Pension Fund Committee

Date Thursday 7 March 2013

Time 10.00 am

Venue Committee Room 2 - County Hall, Durham

Business

Part A

1. Apologies for Absence

2. The Minutes of the Meeting held on 4 December 2012 (Pages 1 - 6)

3. Declarations of interest (if any)

4. Graphs showing recent movements of the Stock and Share Indices (Pages 7 - 14)

5. Graphs showing recent movements of the major currencies against sterling (Pages 15 - 18)

6. Performance Measurement Report (Pages 19 - 28)

7. Pension Fund Investments (Pages 29 - 34)

8. Short Term Investments for the Period Ended 31 December 2012 (Pages 35 - 36)

9. Investment of the Pension Fund's Cash Balances (Pages 37 - 40)

10. Agreement of Accounting Policies for Application in the 2012/2013 Financial Statements of the Pension Fund (Pages 41 - 46)

11. Pension Fund Policy Documents - Funding Strategy Statement and Statement of Investment Principles (Pages 47 - 102)

12. Terms of Reference (Pages 103 - 112)

13. Such other business as, in the opinion of the Chairman of the meeting is of sufficient urgency to warrant consideration

14. 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)

15. The Minutes of the Meeting held on 4 December 2012 (Pages 113 - 122)

16. Report of the Pension Fund Advisor (Pages 123 - 130)

17. Report of BlackRock (Pages 131 - 146)

18. Report of AllianceBernstein (Pages 147 - 164)

19. Report of CBRE Global Investors (Pages 165 - 172)

20. Report of Royal London Asset Management (Pages 173 - 236)

21. Report of Barings Asset Management (Pages 237 - 244)

22. Tender for Global/Emerging Market Equity - Pre-Qualification Stage (Pages 245 - 254)

23. Such other business as, in the opinion of the Chairman of the meeting, is of sufficient urgency to warrant consideration

Colette Longbottom
Head of Legal and Democratic Services

County Hall
Durham
27 February 2013

To: The Members of the Pension Fund Committee

County Council Members:
Councillors Andy Turner, N Martin, C Carr, J Chaplow, A Hopgood, P Jopling, J Lethbridge, D Morgan, R Ord, G Richardson and R Todd

Darlington Borough Council Members
Councillor I G Haszeldine

(vacancy)

Scheduled Bodies Representative
Mr D Sanders

Admitted Bodies Representative:
Mr K Tallintire

Pensioner Representative
Mrs O Brown

Active Members Representative
(vacancy)

Further Education Colleges Representative
(vacancy)

Advisers:
County Council Officers

Chief Executive	G Garlick
Corporate Director, Resources	D McLure
Head of Legal and Democratic Services	C Longbottom
Strategic Finance Manager – Corporate Finance	H Appleton

Independent Advisers
P J Williams
R Bowker

Investment Managers
BlackRock
AllianceBernstein
CBRE Global Investors
Royal London Asset Management
Barings Asset Management Ltd

Staff Observers

UNISON	N Hancock
GMB	

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 Committee Room 2, County Hall, Durham on **Tuesday 4 December 2012 at 10.00 am**

Present:

Councillor Andy Turner (Chair)

Members of the Committee:
Councillors N Martin (Vice-Chair), C Carr, J Chaplow, A Hopgood, P Jopling, J Lethbridge, D Morgan, G Richardson and R Todd

Apologies:
Apologies for absence were received from Councillor R Ord and from Pensioner Representative O Brown

Also Present:
County Council Advisers
D McLure – Corporate Director, Finance
H Appleton – Strategic Finance Manager – Corporate Finance
N Orton – Payroll and Pensions Manager

Independent Advisers:
P Williams – P J Williams
D Banks - PSolve

1 Declarations of interest (if any)

There were no declarations of interest received.

2 Minutes

The Minutes of the meeting held on 4 September 2012 were agreed as a correct record and were signed by the Chairman.

3 Graphs showing recent movements of the Stock and Share Indices

Consideration was given to graphs showing recent movements in the Stock and Share Indices (for copy see file of Minutes).

P Williams, Pension Fund Adviser commented that UK equities had performed well over the last 12 months, outperforming Index Linked Gilts. Index Linked Gilts were linked to the Retail Price Index (RPI) and consultation was currently underway to potentially change the way this should be calculated in future.

Resolved:

That the information given be noted.

4 Graphs showing recent movements of the Major Currencies against Sterling

Consideration was given to graphs showing movements of the major currencies against sterling (for copy see file of Minutes).

Philip Williams advised that the £ was in a reasonably good position despite continuing QE. The yen had weakened which could be attributed to the forthcoming general election in Japan.

Resolved:

That the information given be noted.

5 Performance Management Report

Consideration was given to the report of the Corporate Director, Resources which provided an overview of the performance of the Fund up to 30 September 2012 (for copy see file of Minutes).

The report gave details of the five Managers against their benchmarks for the third quarter, each year and since inception. Hilary Appleton, Strategic Finance Manager - Corporate Finance, advised that the Plan had outperformed the total benchmark by 0.08% over the third quarter.

Resolved:

That the information given be noted.

6 Pension Fund Investments

Consideration was given to the report of the Corporate Director, Resources which gave details of the overall value of the Pension Fund as at 30 September 2012 and of any additional sums available to the Managers for further investment, or amounts to be withdrawn from Managers (for copy see file of Minutes).

Members were advised that for the reasons outlined in the report it was recommended that no money be added to the sums to be allocated to the Managers for investment in the quarter.

Fund Re-balancing had been suspended until the results of the Strategy Review and would re-commence when the new structure was in operation.

The report also gave details of the forecasted cash flow for 2012/2013.

Resolved:

That the information given be noted.

7 Record Keeping - Pensions Regulator Best Practice Guidelines

Consideration was given to the report of the Corporate Director, Resources which advised of best practice guidelines issued by the Pensions Regulator on record-keeping. It sought approval to the commissioning of a tracing agency to trace deferred members who had changed address without informing the pension scheme, and to compare the pensions database against the national register of deaths (for copy see file of Minutes).

Following a question from Councillor Jopling Members were assured that recovery action was taken when cases of overpayment had been identified.

In discussing the options Members felt that in view of the cost of tracing deferred members who had moved without notifying the scheme, the exercise be undertaken shortly before the member reached the age of 60, to avoid having to repeat the exercise should they move again.

In addition, as a one-off initiative, the Committee agreed that the whole database be compared against the National Register of Deaths.

Resolved:

That

(i) the information given be noted;

(ii) the Pension Fund commission a tracing agency to trace deferred members who had changed address without informing the Pension Scheme and who were approaching the age of 60;

(iii) the pensions database be compared against the National Register of Deaths.

8 Terms of Reference

Consideration was given to the report of the Corporate Director, Resources which informed Members of the progress in determining terms of reference for the Pension Fund Committee (for copy see file of Minutes).

A copy of the draft Terms of Reference were attached to the report. Hilary Appleton advised that the Terms of Reference would determine the future programme of works of the Committee and suggested that a workshop session be arranged to enable Members to review the draft terms of reference and develop a document that could be agreed by the Council.

Councillor Carr referred to the review carried out by Audit in relation to the responsibilities of the Committee and expressed concern with regard to the areas highlighted for consideration, in particular the reference to the minutes not covering all relevant information. He hoped that the workshop would address all the issues referred to.

Resolved:

That

(i) the draft operational Terms of Reference be noted;

(ii) a workshop session be arranged to agree the Terms of Reference and the information requirements of the Committee.

9 Local Government Pension Scheme: Investment in Partnerships - CLG Consultation

Consideration was given to the report of the Corporate Director, Resources which informed Members of a consultation by the Department for Communities and Local Government (CLG) (for copy see file of Minutes).

In discussing the report Councillor Morgan asked what the constraints were in terms of the current 15% limit on investment in partnerships. Daniel Banks, Pension Fund Adviser explained that the existing limit was considered to be too low, preventing local authority Pension Funds from pursuing infrastructure opportunities. This in effect limited diversification by constraining access to an asset class that may be well-suited to a local authority Pension Fund's long term needs.

Councillor Jopling asked if investment in infrastructure by Durham Pension Fund would benefit County Durham. Daniel Banks advised that this would depend upon where it chose to invest. The overall aim of the proposals was to make more funds available to invest in infrastructure throughout the UK.

Philip Williams added that this was a complex issue and if the Fund wished to pursue investment in infrastructure Advisers would investigate closely on their behalf. In general terms it would be more attractive to invest in contracts already in place and delivering index linked returns.

Don McLure, Corporate Director, Resources added that it was pleasing to note that the Government's proposed changes to Private Finance Initiatives (PFIs), an approach sometimes used to procure construction projects, would now benefit the public sector.

Resolved:

That the consultation be noted and the Corporate Director, Resources be granted delegated authority to respond to Communities and Local Government on behalf of the Pension Fund, as outlined in paragraphs 10 to 13 of the report.

10 Short Term Investments for the period Ended 30 September 2012

Consideration was given to report of the Corporate Director, Resources which gave details of the Pension Fund's short term investments for the 6 month period ended 30 September 2012 (for copy see file of Minutes).

Resolved:

The position regarding the Pension Fund's short term investments as at 30 September 2012 be noted.

11 Annual Governance Report for the Year Ended 31 March 2012

Consideration was given to the report of the Corporate Director, Resources which informed Members of the completion of the audit of the Pension Fund Accounts and presented the Annual Governance Report for the financial year ended 31 March 2012 (for copy see file of Minutes).

Resolved:

That the information given be noted.

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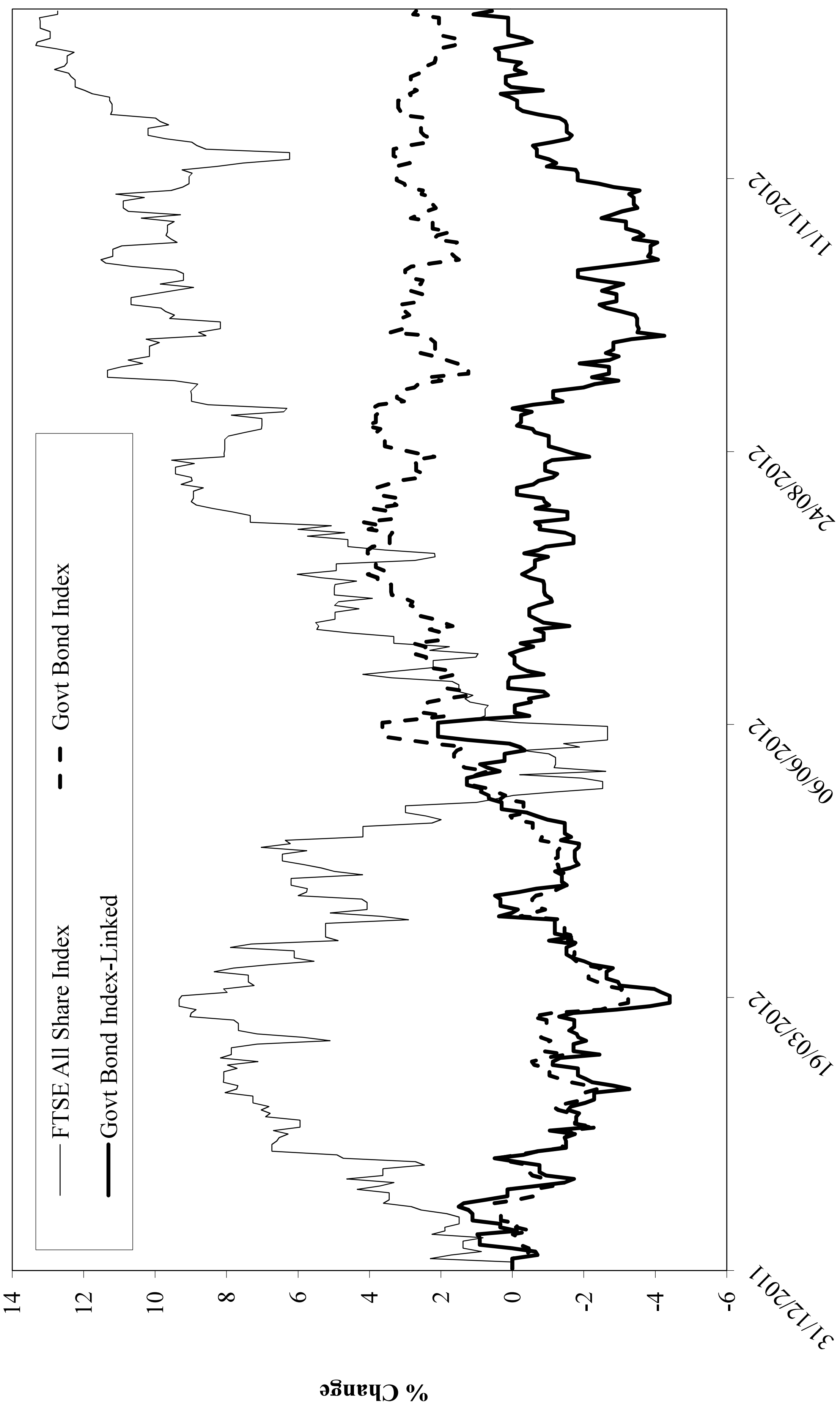
UK Markets


FTSE All Share Index
Govt Bond Index-Linked
Govt Bond Index
% Change
14
12
10
8
6
4
2
0
-2
-4
-6
31/12/2011
19/03/2012
06/06/2012
24/08/2012
11/11/2012

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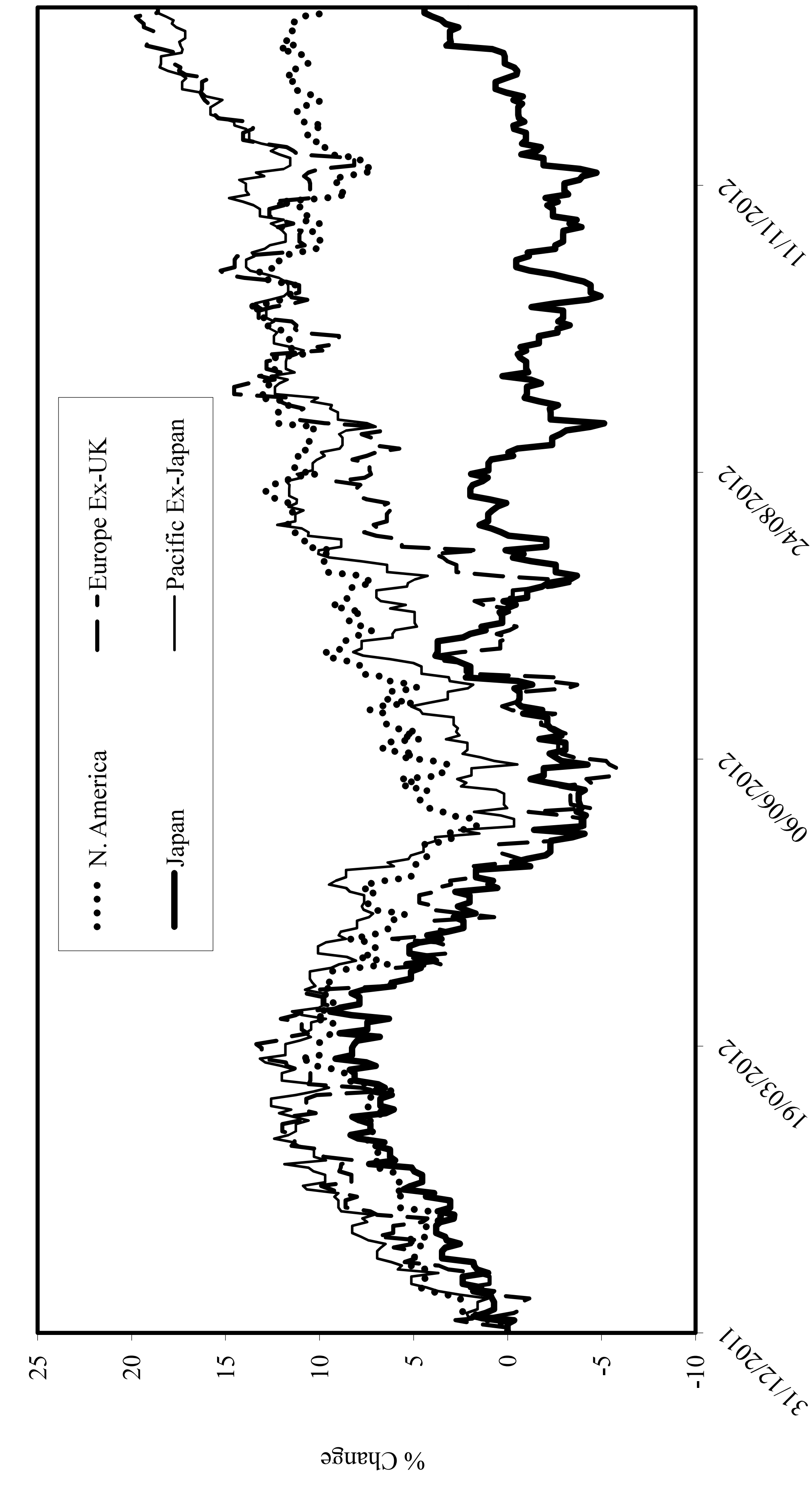
Overseas Equity Markets



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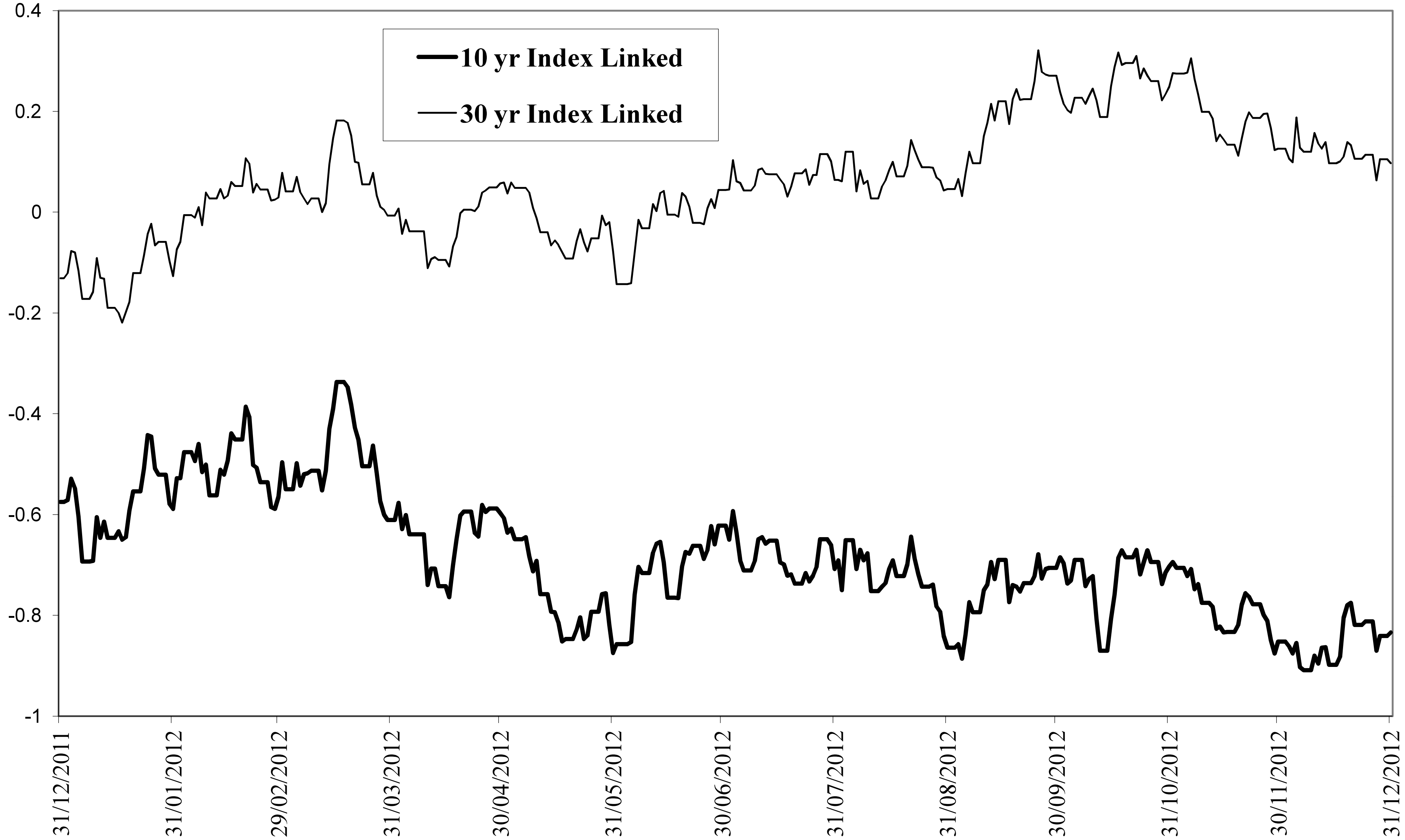
UK Index-Linked Yields



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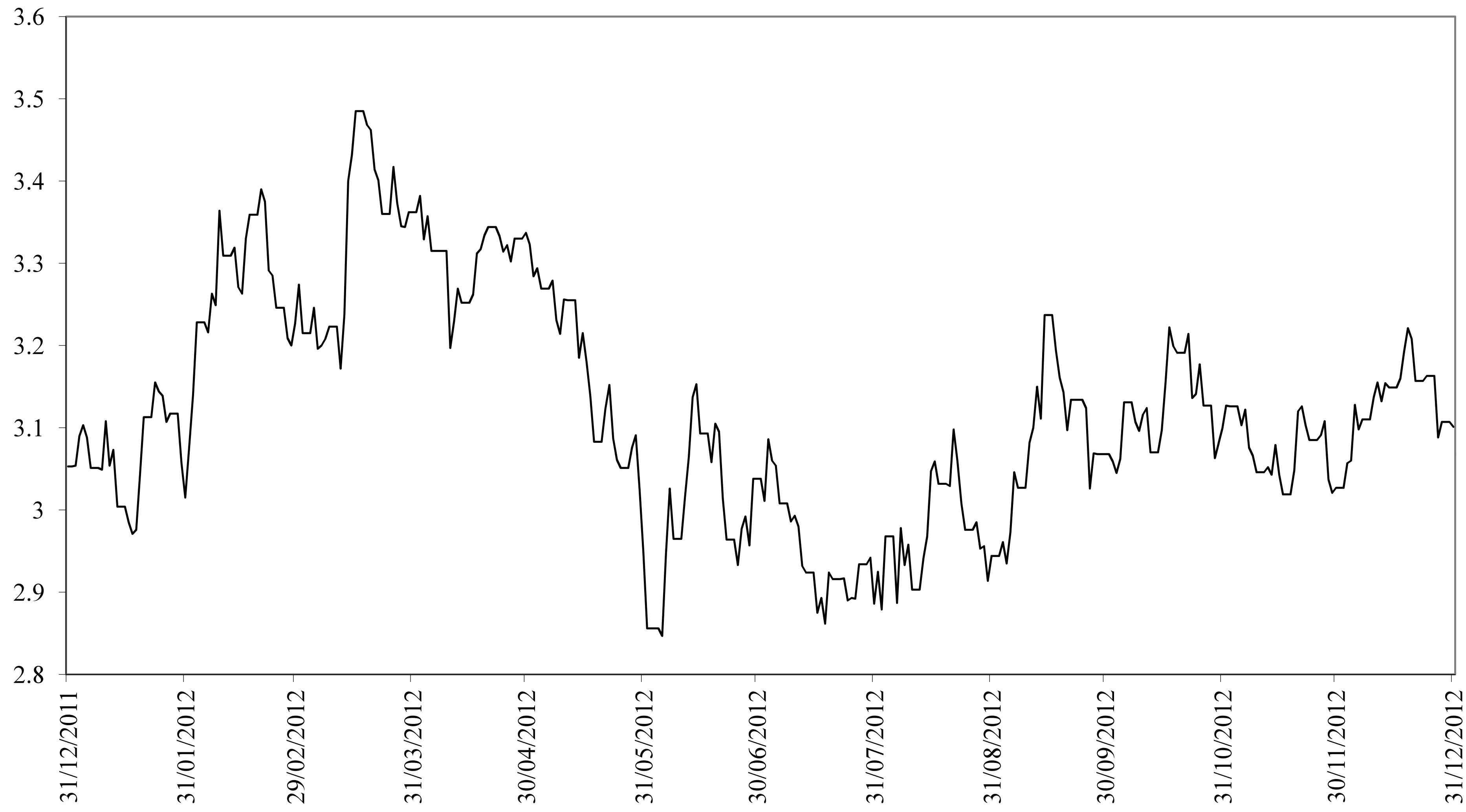
30 yr Gilt


3.6
3.5
3.4
3.3
3.2
3.1
3
2.9
2.8
31/12/2011
31/01/2012
29/02/2012
31/03/2012
30/04/2012
31/05/2012
30/06/2012
31/07/2012
31/08/2012
30/09/2012
31/10/2012
30/11/2012
31/12/2012

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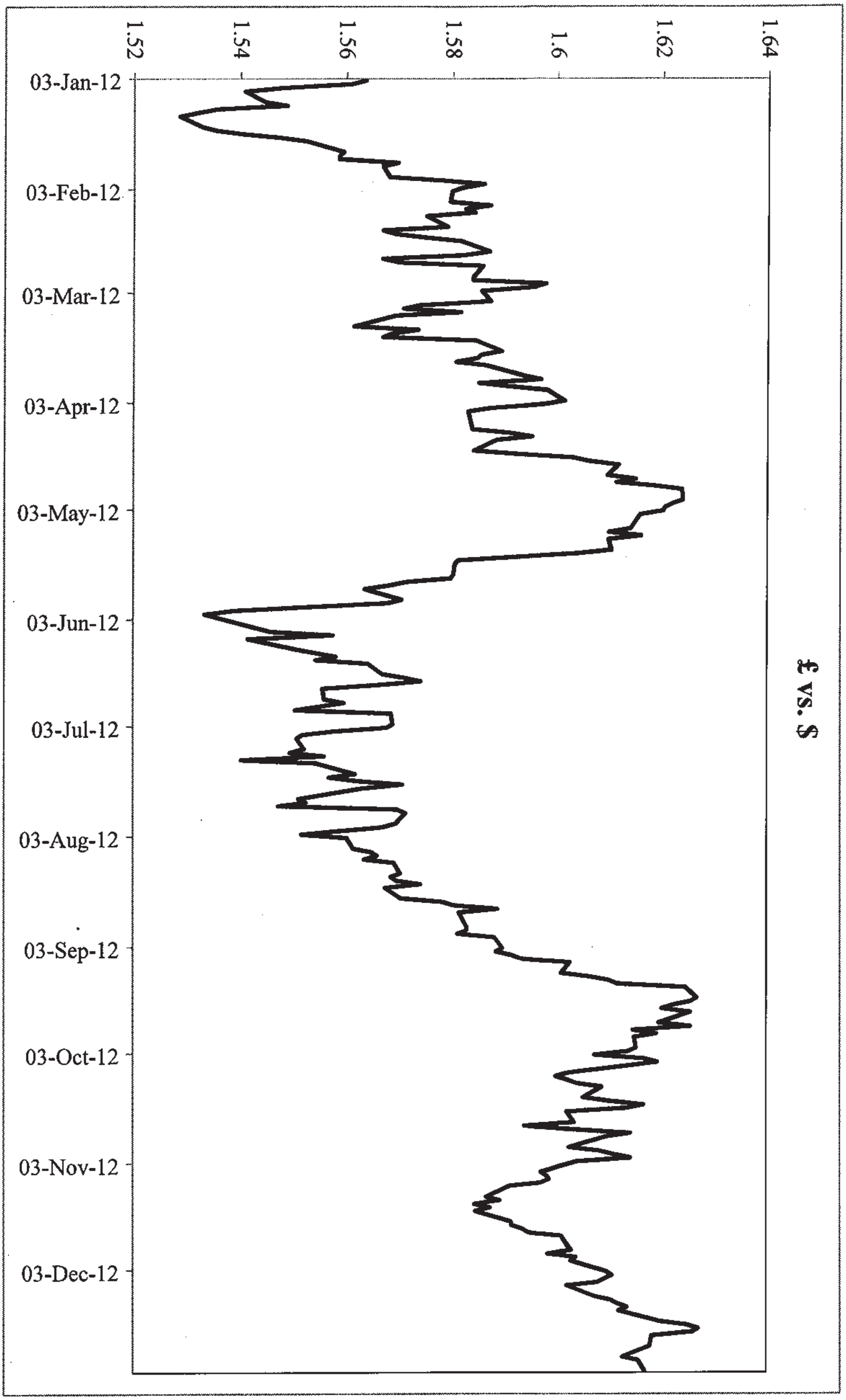
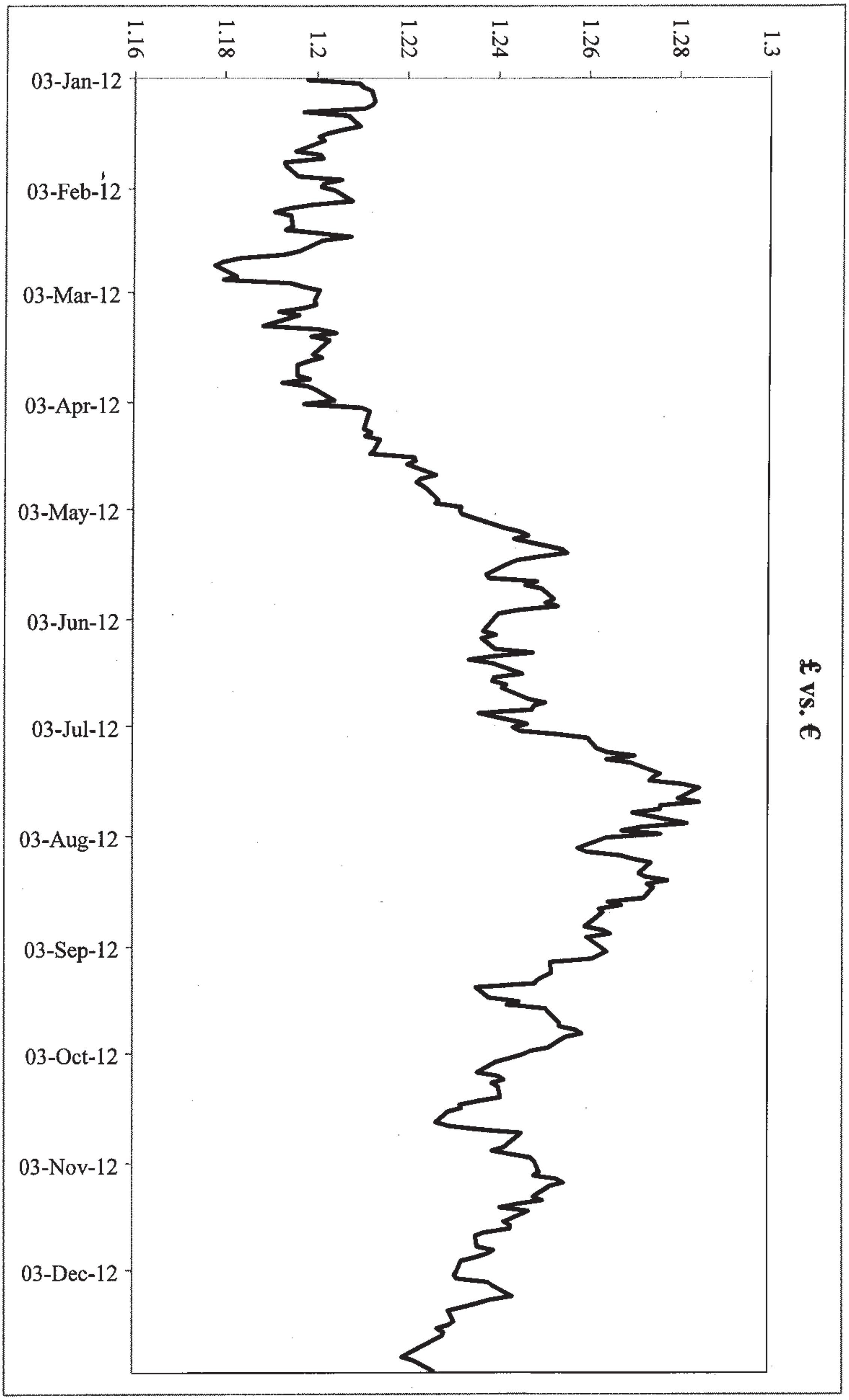

£ vs. $
1.52
1.54
1.56
1.58
1.6
1.62
1.64
03-Jan-12
03-Feb-12
03-Mar-12
03-Apr-12
03-May-12
03-Jun-12
03-Jul-12
03-Aug-12
03-Sep-12
03-Oct-12
03-Nov-12
03-Dec-12


£ vs. €
1.16
1.18
1.2
1.22
1.24
1.26
1.28
1.3
03-Jan-12
03-Feb-12
03-Mar-12
03-Apr-12
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03-Jun-12
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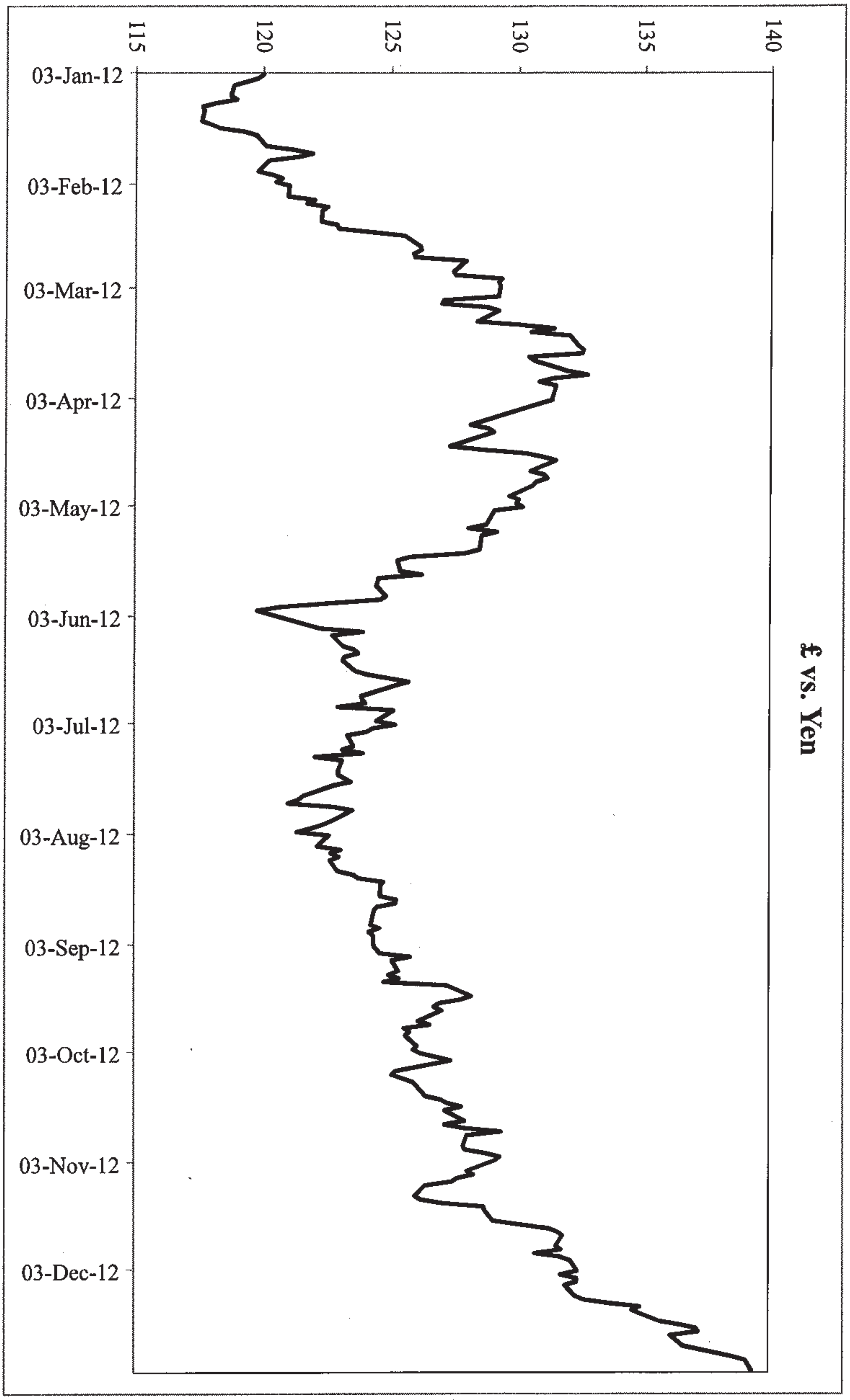
03-Aug-12
03-Sep-12
03-Oct-12
03-Nov-12
03-Dec-12


£ vs. Yen
115
120
125
130
135
140
03-Jan-12
03-Feb-12
03-Mar-12
03-Apr-12
03-May-12
03-Jun-12
03-Jul-12
03-Aug-12
03-Sep-12
03-Oct-12
03-Nov-12
03-Dec-12

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Pension Fund Committee

7 March 2013

Performance Measurement Report

Don McLure, Corporate Director, Resources

Purpose of the Report

1 The purpose of the report is to provide an overview for Members of the performance of the Fund to 31 December 2012.

Background

2 The performance of the five Managers is measured against personalised benchmarks chosen at the inception of the Fund. The attached report from JPMorgan, the Fund's custodian, shows:-

(a) The Managers benchmarks.

(b) The total Fund performance, for the quarter, year to date and since inception.

(c) The Managers' performance in absolute and relative terms against the relevant benchmarks, for the quarter, year to date and since inception.

(d) A portfolio comparison for the quarter ended 31 December 2012 and for the period since inception.

Recommendation

3 Members note the information contained in this report.

Contact: Hilary Appleton Tel: 03000 266239

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J.P.Morgan

Worldwide Securities Services

Performance Measurement Report
for
Durham County Council Pension Fund

for period ending
December 31, 2012

Contents

Benchmark Association Table

PORTFOLIO	INDEX	TARGET	WEIGHT %
Edinburgh Partners	MSCI AC World Index (Gross)	+3% pa	100.00
Blackrock	FTSE All Share (Gross)	+3% pa	100.00
Blackrock Passive Equity	FTSE-Ftse Aw Developed (Gross)	Not Applicable	100.00
Alliance Berstein	GBP Libor (3 month)	+3% pa	100.00
Royal London	FTSE index Linked >5 years	+0.5% pa	100.00
Barings	GBP Libor (3 month)	+4% pa	100.00
CBRE 1	Headline RPI	+5% pa	100.00
CBRE 2	Headline RPI	+5% pa	100.00
Re Alliance Berstein PPIP	GBP Libor (3 month)	+3% pa	100.00
Total Plan Composite	Manager Weighted Benchmark	Not Applicable	100.00

Executive Summary of Total Plan as at 31/12/2012

Overview

During the quarter the total market value of the Durham County Council Pension Plan increased by +£42.00m to £1,900.66m. There was a total outflow from the plan of -£10.24m in the quarter meaning the plan experienced net gains of +£52.25m.

The performance return for the Plan over the fourth quarter of 2012 was +2.82%, compared to the Plan benchmark return of +2.74%. The Plan therefore outperformed the benchmark by +0.09%.

Equity markets were up over this quarter with the FTSE All Share (+3% pa) rising +4.6% and the FTSE AW Developed also up by +2.19% in Sterling terms. Index Linked bonds were up with the FTSE index linked over 5 years index (+0.5% pa) increasing by +5.16%.

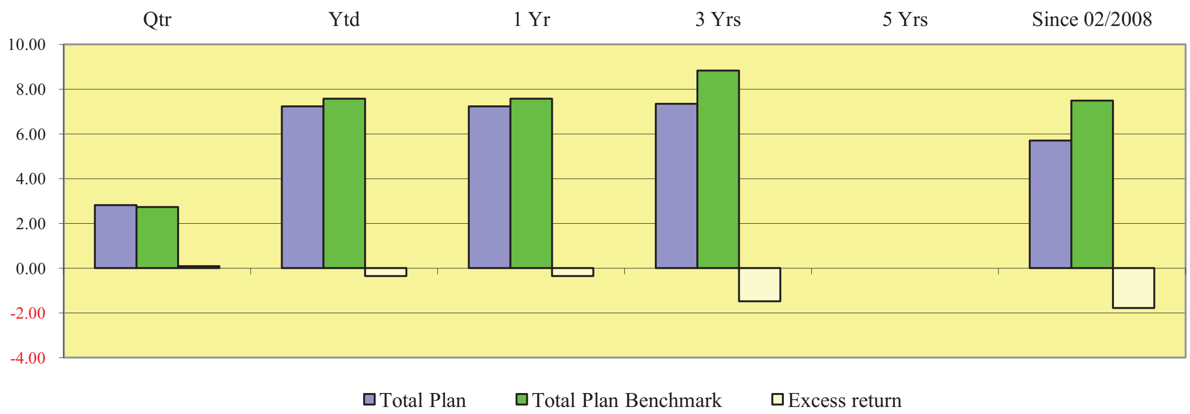
Market Values

	In GBP mil's			
	Qtr 4 - 12	**Qtr 3 - 12**	**Qtr 2 - 12**	**Qtr 1 - 12**
Total Plan	**1,900.66**	**1,858.65**	**1,827.96**	**1,862.81**

Performance

	Performance (%) *					
	Qtr	**Ytd**	**1 Yr**	**3 Yrs**	**5 Yrs**	**Since 02/2008**
Total Plan	2.82	7.23	7.23	7.3	-	5.71
Total Plan Benchmark	2.74	7.57	7.57	8.8	-	7.49
Excess return	*0.09*	*-0.35*	*-0.35*	*-1.48*		*-1.78*

Total Plan Performance

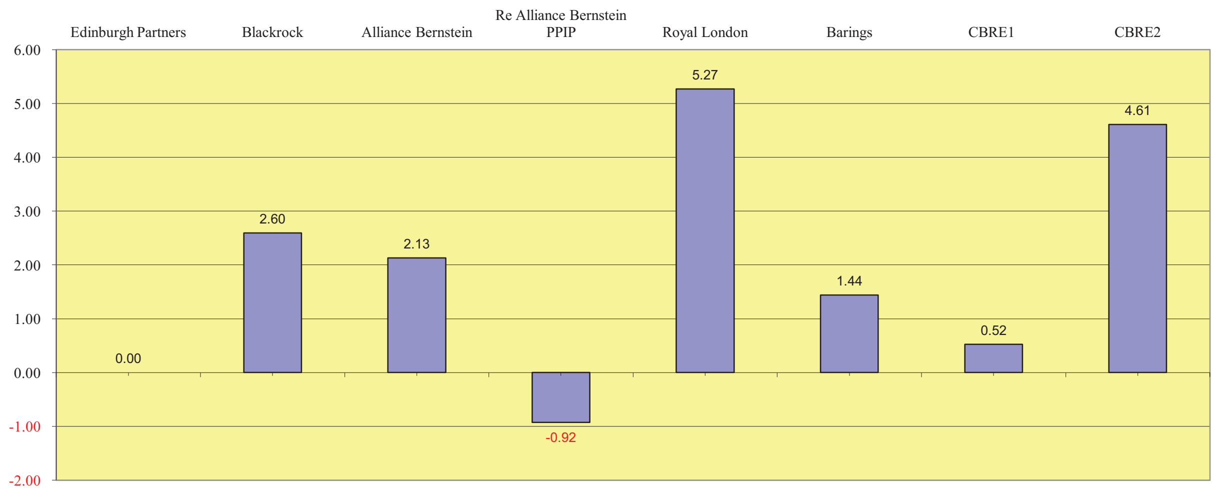


Total Plan Performance Returns as at 31/12/12

Currency GBP	**Mkt. Val. in Mil's**	**Performance (%) ***					
		Qtr	**Ytd**	**1 Year**	**2 Years**	**3 Years**	**Since 02/2008**
Total Plan	**1900.7**	2.82	7.23	7.23	5.09	7.35	5.71
Total Plan Benchmark		2.74	7.57	7.57	6.66	8.83	7.49
Excess return		0.09	-0.35	-0.35	-1.57	-1.48	-1.78

	Mkt. Val. in Mil's	**Qtr**	**Ytd**	**1 Year**	**2 Years**	**3 Years**	**Since 02/2008**
Edinburgh Partners	**0.3**	0.00	0.89	0.89	-3.25	0.45	2.03
Zero Return - Historically MSCI AC World Index (Gross) +3% pa		0.00	6.22	6.22	1.32	7.28	6.78
Excess return		0.00	-5.33	-5.33	-4.57	-6.84	-4.75
Blackrock	**296.8**	2.60	11.27	11.27	4.51	9.76	5.33
FTSE All Share (Gross) +3% pa		4.60	15.95	15.95	7.48	10.87	7.62
Excess return		-2.00	-4.69	-4.69	-2.97	-1.10	-2.29
Blackrock (Passive Equity)	**416.6**	2.10	-	-	-	-	4.41
FTSE-Ftse Aw Developed (Gross)		2.19	-	-	-	-	4.67
Excess return		-0.08	-	-	-	-	-0.26
Alliance Bernstein	**297.2**	2.13	9.19	9.19	5.56	6.15	5.08
GBP Libor +3% pa		0.88	3.85	3.85	3.87	3.82	4.72
Excess return		1.26	5.34	5.34	1.69	2.33	0.36
Re Alliance Bernstein PPIP	**0.0**	-0.92	31.39	31.39	7.85	14.81	14.99
GBP Libor +3% pa		0.58	3.55	3.55	3.72	3.71	3.82
Excess return		-1.51	27.84	27.84	4.13	11.10	11.17
Royal London	**382.6**	5.27	1.15	1.15	11.95	11.18	8.76
FTSE index Linked >5 years +0.5% pa		5.16	1.00	1.00	11.99	11.19	8.56
Excess return		0.11	0.15	0.15	-0.04	-0.01	0.20
Barings	**377.7**	1.44	5.97	5.97	3.92	6.19	7.11
GBP Libor +4% pa		1.12	4.86	4.86	4.88	4.82	5.74
Excess return		0.32	1.11	1.11	-0.96	1.37	1.37
CBRE1	**101.5**	0.52	6.06	6.06	7.10	8.05	-1.57
Headline RPI +5% pa		2.30	8.23	8.23	9.13	9.42	8.40
Excess return		-1.78	-2.17	-2.17	-2.03	-1.37	-9.97
CBRE2	**27.9**	4.61	18.06	18.06	2.83	7.83	3.15
Headline RPI +5% pa		2.30	8.23	8.23	9.13	9.42	8.40
Excess return		2.31	9.83	9.83	-6.30	-1.58	-5.26

Manager Quarterly Returns

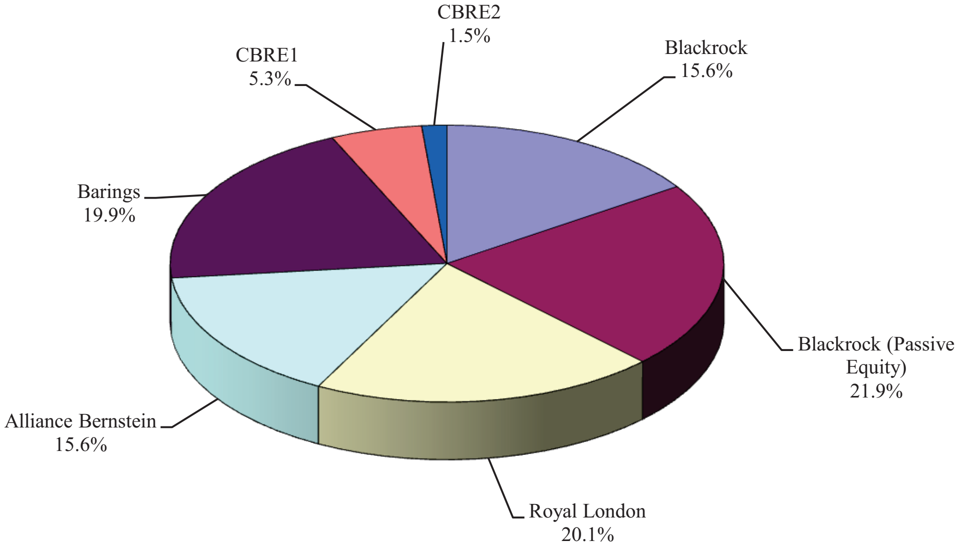


***All Portfolio and Composite returns are Gross of Fees. For time periods in excess of 1 year the performance returns are annualised.**

Portfolio Comparison for Quarter 4, 2012

Portfolio Name	Current Market Value	Portfolio Weight	Portfolio Return (%)	Benchmark Return (%)	Excess Return (%)	Current Contribution to Return
Total Plan	**1,900,655,790**	**100.00%**	**2.82**	**2.74**	**0.09**	**2.82**
Edinburgh Partners	259,594	0.01%	0.00	0.00	0.00	0.00
Blackrock	296,842,631	15.62%	2.60	4.60	(2.00)	0.52
Blackrock (Passive Equity)	416,648,817	21.92%	2.10	2.19	(0.08)	0.49
Royal London	382,565,944	20.13%	5.27	5.16	0.11	1.03
Alliance Bernstein	297,184,548	15.64%	2.13	1.12	1.01	0.34
Barings	377,712,067	19.87%	1.44	1.12	0.32	0.30
CBRE1	101,546,771	5.34%	0.52	2.30	(1.78)	0.03
CBRE2	27,884,873	1.47%	4.61	2.30	2.31	0.07
JPMSL Transition Account	10,521	0.00%	5.22	-	-	0.00
Transition Account	24	0.00%	7.05	-	-	0.05

Manager Allocation



Portfolio Comparison for Year to Date, 2012

Portfolio Name	Current Market Value	Portfolio Weight	Portfolio Return (%)	Benchmark Return (%)	Excess Return (%)	Current Contribution to Return
Total Plan	**1,900,655,790**	**100.00%**	**7.23**	**7.57**	**(0.35)**	**7.23**
Edinburgh Partners	259,594	0.01%	0.89	6.22	(5.33)	0.33
Blackrock	296,842,631	15.62%	11.27	15.95	(4.69)	2.20
Blackrock (Passive Equity)	416,648,817	21.92%	-	-	-	1.29
Royal London	382,565,944	20.13%	1.15	1.00	0.15	0.15
Alliance Bernstein	297,184,548	15.64%	9.19	4.86	4.33	1.34
Re Alliance Bernstein PPIP	0	0.00%	0.00	0.00	0.00	0.36
Barings	377,712,067	19.87%	5.97	4.86	1.11	0.68
CBRE1	101,546,771	5.34%	6.06	8.23	(2.17)	0.31
CBRE2	27,884,873	1.47%	18.06	8.23	9.83	0.26
JPMSL Transition Account	10,521	0.00%	-	-	-	(0.28)
Transition Account	24	0.00%	-	-	-	0.57

The calculation of Value-at-Risk requires numerous assumptions that should be kept in mind when interpreting it. These limitations include but are not limited to the following: VaR measures may not appropriately convey the magnitude of sudden and unexpected extreme events; historical data that forms the basis of VaR may fail to predict content and future market volatility; our VaR methodology does not fully reflect the effects of market illiquidity (the inability to sell or hedge a position over a relatively long period) and does not incorporate credit risk events that may affect its value.

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Pension Fund Committee

7 March 2013

Pension Fund Investments

Don McLure, Corporate Director Resources

Purpose of the Report

1. The purpose of the report is to inform Members of the overall value of the Pension Fund as at 31 December 2012 and of any additional sums available to the Managers for further investment or amounts to be withdrawn from Managers.

Value of the Fund

2. Reports from the five appointed Managers:

- Alliance Bernstein
- Barings
- BlackRock
- CBRE and
- Royal London

are included in the papers, but for information, the Value of the Fund as at 31 December 2012 was £1,900,700,000. The Value of the Fund at 30 September was £1,858,700,000, an increase of £42,000,000 in the quarter.

Allocation of New Money

3. Table 1 details the working cash balance position of the Fund, cash flow for the last four quarters, and an estimated cash flow for the quarter ending 31 March 2013. This table includes only cash held by Durham County Council Pension Fund Bank Account. It does not include cash balances held by the Managers of £10,368,215.

4. In determining the amount of cash to be allocated to Managers at the quarter ended 31 December, the un-invested cash balance at the end of the previous quarter, together with interest received in that quarter, is considered. This does not include cash currently held by Fund Managers.

5. The amount allocated to each Manager is subject to the need to retain money, in the Durham County Council Pension Fund Bank account to meet the Fund's net cash outflow. After taking these issues into account, it is recommended that no money be added to the sums to be allocated to the Managers for investment in the quarter.

Fund Rebalancing

6. Normally Fund Rebalancing takes place on a quarterly basis, but, it has been suspended until the results of the Strategy Review are put into operation.

Cash Flow Forecast 2013/14

7. Table 2 shows the forecasted cash flow for the Pension Fund for 2013/14.

8. The table shows that the Pension Fund Bank Account is estimated to be in deficit in each quarter of the year. However, it should be noted that this is only in respect of the bank account held by the Pension Fund; income received from investments is currently held by Managers. When this is taken into account, the Pension Fund has a positive cash flow.

9. The quarterly rebalancing exercise will be the mechanism by which cash can be moved from Managers to the Pension Fund if the assumptions that have been used in calculating the forecasted cash flow are realised.

10. The assumptions which have been used to calculate the cash flow forecast are:

- Income for 2013/14 estimated at £35m based on last year's actual figures to March 2012, updated for information to 31 December 2012.

- Income is profiled to be received in the same pattern as last year i.e.
    - Quarter ended 30 June 34%
    - Quarter ended 30 Sept 27%
    - Quarter ended 31 Dec. 18% and
    - Quarter ended 31.Mar. 21%.

- Increases in contributions in line with the Actuarial Valuation are included, but the estimate of the amount each quarter has been reduced in line with 2012/13 actual contributions to 31 December 2012.

- 'Transfers in' estimated at £500,000 per quarter. It is anticipated that transfers in will continue, though on a reduced scale, as LGPS will remain relatively attractive to employees.

- Pensions increase will be at broadly the same level as 2012/13.

- Payroll Paysheets are forecast to increase by £100,000 per quarter. This is the line that records payments to pensioners. This line will alter if there are large numbers of retirements in the employing authorities, but it is anticipated that as the County Council's position has been taken into account, as the largest employer in the Fund, this should not be materially different to forecast.

- Payable Paysheets are forecast at a constant level throughout the year, but this can be the most volatile line. Included in this line are

Fund Managers' fees and payments of lump sums. The assumption here errs on the side of prudence, in that this is an average figure taken from previous quarterly payments.

11. This is an early indication of the likely impact on the Pension Fund's cash flow forecast which will be reviewed each quarter and refined to take into account new information as it becomes available.

Recommendation

12. Members are asked to note the information contained in this report and it is recommended that no further allocation of cash be made to Managers.

Contact: Hilary Appleton Tel: 03000 266239

TABLE 1

Cash Flow – Estimated and Actual for the period 31 March 2012 to 31 March 2013

Quarter Ended	31.03.12		30.06.12		30.09.12		31.12.13		31.03.13
(1)	Estimate (2)	Actual (3)	Estimate (4)	Actual (5)	Estimate (6)	Actual (7)	Estimate (8)	Actual (9)	Estimate (10)
	£	£	£	£	£	£	£	£	£
Contributions - DCC	16,600,000	16,011,611	16,600,000	14,486,382	18,306,382	18,136,224	16,400,000	16,056,854	16,000,000
- Other	8,600,000	8,682,517	6,900,000	6,818,377	6,700,000	7,038,163	6,800,000	7,285,052	7,100,000
Pensions Increase	1,200,000	1,230,612	1,200,000	1,215,541	1,200,000	1,210,577	1,200,000	1,242,263	1,200,000
Transfer Values	2,000,000	2,302,354	1,200,000	1,317,438	1,000,000	1,607,552	1,000,000	451,820	500,000
Month end uncleared items	900,000	1,422,165	900,000	866,934	1,000,000	1,338,851	1,000,000	2,125,200	2,000,000
Gross Dividend & Interest	36,000	36,007	60,000	60,013	60,000	0	120,000	139,171	65,000
Total Income	29,336,000	29,685,266	26,860,000	24,764,685	28,226,382	29,331,367	26,520,000	27,300,360	26,865,000
Payroll Paysheets	19,300,000	19,394,550	19,400,000	20,200,100	20,200,000	20,428,758	20,500,000	20,621,401	20,700,000
Payables Paysheets (incl. Managers' fees)	8,000,000	9,971,636	8,000,000	7,433,343	10,000,000	8,269,280	9,000,000	5,714,831	9,000,000
Total Expenditure	27,300,000	29,366,186	27,400,000	27,633,443	30,200,000	28,698,038	29,500,000	26,336,232	29,700,000
Surplus / (Deficit)	2,036,000	319,080	(540,000)	(2,868,758)	(1,933,618)	633,329	(2,980,000)	964,128	(2,835,000)
Net Capital payments/(receipts)		0		0		110,000		0	
Balance at Bank (opening)		7,444,969		26,395,763		15,386,952		14,024,338	
Balance at Bank (closing)		26,395,763		15,386,952		14,024,338		24,538,401	
Money paid/(recovered) to/(from Manager)		(15,000,000)		0		0		(10,000,000)	

TABLE 2

Projected Cash Flow – including dividends received by Fund Managers for the period 31 March 2013 to 31 March 2014

Quarter Ended	**31.03.13**	**30.06.13**	**30.09.13**	**31.12.13**	**31.03.14**
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£	**£**	**£**	**£**	**£**
Contributions - DCC	16,000,000	16,200,000	16,300,000	16,300,000	16,300,000
- Other	7,100,000	7,136,000	7,150,000	7,150,000	7,150,000
Pensions Increase	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000
Transfer Values	500,000	500,000	500,000	500,000	500,000
Month end uncleared items	2,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Gross Dividend & Interest	65,000	65,000	70,000	70,000	70,000
Total Income	26,865,000	26,101,000	26,220,000	26,220,000	26,220,000
Payroll Paysheets	20,700,000	20,800,000	20,900,000	21,000,000	21,100,000
Payables Paysheets (incl. Managers' fees)	9,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Total Expenditure	29,700,000	30,800,000	30,900,000	31,000,000	31,100,000
Surplus / (Deficit)	(2,835,000)	(4,699,000)	(4,680,000)	(4,780,000)	(4,880,000)
Dividends Received by Managers	7,350,000	11,900,000	9,450,000	6,300,000	7,350,000
Net Cash Flow Position	4,515,000	7,201,000	4,770,000	1,520,000	2,470,000

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Pension Fund Committee

7 March 2013

Short Term Investments for the period ended 31 December 2012

Don McLure, Corporate Director Resources

Purpose of Report

1. To provide the Committee with information on the performance of the Pension Fund's short term investments for the quarter ended 31 December 2012.

Short Term Investments

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

3. The Pension Fund's surplus cash holding as at 31 December 2012 was £26.396m which was held in the institutions listed in the table below alongside their credit rating at 31 December 2012.

Financial Institution	Rating	Amount Invested £m
Bank Deposit Accounts		
The Co-operative Bank	BBB+	0.925
Natwest Bank	A	7.492
Santander UK plc	A	1.872
Fixed Term Deposits		
Barclays	A	1.311
Royal Bank of Scotland	A	9.365
Nationwide Building Society	A+	2.809
Natwest Bank	A	1.872
UK Local Authorities	N/A	0.563
National Savings & Investments	N/A	0.187
Total		**26.396**

4. The following table provides information on the interest earned during the 6 month period, the average daily investment balance and the average return earned in comparison to the average bank base rate, along with the fee charged:

	Total
Interest Earned	£240,024
Average Return Earned	1.608%
Average Bank of England base rate	0.500%
Average Daily Balance of Investments	£20.395m
Administrative Fee	£15,436

Recommendation

5. Members are asked to note the position at 31 December 2012 regarding the Pension Fund's short term investments.

Contact: Hilary Appleton Tel: 03000 266239

Pension Fund Committee

7 March 2013

Investment of the Pension Fund's cash balances

Don McLure, Corporate Director Resources

Purpose of Report

1. To inform the Committee of the Treasury Management service provided to the Pension Fund and of changes to the calculation of interest on short term investments administered by the County Council.

Background

2. 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.

3. As a result of the 2009 Regulations, a report was presented to the Pension Fund Committee in June 2010. At this meeting, the Pension Fund Committee gave its agreement to Durham County Council continuing to invest the cash balances of the Pension Fund in line with the County Council's Treasury Management Policy and Annual Investment Strategy.

4. The County Council's Treasury Management Policy and Annual Investment Strategy sets out the maximum amounts and time limits in respect of deposits which can be placed with each financial institution.

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

6. Reports on the return on short term investments are presented to the Pension Fund Committee.

Administration of the Treasury Management Function

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

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

9. After this main principle the Council will ensure:

   (a) It 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.

   (b) It 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.

   (c) It maintains a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the County Council for approval as necessary.

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

11. The County Council's treasury management team monitors the cash, the bank account balances and the cash codes for the County 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.

12. All bank charges incurred by the Pension Fund are recharged to the Pension Fund by the Treasury Management team,

13. The Treasury Management Team maintains full and accurate records in the performance of this service and makes them available for inspection by the Pension Fund Accounting Team, Internal and External Audit.

14. For the provision of this service, an administration fee of 0.1% of the investment made is charged to the Pension Fund.

Calculation of Interest on Cash Balances

15. Interest is currently calculated as a pooled interest rate based on all of the investments of the County Council. This rate is then applied to the daily cash balance held by the Pension Fund. Interest is then paid quarterly to the Pension Fund.

16. As a result of this methodology, the Pension Fund has been benefitting interest earned from the longer term (365 days) investments of the County Council, although the Pension Fund's cash balance needs to be available at least quarterly for the rebalancing of Managers' portfolios.

17. It is now recommended that with effect from 1 April 2013 the interest paid to the Pension Fund in respect of its cash balances should be based on an appropriate published three month rate, for example the LIBOR or LIBID three month rate. However, the choice of the rate would be subject to review by the Treasury Management team, to ensure an appropriate rate is applied.

Investments

18. It was also agreed by the Committee in 2010, that the Pension Fund's cash balances would be invested as part of the County Council's overall investments. This was advantageous to the Pension Fund as it has benefitted from higher interest rates being achieved due to the larger amounts of cash being invested.

19. 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 County Council would be liable for the loss. This is due to the investment being in the name of the County Council although the investment would include Pension Fund balances.

20. The Pension Fund Committee is asked to agree to 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 County Council and the Pension Fund.

Recommendation

21. It is recommended that:

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

    (b) Interest be paid quarterly to the Pension Fund at a rate based on the daily cash balance and a published 3 month interest rate;

    (c) An administration fee of 0.1% be paid to the County Council for the Treasury Management function being carried out on behalf of the Pension Fund; 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 Papers

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

(b) Pension Fund Committee – 4 December 2012 – Short Term Investments for the period ended 30 September 2012

(c) Durham County Council's Treasury Management Policy.

Contact: Hilary Appleton Tel: 03000 266239

Pension Fund Committee

7 March 2013

Agreement of Accounting Policies for Application in the 2012/13 Financial Statements of the Pension Fund

Don McLure, Corporate Director Resources

Purpose of the Report

1. The purpose of this report is to inform the Pension Fund Committee of the accounting policies to be applied in the preparation of the 2012/13 Accounts and to seek confirmation from the Committee that appropriate policies are being applied.

Background

2. Although the Audit Committee have responsibility for the approval of the Statement of Accounts which contains the Pension Fund Accounts, the Pension Fund should approve the Accounting Policies to be used in the preparation of those accounts.

Accounting Policies

3. It is a requirement of the Local Government Act 2003 and the Accounts and Audit (England) Regulations 2011 for the Statement of Accounts to be produced in accordance with proper accounting practices. The 'Code of Practice on Local Authority Accounting 2012/13' (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.

4. 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"*.

5. 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.*

6. 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.

7. The proposed accounting policies are in line with those used in the preparation of the 2011/12 accounts and there have been no changes to the Code necessitating a change for 2012/13.

8. 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.

Recommendation

9. The Committee is recommended to:

- review the accounting policies; and
- approve their use in the preparation of the 2012/13 financial statements for the Pension Fund.

Contact: Hilary Appleton Tel: 03000 266239

Appendix 1: Accounting Policies for 2012/13

Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these accounts.

The accounts have been prepared on the normal accruals basis of accounting.

Valuation of Investments

Investments are included in the accounts at their fair value as at their reporting date; in the case of marketable securities fair value is equal to market value. Market value is the bid price quoted in an active market for securities and unitised investments. Fair value is the price that a buyer and seller may reasonably exchange an asset in an arm's length transaction. The accounting policies used for specific material types of investment follow:

- Quoted equity securities that are traded on an exchange are accounted for on a bid market price basis as a basis of fair value where fund managers provide valuations in this manner.
- Unquoted equity investments are included based on an estimated price of the investments held. Valuation techniques are used to establish a price at the year end date based on an arm's length exchange given normal business considerations.
- Unitised securities are valued at the closing bid price if bid and offer prices are reported by the relevant exchange and in the fund manager's valuation report. Single priced unitised securities are valued at the reported price.
- Fixed interest securities that are traded on an exchange are accounted for at bid market price as a basis of fair value where fund managers provide valuations in this manner.
- The Public-Private Investment Plan (PPIP), an unquoted pooled investment vehicle, is valued at fair market value as determined by the Valuation Agent, the Bank of New York Mellon. The process for the determination of the value of the portfolio investments forms part of the investment agreement for the PPIP.
- Index linked securities are valued at bid market value where fund managers provide valuations in this manner.
- All prices in foreign currency are translated into sterling at the prevailing rate on the 31 March.
- Derivatives are included in the Net Assets Statement at fair value and gains and losses arising are recognised in the Fund Account as at 31 March. The future value of foreign currency contracts is based on

market forward exchange rates at the reporting date and determined as the gain or loss that would arise if the outstanding contract were matched at that date with an equal and opposite contract.

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

Investment transactions

Investment transactions arising up to 31 March but not settled until later are accrued in the accounts.

Acquisitions costs of investments

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

Interest on property development

The Fund does not directly hold any property investments; all property investment is made through Pooled Investment Vehicles.

Contributions receivable

Contribution income is categorised and recognised as follows:

- Member contributions are recognised in the period they are deducted from salary;
- Employer’s normal contributions are recognised in the period in which the employee’s normal contributions are deducted from salary;
- Employer’s augmentation contributions are accounted for in the year in which they become due;
- Employer’s other contributions are accounted for on the terms of the arrangement.

Additional Voluntary Contributions (AVCs)

Deductions from employees’ salary Additional Voluntary Contributions (AVCs) and their subsequent investment in insurance policies are not recognised as income or assets in the Pension Fund Accounts. The investments held outside the scheme can be found in Note X.

However when these AVCs are used to purchase extra years’ service from the Pension Fund, this is recognised as contribution income in the Accounts on an accruals basis. Amounts received in this way can be found in Note X as additional contributions from members.

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 out/ in 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.

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.

Administrative expenses

A proportion of relevant officers' salaries have been charged to the Fund on the basis of actual time spent on investment and related matters and pensions' administration. Certain specific expenses have been charged directly to the Fund and other office expenses and related overheads have been charged to the Fund in proportion to the salaries charged.

Investment income

Income from equities is recognised in the fund account on the date stocks are quoted ex-dividend. Income from overseas investments is recorded net of any withholding tax where this cannot be recovered.

Income from fixed interest and index-linked securities, cash and short-term deposits is accounted for on an accruals basis.

Income from other investments is accounted for on an accruals basis.

Foreign income has been translated into sterling at the date of the transactions, when received during the year, or at the exchange rates applicable at 31 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 no taxation is separately disclosed in the Pension Fund Account when fund managers are not able to supply the necessary information.

Investment Management Fees

All investment management fees are accounted for on an accruals basis. Fees of the external investment managers are agreed in the respective mandates governing their appointments. 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 year is used for inclusion in the fund account.

The cost of obtaining independent investment advice from consultants is also included in investment management fees. Independent advisers' fees are based on a retainer for attendance at Pension Fund Committee Meetings and the provision of advice to the Pension Fund Committee. Fees for any additional work are based on a daily or hourly rate, as provided for by agreement or by separate arrangement.

Pension Fund Committee

7 March 2013

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

Report of Don McLure, Corporate Director Resources

Purpose of the Report

1 To inform Members of the review of the policy documents for the year ended 31 March 2013.

Background

2 The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 provide the statutory framework from which Local Government Pension Schemes (LGPS) administering authorities are required to have prepared a Funding Strategy Statement (FSS).

3 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 CIPFA for this purpose; and
  ii. their own Statement of Investment Principles (SIP) for the Fund.
  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 Statement of Investment Principles.

4 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 consolidate the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (the “Regulations”) which require administering authorities to prepare and review a written statement recording the investment policy of the Pension Fund – the ‘Statement of Investment Principles’ (SIP).

5 The 2009 regulations also require pension fund administering authorities to state the extent to which they comply with guidance given by the Secretary of State, previously the Chartered Institute of Public Finance (CIPFA) Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom.

Review of the FSS and SIP

6 The FSS should be reviewed regularly and when there is a material change to the SIP. The FSS is the framework within which the Fund's actuary carries out triennial valuations to set contribution rates for individual scheme employer contribution rates.

7 The FSS was updated following the last triennial valuation in 2010/11 and amendments made following consultation with stakeholders. In September 2012, a revised FSS was presented to committee and this current FSS is attached at Appendix 1.

8 The 2009 Regulations required that the SIP containing the compliance statement was published by 1 July 2010 in line with the Regulations, and that it is reviewed and if necessary, revised from time to time, and in the case of any material change in the administering authority's policy on investments or their management.

9 The SIP was reviewed in March 2012 and changes made to reflect the introduction of a passive equity investment with BlackRock into the asset allocation. This revised SIP was presented to the committee in September 2012.

10 As the Pension Fund is currently undertaking a procurement for Global Equity and Emerging market managers, the SIP will need to be updated when the new managers are appointed. No change to the SIP is therefore suggested at this time. The SIP is attached at Appendix 2.

11 It is anticipated that further review of the FSS and the SIP will be considered as part of the on-going Review of the Pension Fund Arrangements.

Summary

12 Members are asked to note the contents of this report and the review of the Pension Fund's policy documents.

Background papers

(a) Pension Fund Committee - 25 October 2004 – Funding Strategy Statement

(b) Pension Fund Committee – 21 June 2010 – The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

(c) Pension Fund Committee – 5 March 2012 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

(d) Pension Fund Committee – 4 September 2012 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

Contact: Hilary Appleton Tel: 03000 266239

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Appendix 1

Durham County Council Pension Fund

Funding Strategy Statement

2012

Version Updated August 2012

Index

(A) STATUTORY BACKGROUND AND KEY ISSUES

1. The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 come into effect on 1 April 2004. They originally provided the statutory framework from which Local Government Pension Schemes (LGPS) administering authorities are required to prepare a Funding Strategy Statement (FSS) by 31 March 2005. The requirements are now set out under Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 (the Administration Regulations).

2. Key issues:

   - After consultation with relevant interested parties involved with the Fund, e.g. local authority employers, admitted bodies, scheduled/resolution bodies, the administering authority is required to prepare and publish their funding strategy.

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

     - o Guidance published by CIPFA in March 2004 entitled "Guidance on Preparing and Maintaining a Funding Strategy Statement and to the Fund's Statement of Investment Principles".
     - o Its Statement of Investment Principles (SIP) published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (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 Statement of Investment Principles.

   - 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.

   - Benefits payable under the Scheme are secure, because they are guaranteed by statute. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, allowing for scrutiny and accountability through improved transparency and disclosure.

   - The Scheme is a defined benefit final salary scheme. The benefits are specified in the governing legislation, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (Benefits Regulations). Constraints on the levels of employee contributions are also specified in the Benefits Regulations.

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

3. This Statement has been reviewed in accordance with Regulation 35 of the Administration Regulations in March 2010 as part of the triennial valuation as at 31 March 2010

(B) PURPOSE OF THE FUNDING STRATEGY STATEMENT

4. The purpose of this Funding Strategy Statement (FSS) is:

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

- To support the regulatory requirement to maintain as nearly constant employer contribution rates as possible; and

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

The intention is for this Strategy to apply comprehensively for the Scheme as a whole, 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 36 of the Administration Regulations and specifically to adequately fund benefits to secure the Fund's solvency while taking account of the desirability of maintaining as nearly constant employer contribution rates as possible**

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

  o the regulatory requirement to secure solvency

- the requirement to ensure that costs are reasonable, and
- maximising return from investments

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. These assets are more risky in nature than fixed interest investments, and this can lead to more volatile returns in the short-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 smoothness 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.

- **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. 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 Statement of Investment Principles
  - Restricting investment to asset classes recognised as appropriate for UK Pension Funds.

(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:

- Collect employer and employee contributions

- 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 late payments of contributions to the Pensions Regulator.

- Take action to recover assets from admission bodies whose Admission Agreement has ceased.

- Invest surplus monies in accordance with the regulations.

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

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

  Ensure effective communications with the Fund's Actuary to:

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

- Consider the appropriateness of interim valuations.

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

- Monitor all aspects of the fund's performance and funding and amend the FSS and SIP on an annual basis as part of the on-going monitoring process.

9. The individual employers should:

- Deduct contributions from employees' pay correctly.

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

- Exercise discretions within the regulatory framework.

- Make additional contributions in accordance with agreed arrangements in respect of, for example, 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.

10. The fund actuary should:

- Prepare triennial valuations including the setting of employers' contribution rates after agreeing assumptions with the administering authority and having regard to the FSS.

- Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

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

(E) FUNDING TARGETS, SOLVENCY AND NOTIONAL SUB-FUNDS

Funding principle

11. The Fund is financed on the principle that it seeks to provide funds sufficient to enable payment of 100% of the benefits promised.

Funding Targets and assumptions regarding future investment strategy

12. The Funding Target is the amount of assets which the Fund needs to hold at any point in time such that the funds held, plus future anticipated investment returns on those funds, and taking into account the anticipated future experience of the membership and contributions due from the membership, meet the funding principle.

13. Some comments on the principles used to derive the Funding Target for different bodies in the Fund are set out below.

    <u>Scheduled Bodies and Admission Bodies with guarantors agreeing to subsume assets and liabilities following cessation</u>

    The Administering Authority will adopt a general approach in this regard of assuming indefinite investment in a broad range of assets including equities for Scheduled Bodies and certain other bodies. With regard to Admission Bodies the guarantor must have been judged to be of suitable covenant by the Administering Authority (see section on Guarantors on page 14).

    <u>Admission Bodies and other bodies whose liabilities are expected to be orphaned</u>

    For Admission Bodies 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 cessation, and any likely change in notional or actual investment strategy as regards the assets held in respect of the Admission Body's liabilities at the date of cessation (i.e. whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities).

    <u>Orphan liabilities</u>

    These are liabilities with no access to funding from any employer in the Fund. To minimise the risk to other employers in the Fund the assets notionally related to these liabilities will be assumed to be invested in low risk investments. This is described in more detail later in this document

Full Funding

14. The Fund is deemed to be fully funded when the assets held are equal to 100% of the Funding Target. When assets held are greater than this amount the Fund is deemed to be in surplus, and when assets held are less than this amount the Fund is deemed to be in deficiency.

Solvency and 'funding success'

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

16. A further Aspirational Funding Target is set by reference to a similar level of prudence as used for the actuarial valuation of the Fund carried out as at 31 March 2007. The Administering Authority deems funding success to have been achieved if the Fund, at the end of the Recovery Period, is fully funded on the basis of the Aspirational Funding Target.

Assumptions and methodology

17. The Administering Authority will agree with the Fund's Actuary the assumptions used in this calculation prior to each actuarial valuation.

18. The Administering Authority has agreed with the Fund Actuary that a market led approach should be used for future valuations at least for the foreseeable future. Under this method of valuation, the assets are taken into account at their mid market value and the value is then compared with the value of the Fund's liabilities calculated using consistent, market rates of interest. The Administering Authority has also agreed with the Fund Actuary that some element of smoothing of the assets can be used in the valuations. The size of the smoothing adjustment if applied will be discussed at each valuation.

19. The rates of interest are obtained by examination of prevailing yields in the long term gilt market, which are then adjusted to make partial allowance for excess returns expected on other types of riskier investments such as equities. The risk of this approach is that the additional returns may not be achieved.

Recovery Periods

20. Where a valuation shows the Fund to be in surplus or deficit against the solvency measure, employer's contribution rates will be adjusted to reach the solvent position over a number of years. The 'recovery period' for reaching 'full' funding is set by the Administering Authority in consultation with the Actuary 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.

21. 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. 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. 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 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

22. The Administering Authority will also consider at each valuation whether new contribution rates should be payable immediately or reached by being stepped over a number of years. Stepping is a generally accepted method of smoothing the impact of rate changes for local authority pension funds. In consultation with the Actuary the Administering Authority accepts that long term employers may step up to the new rates in equal annual steps. This is in line with the aim of having contribution rates as nearly constant as possible. The Administering Authority usually allows a maximum of three steps however, in exceptional circumstances up to six steps may be used.

Grouping

23. In some circumstances it is may be desirable to group employers within the Fund together for funding purposes (i.e. to calculate employer contribution rates). Reasons might include reduction of volatility of contribution rates for small employers, facilitating situations where employers have a common source of funding or accommodating

employers who wish to share the risks related to their participation in the Fund.

24. The Administering Authority recognises that grouping can give rise to cross subsidies from one employer to another over time. The Administering Authority's policy is to consider the position carefully at each valuation and to notify each employer that is grouped that this is the case, and which other employers it is grouped with. If the employer objects to this grouping, it will be set its own contribution rate.

25. 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.

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

27. All employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service – in other words, the cost of such benefits is shared across the employers in the Fund. Such lump sum 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.

Notional sub-funds

28. 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 notional sub-fund within the Fund.

29. 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 sub-funds

30. The notional sub-fund 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 allocated as set out below. 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.

31. Further adjustments are made for:

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

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

- 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.

32. 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 notional sub-fund. 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.

33. 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.

(F) SPECIAL CIRCUMSTANCES RELATED TO ADMISSION BODIES

Interim reviews for Admission Bodies

34. Regulation 38(4) of the Administration Regulations provides the Administering Authority with a power to carry out valuations in respect of Admission Bodies, and for the Actuary to certify revised contribution rates, between triennial valuation dates.

35. The Administering Authority's overriding objective at all times in relation to Admission Bodies 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 date of cessation of participation may be unknown (for example, participation may be assumed at present to be indefinite), and also because market conditions change daily.

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

- Where the date of cessation is known, and is more than 3 years hence, or is unknown and assumed to be indefinite, interim valuations will generally not be carried out at the behest of the Administering Authority.

- For Transferee Admission Bodies 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 date of cessation 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 admissions 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.

37. Notwithstanding the above guidelines, the Administering Authority reserves the right to request an interim valuation of any Admission Body at any time in accordance with Regulation 38(4).

Guarantors

38. Some Admission Bodies 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 Admission Body ceases 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.

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

Bonds and other securitization

40. Regulation 6 of the Administration Regulations creates a requirement for provision of risk reviews and bonds in certain circumstances. The Administering Authority's approach in this area is as follows:

- In the case of Transferee Admission Bodies admitted under Regulation 6(2)(a) of the Administration Regulations, and so long as the Administering Authority judges the relevant Scheme Employer 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 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 Transferee Admission Bodies admitted under Regulation 6(2)(a) of the Administration Regulations, where the Administering Authority does not judge the relevant Scheme Employer 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 notes that levels of required bond cover can fluctuate and will require the relevant Scheme Employer to jointly review the required cover with it regularly, at least once a year.

- In the case of Transferee Admission Bodies admitted under Regulation 6(2)(b) of the Administration Regulations, 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 notes that levels of required bond cover can fluctuate and will review the required cover regularly, at least once a year.

Subsumed liabilities

41. Where an employer is ceasing participation in 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.

42. In such circumstances the liabilities are known as subsumed liabilities (in that responsibility for them is subsumed 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

43. Where an employer is ceasing participation in 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 cessation valuation, carried out in accordance with Administration Regulation 38, 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.

44. 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.

45. 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 employer's notional assets.

Cessation of participation

46. Where an Admission Body ceases participation, a cessation valuation will be carried out in accordance with Administration Regulation 38. That valuation will take account of any activity as a consequence of cessation of participation regarding any existing contributing members (for example any bulk transfer payments due) and the status of any liabilities that will remain in the Fund.

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

- For orphan liabilities the Funding Target in the cessation valuation will anticipate investment in low risk investments such as Government bonds.

- For subsumed liabilities the cessation valuation will anticipate continued investment in assets similar to those held in respect of the subsuming employer's liabilities.

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

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

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

General Principles and diversification

50. 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.

51. 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.

52. 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.

53. 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 Statement of Investment Principles (SIP) and the funding policy set out in this document.

54. The SIP sets out the investment responsibilities and policies relevant to the Fund.

55. 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

56. 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.

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

57. Financial

These include:

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment fund managers fail to achieve performance targets over the longer term
- Asset reallocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- The effect of a possible increase in employer's contribution rate on service delivery and admitted or scheduled bodies

The Administering Authority will ensure it takes appropriate advice and regularly assess such aspects including regular monitoring of the funding position of the Fund.

58. Demographic

These include:

- The longevity horizon continues to expand
- Deteriorating pattern 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.

59. Regulatory

These include:

- Changes to 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

The Administering Authority will keep up to date with all proposed changes, and, if appropriate, request the Actuary to assess the impact on costs of the changes. The Administering Authority will notify employers of the likely impact of changes.

60. 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.

61. Choice of Funding Target

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, 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 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.

62. 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 the impact of this adjustment at each valuation to ensure that it remains within acceptable limits.

63. 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.

64. 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

65. The FSS should be reviewed formally at least every three years and as part of the triennial valuation cycle. The valuation exercise will establish contribution rates for all employers contributing to the fund for the following three years within the framework provided by the strategy.

Appendix 2

Durham County Council
Pension Fund

Statement of Investment Principles

Version Updated August 2012

Table of Contents

1. Introduction

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 consolidate the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (the “Regulations”) which require administering authorities to prepare and review a written statement recording the investment policy of the Pension Fund. The 2009 regulations also require pension fund administering authorities to state the extent to which they comply with guidance given by the Secretary of State, previously the Chartered Institute of Public Finance (CIPFA) Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom. The compliance statement is attached at Appendix A.

Durham County Council is the administering authority (the “Authority”) for the Durham County Council Pension Fund (the “Pension Fund”) and the purpose of this document is to outline the broad investment principles governing the investment policy of the Pension Fund, thereby satisfying the requirements of the Regulations.

2. Investment Responsibilities

The County Council, as Administering Authority, has delegated the investment arrangements of the Pension Fund to the Pension Fund Committee (the “Pension Fund 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 Pension Fund 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 Statement of Investment Principles. Monitoring compliance with the Statement and reviewing its contents following any strategic changes and at least every three years;
- Appointing the investment managers, custodian, 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 resources allocated to investment managers on a regular basis.

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 Pension Fund Committee as requested;
- Assisting the Corporate Director, Resources and Pension Fund Committee in the preparation and review of this document; and
- 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 Independent Advisers are responsible for:

- Assisting the Corporate Director, Resources and Pension Fund 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 Pension Fund Committee in the preparation and review of Policy documents;
- Assisting the Corporate Director, Resources and Pension Fund Committee in their regular monitoring of the investment managers' performance;
- Assisting the Corporate Director, Resources and Pension Fund Committee in the selection and appointment of investment managers, custodians and Pension Fund Actuary;
- Advising and assisting the Corporate Director, Resources and the Pension Fund Committee on other investment related issues, which may arise from time to time; and
- Providing continuing education and training to the Pension Fund 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 Pension Fund Committee in balancing the short term and long-term objectives of the Pension Fund.
- Undertaking the statutory triennial valuation of the 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 Pension Fund Committee;
- Ensuring that this document is regularly reviewed and updated in accordance with the 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 1997 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. Authorised Investments

The powers and duties of the Authority to invest monies are set out in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 as amended from time to time and updated in 2009. The Authority is required to invest any money which is not required immediately to pay pensions and any other benefits and, in so doing, take account of the need for a suitable diversified portfolio of investments and the advice of persons properly qualified on investment matters.

3.1 Types of Investment

Investment can be made in accordance with the regulations in a broad spectrum of investments such as equities, fixed interest and other bonds, collective investment schemes, deposits, money market instruments, unquoted equities and property, both in the UK and overseas. The regulations also specify other investment instruments that may be used such as stock lending, financial futures, traded options, insurance contracts, sub underwriting contracts and a contribution to an unquoted limited liability securities investment partnership.

The limits on the amount of money that can be invested in each individual type of investment are specified in schedule 1 of the Regulations. We do not participate in stock lending or underwriting.

The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2003 amended the regulations so as to give Authorities the option to increase some of the limits on certain types of investments provided that the Authority complies with the requirements of the Regulations. These requirements include taking proper advice, the suitability of particular investments and types of investments, the limit on the amount of such investment, the reason for such investment and the period for which the increase in the limit of the type of investment will apply. Any increase in the limit must be kept under review.

The 2009 Regulations now prevent the administering authority from investing the Pension Fund's cash that is not required immediately along with its own cash. The Pension Fund Committee has agreed that as part of its investment strategy it will allow the administering authority to invest, in the short term, on its behalf in line with the administering authority's Treasury Management Strategy.

Investment Managers are instructed to comply with the regulations in respect of the relevant portfolio subject to any specific instructions. The Authority is responsible for oversight of how compliance affects the compliance of the Pension Fund as a whole.

3.2 Investment Risk

The investment policy has been set with the objective of controlling the risk that the assets will not be sufficient to meet the liabilities of the Pension Fund while achieving a good return on investment.

Dividing the management of the assets between six investment managers, further controls risk. Asset allocation benchmarks have been set and performance is monitored relative to the benchmarks. This is to ensure the investment manager does not deviate from the Pension Fund Committee's investment strategy.

The setting of specific control ranges and other investment guidelines within which the investment managers must operate also controls risk.

The 2009 Regulations require the Pension Fund to describe how it measures and manages risk.

Risk is measured, in part, by the administering authority's risk management section as part of its assessment of the County Council's risks, and is reviewed as part of the independent Governance review undertaken by the Pension Fund.

3.3 Realisation of Investments

The vast majority of the Pension Fund's investments are readily marketable and may be easily realised if required. Some investments may be less easy to realise in a timely manner but the total value of these types of investments is not considered to have any adverse consequences for the Pension Fund.

3.4 Approval has been given to investment as follows:

In-House Management

i. Midland Enterprise Fund for the North East Exempt Unit Trust

- Small, private and growing companies in the North East of England:
- £200,000 invested.

ii. Capital North East

- Start up and development capital for businesses in the North East:
- £400,000 invested, up to £500,000 may be invested.

External Investment Management

The Pension Fund Committee has appointed six investment managers to manage the remainder of the Pension Fund's assets. They have been appointed under the terms of the Regulations and their roles are described in the Investment Policy in Appendix B.

4. Allocation Strategy

Having considered advice from the Independent Advisers, and also having due regard for the objectives, the liabilities of the Pension Fund and the risks facing the Pension Fund, the Pension Fund Committee have decided upon the following strategic target asset allocation:

Asset Class	**Permitted Assets**	**Benchmark & Performance Target**	**Proportion of Total Fund ***
Conventional Bonds	Investment grade sterling bonds	FTSE Over 5 Year Index-Linked Gilt Index +0.5%	20%
Broad Bonds	Global bonds	UK 3-month LIBOR +3.0%	16%
UK Equity	UK equities	FTSE All Share Index +3.0%	20%
Global Equities	Global Equities	MSCI AC World Index +3.0%	21%
Global Equities	Global Equities	FTSE All-World Developed index	7%
Dynamic Asset Allocation	**All major asset classes with the ability to take derivative positions**	UK 3-month LIBOR +4.0%	8%
Global Property	Global property	UK Retail Price Inflation +5.0%	8%

* Excluding in-house managed funds

More detailed definitions of the mandates are given at Appendix B.

The Pension Fund Committee and the Corporate Director, Resources, in conjunction with the Independent Advisers, will formally monitor the actual asset allocation of the Pension Fund on a quarterly basis.

5. Stock Selection

Individual investments are chosen by the Investment Managers with the Pension Fund Committee, Corporate Director, Resources and independent external advisers able to question the investment managers on their actions at each quarterly meeting.

6. Cash Management

The administering authority will invest the short term cash balances on behalf of the Pension Fund. This will be done in line with the administering authority's Treasury Management Policy and interest will be paid quarterly to the Pension Fund.

7. Investments Requiring Prior Approval

Subject to changes and agreements with Investment Managers, as included at Appendix B, a detailed report must be submitted to and approved by the Pension Fund Committee prior to making investments in the following:

- Private equity/Venture capital funds and enterprises
- Commodities
- Stock lending
- Currency Hedging - Agreed in principle, subject to prior consultation with the Corporate Director, Resources.

8. Socially Responsible Investing

The Pension Fund Committee must act with the best financial interests of the beneficiaries, present and future, in mind. The Pension Fund 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.

9. Corporate Governance

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.

10. Fee Structure

Investment Managers' fees are based on the value of assets under management. In the case of four investment managers, a performance related fee structure is in place based on a base fee plus a percentage of out-performance. In the case of the two remaining investment managers an ad-valorem fee is payable.

Independent Advisers' fees are based on a retainer for attendance at Pension Fund Committee and Annual Meetings and the provision of advice to the Pension Fund Committee. Fees for any additional work are based on a daily or hourly rate, as provided for by agreement or by separate arrangement.

Any additional work will be subject to a suitable fee arrangement or subject to separate tendering exercises.

The administering authority fee for Treasury Management will be based upon a percentage of the interest earned on the Pension Fund cash invested.

11. Reporting Requirements

The investment managers must report quarterly on matters covered in their individual agreements, but should include common items such as:

- Investment Managers' views on the UK or other relevant economies and the proposed asset allocation for the past, present and future quarter.
- Reports on any new investment policy issues requiring the approval of the Pension Fund Committee.
- Performance during the previous quarter, previous twelve months, three years and five years.
- A Portfolio valuation, including details of individual holdings.
- Investment transactions schedule for the previous quarter.
- Portfolio distribution and the changes in the markets - summarised by:
    - type of investment;
    - sector
    - geographic area as appropriate.
- Performance of any collective investment funds or internal pooled funds in which investments are held.
- Underwriting commitments relevant to the Portfolio.
- The cash position of the Pension Fund.
- Voting actions and forthcoming activity.
- Any material matters reported to the Financial Services Authority (FSA) in respect of the Portfolio or which reasonably might be brought to the attention of the Pension Fund Committee.
- Any material matters in respect of the interface with the Custodian.

- Investment or ancillary activities carried out in relation to the Portfolio where there arose a material risk of damage to the interests of the Pension Scheme or where a material risk of damage may arise in the future.
- Dealing errors and action taken.
- Any breach of confidentiality.
- Any breach of this Agreement.

Annually, the Global Custodian must present a detailed report relating to the individual investment managers' fund performance and the combined fund performance.

Appendix A - 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 ten principles of investment practice set out in the document published in April 2002 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom" (Guidance note issue No. 5), 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 Pension Fund 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 – Focus on asset allocation

Fully compliant: All major asset classes are considered. An asset liability modelling exercise is being considered as part of the ongoing review of the administration of the Pension Fund.

Principle 4 – Expert advice

Fully compliant: Two independent advisers were appointed in November 2004. Actuarial services have been subject to a separate open tender process.

Principle 5 – Explicit mandates

Fully compliant: Explicit written mandates agreed with all investment managers. Investment managers have been asked to report on transaction costs and commission.

Principle 6 – Activism

Partial compliance: 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 Pension Fund Committee. The mandates do not specifically incorporate the principle of the US Department of Labor Interpretative Bulletin on activism.

Principle 7 – Appropriate benchmark

Fully compliant: Appropriate benchmarks have been set in consultation with the independent advisers and the actuary.

Principle 8 – Performance measurement

Partial compliance: Performance of the Pension Fund is measured; separate monitoring of Pension Fund Committee performance and independent adviser performance has yet to be established.

Principle 9 – Transparency

Fully compliant: Investment objective and asset allocation strategy covered in the Funding Strategy Statement or Statement of Investment Principles. Investment Manager and independent adviser fee structures are included.

Principle 10 – Regular reporting

Fully Compliant: The Funding Strategy Statement including the Statement of Investment Principles is available on the internet and is included in the Pension Fund's Annual Report and Accounts. A summary of overall Pension Fund performance is reported to members of the Pension Fund annually.

Appendix B - Investment Managers

The Pension Fund Commitee has appointed six Investment Managers: Edinburgh Partners Limited ('Edinburgh Partners'), BlackRock Investment Management (UK) Limited ('BlackRock'), AllianceBernstein Limited ('AllianceBernstein'), Royal London Asset Management ('RLAM'), CB Richard Ellis Collective Investors Limited ('CBRE') and Baring Asset Management Limited ('Barings') to manage the assets of the Pension Fund.

The long-term strategic allocation is as follows (the actual allocation may vary due to market movements):

Investment Manager	**%**	**Asset Classes**	**Investment Style**
Edinburgh Partners	21	Global Equities	Active
BlackRock	20	UK Equities	Active
BlackRock	7	Global Equities	Passive
AllianceBernstein	16	Global Bonds	Active
RLAM	20	Investment grade sterling **and non-sterling** bonds	Active
CBRE	8	Global Property	Active
Barings	8	Dynamic Asset Allocation – All major asset classes with derivative overlay	Active

The investment restrictions detailed in this Appendix form part of the contractual agreement with Investment Managers and will only be varied after consultation with the Investment Managers in accordance with their contracts.

The Investment Manager may hold cash up to the value of 5% of the market value of the portfolio in respect of which the Investment Manager has been appointed, subject to agreements with individual Investment Managers, who may require a different limit to invest their part of the Pension Scheme's assets. Cash in excess of this value should be returned to Durham County Council as Administering Authority.

The mandates for each Investment Manager, subject to the overall requirements of the Regulations and this Statement of Investment Principles, are as follows:

Edinburgh Partners

The Pension Fund Committee has appointed Edinburgh Partners to manage a portfolio to be invested in Global Equities.

The Investment Manager's objective is to outperform the benchmark by 3% per annum net of fees over 3 year rolling basis.

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Equities	MSCI AC World Index

Edinburgh Partners intend to invest in the following to achieve their objective:

Portfolio	%
EP Global Equity	100

Edinburgh Partners have a number of guidelines in place at the regional, sectoral and stock level when considering the control of risk within the portfolio. These are detailed below:

Sector	Range
Number of Stocks	Typically holding 30 to 50 stocks
Maximum holding in one stock	5% of the portfolio's value at time of investment. With market movement max. 7.5% before reduction in holding
Holding in cash	Typically not expected to exceed 5% of the portfolio's value following the initial investment process
Maximum holding in one sector	Diversified (e.g. Financials/Industrials) 40% Partially Diversified (e.g. Consumer Goods) 30% Homogeneous (e.g. Oil) 20%
Maximum holding in any one country	US, Japan, UK max 50% each Other developed markets max 20% each Emerging Market Country (as defined by MSCI Emerging Markets Index) max 10% each

There are limits on the holding of the following asset classes:

Asset Class	Maximum Holding
Collective Investment Schemes (CIS)	10% of the Portfolio or as otherwise advised in writing from time to time
CIS	No CIS sponsored by AllianceBernstein may be held
FM Funds (a sub-class of CIS)	10% of the portfolio or as otherwise advised from time to time
CIS of any one body (a sub-class of CIS)	10% of the Portfolio or as otherwise advised from time to time

BlackRock

The Pension Fund Committee has appointed BlackRock to manage a portfolio to be invested in UK Equities.

The Investment Manager's objective is to outperform the benchmark by 3% per annum net of fees over a rolling three year basis.

The benchmark allocation is as follows:

Asset Class	Benchmark
UK Equity	FTSE All-Share Index

BlackRock intend to invest in the following to achieve their objective:

Portfolio	%
UK Focus approach	100

While the BlackRock UK Focus Fund is unconstrained there are some guidelines within the investment process in respect of the portfolio. These guidelines are set out below:

Sector	Range
No. of stocks	Typically holding 15 to 30 stocks
Maximum holding in one stock	15% of the portfolio's value
Maximum holding in one sector	No maximum limit
Holding in cash	Typically not expected to exceed 2% to 5% of the fund value
Active risk	Expect the ex-ante tracking error (active risk) to fall within the range 5% pa to 11% pa.

There are limits on the holding of the following asset classes:

Asset Class	Maximum Holding
Collective Investment Schemes (CIS)	0% to10% of the Portfolio or as otherwise advised in writing from time to time

BlackRock

The Pension Fund Committee has appointed BlackRock to manage a portfolio to be invested passively in Global Equities.

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Equity	FTSE All-World Developed Index

The Investment Manager's objective is to match the Index whilst minimising tracking error, with a target tracking error of 0.3% or less.

BlackRock intend to invest in the following to achieve their objective:

Portfolio	%
Aquila Life World Index Fund	100

The Aquila Life World Index Fund invests in shares of companies worldwide (UK, Europe, Japan, Israel, Pacific Rim, US and Canadian markets) according to the market capitalisation weights of the FTSE All-World Developed Index. Within each of those markets, the Fund aims to generate returns consistent with those of each country's primary share market. Tracking error within portfolios comes from a number of sources. The principal reasons include: allocation misweights against the index; costs associated with rebalancing, and 'cash drag'.

The contributions into or withdrawals out of the Fund, changes to the construction of the benchmark and different market returns may cause the Fund to move outside the +/- 1% bandwidths around the benchmark. The bandwidths used aim to give optimum balance between close tracking and the cost of trading. To keep the portfolio in line with its benchmark, the Fund is reviewed daily and rebalancing trades are placed in the event of an asset class breaching the bandwidths.

AllianceBernstein

The Pension Fund Committee has appointed AllianceBernstein to manage a portfolio to be invested in Global Bonds.

The Investment Manager's objective is to outperform the benchmark by 3% per annum net of fees over a rolling three year basis, with 5 – 10% volatility.

The benchmark allocation is as follows:

Asset Class	Benchmark
Broad Bonds	UK 3-month LIBOR

AllianceBernstein intend to invest in the following to achieve their objective:

Portfolio	%
Diversified Yield Plus Fund	100

AllianceBernstein can use a wide variety of financial instruments to generate returns within the portfolio.

AllianceBernstein intends to make use of financial derivative instruments and shall employ the Value-at-Risk (VaR) approach to measure risk associated with the use of such instruments. The Diversified Yield-Plus strategy employed by AllianceBernstein anticipates VaR exposure of less than or equal to 5%, as calculated by AllianceBernstein or its delegates.

VaR reports will be produced and monitored on a daily basis based on the following criteria:

- 1 month holding period
- 99% confidence level.

The limitations that apply to the investments are detailed below:

Sector	Range
High Yield	0% to 30%
Bank Loans	0% to 25%
Emerging Markets	0% to 20%
Foreign Exchange	0% to 30% gross,0% to 15% net
Sovereign	0% to 100%
MBS	0% to 40%
CMBS/ABS	0% to 30%
Investment-Grade Corporates	0% to 75%

Up to 100% of the Portfolio may be invested in Unit-linked Insurance Contracts issued by Associates of the Investment Manager. Direct investment in Collective Investment Schemes (CIS) is subject to prior approval.

RLAM

The Pension Fund Committee has appointed RLAM to manage a portfolio to be invested in Investment Grade Bonds.

The Investment Manager's objective is to outperform the benchmark by 0.5% per annum net of fees over a rolling three year basis.

The benchmark allocation is as follows:

Asset Class	Benchmark
Conventional Bonds	FTSE Over 5 Year Index-Linked Gilt Index

RLAM intend to invest in the following to achieve their objective:

Portfolio	%
Segregated – with a specified range of +/- 2 years duration of the benchmark, mainly index-linked securities	100

RLAM can invest in a wide variety of bonds to generate returns within the Fund. The limitations to the extent of the investments in each classification are detailed below:

Bond classification	Range
UK Government Index Linked Bonds	50% to 100%
Overseas Government Index-Linked Bonds*	0% to 20%
UK Non-Government Index Linked Bonds	0% to 20%
UK Conventional Government Bonds	0% to 20%
UK Investment Grade Corporate Bonds (or equivalent)	0% to 20%
Overseas Conventional Bonds**	0% to 10%
Derivatives***	0%
Cash or cash equivalents (less than 1 year maturity)	0% to 10%

*Includes government and non-government bonds

**Includes government and corporate bonds and Currency hedged into sterling.

***Derivatives may only be used for the purpose of hedging currency risk.

There are limits on the holding of the following asset classes:

Asset Class	Maximum Holding
Collective Investment Schemes (CIS)	0% of the Portfolio or as otherwise advised in writing from time to time
Any single security excluding government bonds	Maximum of 5% of portfolio

CBRE

The Pension Fund Committee has appointed CBRE to manage a portfolio to be indirectly invested in Property. Investment will not be restricted to UK vehicles, but can be invested **globally as well as a pan-European basis**.

The Investment Manager's objective is to outperform the benchmark by 5% per annum net of fees to be achieved over a five year time horizon.

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Property	UK Retail Price Inflation

CBRE intend to invest in the following to achieve their objective:

Portfolio	%
CB Richard Ellis RPI +5%	100

There are limitations that apply with the construction of the CBRE portfolio. They are as follows:

Restrictions	Range
Collective Investment Schemes (CIS)	0% to 50% until notified in writing and thereafter 0% to 100%
Maximum allocation to any single fund	0% to 15%
Maximum allocation to listed investments	0% to 30%
Maximum allocation to any single country (including the UK)	0% to 25%
Maximum regional allocations -	
Asia Pacific Region	0% to 40%
North American Region	0% to 40%
Other Regions (excluding Europe)	0% to 10%

In the case of Collective Investment Schemes (CIS) taken on at the Effective Date, the requirement shall be that the Investment Manager liquidate these assets at a time that is appropriate in the reasonable opinion of the Investment Manager. There is no long stop date on this process.

Baring Asset Management

The Pension Fund Committee has appointed Barings to manage a portfolio to be invested in a fully diversified Global portfolio. It is expected that target return will be delivered using dynamic asset allocation over the market cycle incorporating the full range of global investment opportunities.

The Investment Manager's objective is to outperform the benchmark by 4% per annum net of fees over a rolling three year basis, with 5 – 10% volatility.

The benchmark allocation is as follows:

Asset Class	Benchmark
DAA	UK 3-month LIBOR

Barings intend to invest in the following to achieve their objective:

Portfolio	%
Extended Risk Solutions	100

Barings can use a wide variety of asset classes to generate returns within the Fund.

The expected volatility arising from the asset distribution over the medium term is 7% to 11% per annum as represented by standard deviations of monthly returns annualised. Value at Risk (VaR) limit of 5% per 10 days with a 99% confidence level based on three years of data.

The limitations to the extent of the investments in each classification are detailed overleaf:

Asset Class	Range
Equities (segregated and/ or pooled)* and depositary receipts, warrants and P-Notes	0% to 65%
Commodities* in the form of ETFs, CIS' and Index Futures.	0% to 30%
Bonds	0% to 80%
Investment-Grade Corporate Bonds	0% to 50%
High Yield Debt** being all corporate and government sub-investment grade debt securities.	0% to 15%
Emerging Market Debt** being all government debt securities issued by countries falling within the World Bank definition of a developing market country (or similar) at the time of acquisition.	0% to 15%
Property in the form of REITs and CIS'	0% to 30%
Hedge Funds/Structured Products/Private Equity	0% to 50%
Foreign Exchange including Forwards	0% to 40%
Cash/Near Cash	0% to 25%

* Equities and Commodities, aggregate maximum 80%

** High Yield and Emerging Market Debt, aggregate maximum 20%

There are limits on the holding of the following asset classes:

Asset Class	Maximum Holding
Collective Investment Schemes (CIS)	50% of the Portfolio or as otherwise advised in writing from time to time
CIS	No CIS sponsored by AllianceBernstein, titled Diversified Yield Bond Plus Fund, may be held.
FM Funds (a subclass of CIS)	50% of the Portfolio or as otherwise advised in writing from time to time.
CIS of any one body (a subclass of CIS)	50% of the Portfolio or as otherwise advised in writing from time to time.

Note: Allocations to other bond assets such as mortgage backed securities or asset backed securities and bank loans as well as foreign currency exposure are also permitted.

The Pension Fund Committee will allow the Investment Manager to exercise Long/Short strategies; however there will be no net short positions permissable in any asset class.

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Pension Fund Committee

7 March 2013

Terms of Reference

Don McLure, Corporate Director Resources

Purpose of the Report

1 To inform Members of the progress in determining terms of reference for the Pension Fund Committee.

Background

2 The Pension Fund Committee has responsibility delegated from the Council to discharge the powers and duties arising from Section 7 of the Superannuation Act 1972 and Regulations made following from this, including:

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

3 An Internal Audit report considering the Governance and Funding of the Pension Fund was presented to this committee on 6 December 2011 by the Internal Auditor in order to provide assurance over the governance arrangements in place for the Pension Fund. The report recommended that a review should take place to clarify that the responsibilities of the Pension Fund Committee were clearly defined and understood.

4 The audit approach involved reviewing documentation provided by the Fund, as well as interviews with County Council officers and members of the Pension Fund Committee.

5 The establishment of clear Terms of Reference for the Committee was a recommendation of the report and this is considered to be necessary as a precursor to the other recommendations of the Internal Auditor's report being implemented.

6 A workshop was held on 6 February 2013 when the proposed Terms of Reference were discussed in detail. A note of the main points raised at that meeting is attached at Appendix 1.

Terms of Reference

7 Following discussions at the workshop, amendments have been made to the draft Terms of Reference presented to the Committee in December. A revised Terms of Reference is attached at Appendix 2. The amendments have been shaded in the Appendix.

8 The Operational Terms of Reference attached provide clarity to the members of the Pension Fund Committee in a number of areas:

- High level objective of the Committee
- Authority of the Committee
- Composition of the Committee
- Detailed Terms of Reference to achieve the High Level Objective
- Meetings
- Programme of work
- Performance and Review

9 The Terms of Reference will determine the future programme of work of the committee and following discussions, the frequency of reporting on the individual term of reference has been included.

10 It is recommended that the Terms of Reference be reviewed at least annually to ensure that they include any changes to items described in paragraph 8.

Delegated Authority

11 The delegation of authority from the County Council is wide-ranging and covers the management of all of the Pension Fund's activities. Any changes to this delegation would require the consideration and agreement of the Constitution Working Group.

12 No changes are suggested to be made to this delegation.

Recommendations

13 It is recommended that:

- Members agree to adopt the Terms of Reference as shown in Appendix 2

- The Terms of Reference are reviewed at least on an annual basis.

Background papers

(a) Pension Fund Committee – 6 December 2011 – Internal Audit Progress Report

(b) Durham County Council Constitution

(c) CIPFA – Pensions Finance – Knowledge and Skills Framework: Technical Guidance for Pensions Practitioners in the Public Sector

(d) CIPFA – Pensions Finance – Knowledge and Skills Framework: Technical Guidance for Elected Representatives and Non-executives in the Public Sector

(e) CIPFA – Investment Decision Making and Disclosure in the Local Government Pension Scheme: A guide to the Application of the Myners Principles

(f) Pension Fund Committee -4 December 2012 - Terms of Reference

Contact: Hilary Appleton Tel: 03000 266239

Appendix 1: Pension Fund Committee Workshop Session – 6 February 2013

Agenda

- Items that are in the Constitution and accepted:
  - The delegated authority for the Committee
  - The delegated authority for the Corporate Director, Resources
  - The composition of the Committee

- Items for discussion:
  - Objectives for the Committee
  - Terms of Reference
  - Programme of Work for the Committee

- Next Steps
  - Report the amended Terms of Reference to Pension Fund Committee for approval.
  - Implement the agreed programme of work

Notes of the Meeting

Present:
Councillors:

A Turner, N Martin, J Chaplow, A Hopgood, P Jopling, J Lethbridge, D Morgan, R Ord, G Richardson. D Sanders, N Hancock.

Officers:
N Orton, H Appleton, P Monaghan, B White, A Merritt, P Turner, R Auty.

The meeting discussed the Terms of Reference in line with the Agenda circulated at the meeting.

Points raised at the meeting:

- Should Internal Audit's recommendations influence the Terms of Reference for the Committee? Member responsibilities and the discharge of their duties should be the main driver for the TOR and the programme of work.
- Clarification of the difference between members and trustees was requested.

- Responsibility for the appointment and termination of Investment Managers – how does this fit into the current procurement process, and how does the Committee gain assurance over the Investment Managers' selection process? There needs to be a relationship of respect and trust between Members and the Investment Managers.
- Training for Committee was discussed – in particular induction for new Members of the Pension Fund Committee – should the June meeting be postponed until training is completed?
- An investment sub-committee was discussed as a way of having a more active role with the Investment Managers – possibly holding sub-committee meetings between the quarterly Pension Fund Committee meetings to have more time to interrogate the Investment Managers.
- An investment sub-committee would require a skills set to provide more challenge to the Managers; training items could be put on the Agenda. It was thought that it would be useful to have the capacity to do this.
- It was thought that the Investment Managers were not held to account sufficiently. Members were unsure that the right questions were being asked of the Managers and in some cases, whether the answers were fully understood.
- An alternative view was given that 'common sense' questions are useful. The committee having two advisers who could give contrasting views was also considered useful in this context.
- The time taken to terminate the contract of a Manager was also discussed; it was felt that this should have happened in a more timely manner.
- It was felt that the committee ought to be informed of any late payments of contributions from employers due to the implications on the fund, e.g. reducing amounts available for investments, or problems with an employing organisation.
- An annual review of the Terms of Reference, as well as consideration of the appropriateness of the reports presented, and their frequency was accepted. This should be done at December Committee, with revised Terms of Reference being reported in March.

As a result of the meeting, the draft Terms of Reference were amended to reflect the discussions, and a 'frequency of reporting' added to each of the terms.

Appendix 2: 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

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.

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Agenda Item 15

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Agenda Item 16

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Agenda Item 21

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