 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.

44. 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

45. 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.

46. 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.

47. 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.

48. 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

49. 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.

50. 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

51. 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.

52. 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.

53. 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

54. 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. This is a form of risk sharing between the employers.

55. 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

56. 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.

57. 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.

58. 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.

59. 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

60. 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.

61. 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.

62. 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, to a maximum of 100%. The funding level applicable to the active members is then used to calculate the notional asset transfer to the new employer.

63. 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

64. 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 any asset transfer associated with the transfer of active members to another employer in the Fund) and the status of any liabilities that will remain in the Fund.

65. In particular, the exit valuation will be carried out assuming investment in low risk investments such as Government bonds.

66. Where the exit valuation shows a deficit, an exit payment will be required from the exiting employer. The administering authority, at its sole discretion, may allow phased payments.

67. For exits on or after 14 May 2018, where the exit valuation discloses that there is a surplus in the Fund in respect of the exiting employer, and the surplus is due to be paid to the exiting employer, the Administering Authority will, unless otherwise agreed with the employer, pay the exit credit to the employer within 3 months of the later of the exit date and the date when the employer has provided all the necessary information required by the administering Authority to enable the Fund Actuary to calculate the final liabilities on exit.

68. The administering authority may allow another participating scheme employer (such as a guarantor) to subsume the assets and liabilities of the exiting employer. The subsuming employer will assume responsibility for all assets and liabilities of the exiting employer and for the future funding of those assets and liabilities. In such a case, no exit payment would be required from the exiting employer. Where there is an agreement entered into with provisions relating to the exit valuation (including the funding target to be used) then the agreed approach set out in the agreement will be adhered to.

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

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

General Principles and diversification

70. 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.

71. 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.

72. 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.

73. 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.

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

75. 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

76. 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.

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

78. 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
- risks associated with the transition of assets to the pool

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.

79. 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

80. 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.

81. 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

There are a number of uncertainties associated with the benefit structure at the current time including:

- How Government will address the issues of GMP indexation and equalisation for the LGPS beyond expiry of the current interim solution from 6 April 2021
- The remedy to compensate members of illegal age discrimination following the outcome of the McCloud / Sargeant cases. Whilst the Government's application for leave to appeal has been denied there is currently still uncertainty relating to the remedy and exactly how this will apply to the LGPS
- The outcome of the cost management process and whether the agreement reached in relation to the Scheme Advisory Board (SAB) process for member contributions to be reduced and benefits enhanced to aschieve an additional cost of 0.9% of pay will change as a result of the MccCloud / Sargeant ruling.

  In determing how these uncertainties should be allowed for in employer conmtributions from 1 April 2020 the Administering Authority has had regard to guidance issued by SAB and taken Fund Actuary advice and decided to add 0.9% of pay to each employer contribution rate.

82. 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.

83. 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.

84. 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.

85. 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.

86. 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.

87. 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

88. 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.

Appendix: Groups / Pooling

Issues relevant to all employers

The assets and liabilities for employers will allow for any assets and liabilities the employer has agreed to subsume relating to employers who have exited or have been taken over / merged as a result of reorgainisation. This for example includes:

- For Durham County Council the assets and liabilities relating to the District Councils which formed the Durham County Council unitary authority and the assets and liabilities those District Councils originally were responsible for.
- For Multi Academy Trusts (MAT) the assets and liabilities relating to schools or other academies which now form part of the MAT.

Town Council Group

Employers in this group are pooled together for funding and contribution purposes, all risks are shared within the group and they have a single contribution rate.

The active participants of this Group at the date of writing this Statement are:

Framwellgate Moor Parish Council
Fishburn Parish Council
Trimdon Parish Council
Horden Parish Council
Murton Parish Council
Easington Colliery Parish Council
Shotton Parish Council
Wingate Parish Council
Lanchester Parish Council
Monk Hesledon Parish Council
Thornley Parish Council
Wheatley Hill Parish Council
Trimdon Foundry Parish Council
Easington Village Parish Council
Sedgefield Town Council
Spennymoor Town Council
Ferryhill Town Council
Great Aycliffe Town Council
Peterlee Town Council
Shildon Town Council
Seaham Town Council
Brandon & Byshottle Parish Council
South Hetton Parish Council
Peterlee Parish Council
Hutton Henry Parish Council
Chilton Parish Council

Stanley Town Council
Barnard Castle Town Council
Bishop Auckland Town Council
Greater Willington Town Council
Haswell Parish Council
Winston Parish Council
Durham City Parish Council

In addition, there are liabilities related to the following bodies which currently have no active members. These liabilities remain part of the group:

Esh Parish Council
Healeyfield Parish Council
Pelton Parish Council
Central Durham Joint Crematorium Committee
North Lodge Parish Council

If a Town Council has no contributing members it will become an exiting employer under Regulation 64(1) unless a suspension notice has been issued (a suspension notice can be issued for a period of up to three years if there is a reasonable likelihood an active member will join the Fund within the suspension period (Regulations 64(2A) to 64(2C)).

Given the liabilities are generally small the Administering Authority will not expect an exiting employer from the Group to make an exit payment or receive any exit credit unless the exiting employer has a material impact on the other employers in the Group. The assets and liabilities relating to the exiting employer will remain part of the Group.

Durham County Council

In addition to the subsumption of the assets and liabilities relating to relevant exiting employers and District Councils referred to above, Durham County Council has a pass through contractual arrangement with the following employers who as a consequence have been pooled with Durham County Council and will pay the primary contribution rate relating to the pool:

Investing in Children (195)
Harbour Support Services (206)
Science Museum Locomotion (224)
YS Services (228)

Darlington County Borough Council

In addition to the subsumption of the assets and liabilities relating to relevant exiting employers Darlington Council has a pass through contractual arrangement with the following employers who as a consequence have been pooled with Darlington Council and will pay the primary contribution rate relating to the pool:

Blackwell Grange Golf Club (198)
NECA (199)
Making Space (205)

Appendix 2: Investment Strategy Statement

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:

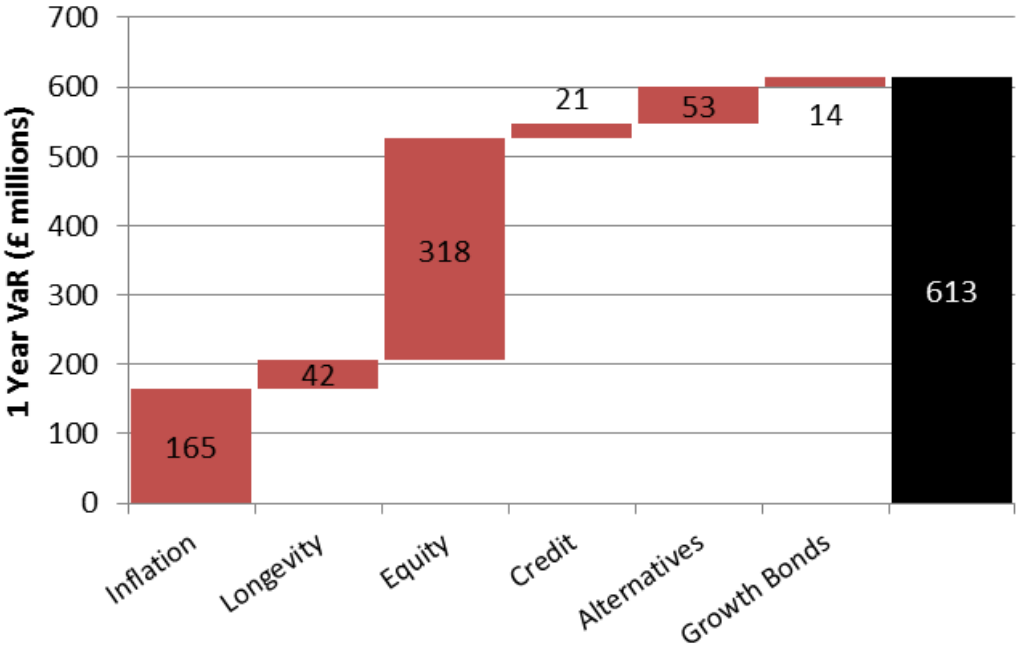
- The required level of return that will mean the Pension Fund can meet its future benefit obligations as they fall due
- The level of risk that the Pension Fund can tolerate in absolute terms, and in relation to its funding level and deficit
- An analysis of the order of magnitude of the various risks 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.

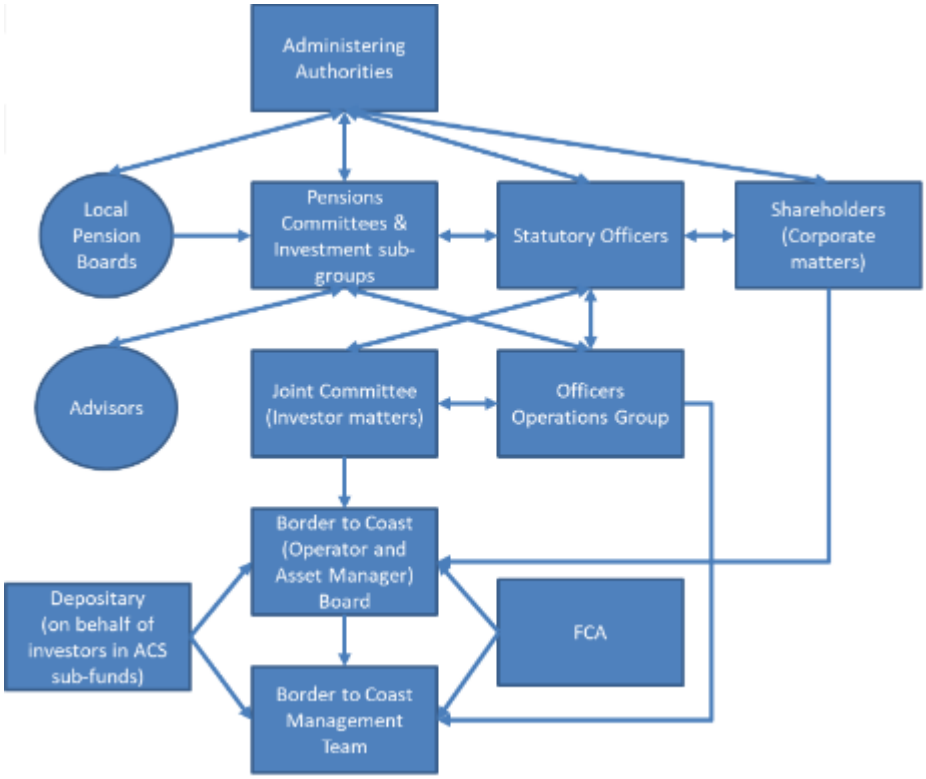
5.2 Structure and governance of BCPP Ltd

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 Committee

12 March 2020

Review of Pension Fund Risks

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 2020.

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 of February 2020, 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 2020, there were 14 risks on the Pension Fund risk register, which is attached as Appendix 2.

Author(s)

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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, February 2020

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 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 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 Advisors 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. 15. ISS Approach to Risk. 16. ISS Counterparty Risk Acceptability. 17. High level of compliance with Myners Principles. 18. Mitigating actions would be taken such as investing in assets which produce cashflows or withdrawing cash from fund managers. 19. Regular cashflow monitoring. 20. Quarterly reporting to PFC.	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	1. Spreading of investments across different counter parties reduces risk of defaults being material. 2. Due diligence before appointing counterparty. 3. Appointment of pension fund custodian.	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 Fund'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 form part of asset manager selection rationale. 3. Reporting from current investment managers includes details of voting activity. BCPP publish voting activity quarterly. 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	15	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. 9. Targeting returns in excess of the discount rate.	5	2	10

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. Annual returns reconciled to monthly payments. 2. As part of the process for the actuary's triennial valuation, bodies have opportunity to discuss funding. 3. Use of bonds and guarantees. 4. The Fund considers admittance of admitted bodies, following process to manage risk of each admission 5. 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. The Fund considers admittance of admitted bodies, following process to manage risk of each admission	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 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. PF Committee consider risks of investment and approve transitions into BCPP. 4. Due diligence on sub-funds in conjunction with investment consultants. 5. Part owners/control – fund represented on BCPP Joint Committee by PFC Chair, statutory officer groups, senior pension officer groups and AGM, 6. Transitions managed by externally appointed Transitions Manager.	5	2	10
9	A serious ICT failure, leading to disruption to the discharge of administering authority functions (Administrative Risk).	Service delivery	4	4	16	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

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
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. Collection of member data through automated monthly process for large employers. 3. Internal checking and validation procedures. 4. Checking and validation by the Actuary. 5. Annual data quality report to regulator.	2	2	4
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

Ref	Risk	Potential Impact	Gross Impact Score	Likelihood	Gross Risk Score	Mitigating controls	Net Impact Score	Net Likelihood	Net Risk Score
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. 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	3	3	9	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.	3	1	3
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	4	8	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. 4. Staff training. 5. Subscription to providers' legislative updates.	2	2	4

Pension Fund Committee

12 March 2020

Agreement of Accounting Policies for Application in the 2019/20 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 2019/20 financial statements of the Pension Fund and to seek confirmation from the Committee that appropriate policies are being applied.

Executive summary

2. All accounting policies which were agreed by the Pension Fund Committee at its meeting in March 2019 and applied in the preparation of the 2018/19 Statement of Accounts remain appropriate for the preparation of 2019/20 Statement of Accounts.

3. The full list of accounting policies proposed for disclosure in the Pension Fund's Financial Statements for 2019/20 is detailed in Appendix 1.

Recommendations

4. The Committee is recommended to:

- review the accounting policies;
- approve their use in the preparation of the 2019/20 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 2019/20' (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 2018/19 accounts and there have been no changes to the Code necessitating a change for 2019/20.

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 2019/20

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). The Fund has a policy of accruing for items of £10,000 or over, unless in exceptional circumstances.

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 using the effective interest rate of the financial instrument as at the date of acquisition.
- 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.

Voluntary and Mandatory Scheme Pays (VSP, MSP) and Lifetime Allowances

Members are entitled to request the Pension Fund pays their tax liabilities due in respect of annual allowance and lifetime allowance in exchange for a reduction in pension. Where the Fund pays member tax liabilities direct to HMRC it is treated as an expense in the year in which the payment occurs.

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.

- Shares in the Border to Coast Pensions Pool (BCPP) have been valued at cost as a proxy for fair value;

- 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. 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.

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 in the Fund Account as part of the Change in Value of Investments.
Other financial liabilities classed as amortised cost are carried at amortised cost i.e. the amount carried in the net asset statement is the

outstanding principal repayable plus accrued interest. Any interest charged is accounted for on an accruals basis and included in administration costs.

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 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.

Prior Period Adjustments
Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

Events After the Reporting Period
Events after the Balance Sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the Statement of Accounts is authorised for issue. Two types of events can be identified:

- Those that provide evidence of conditions that existed at the end of the reporting period - the Statement of Accounts is adjusted to reflect such events.
- Those that are indicative of conditions that arose after the reporting period - the Statement of Accounts is not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the Statement of Accounts.

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Agenda Item 21

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