Durham County Council

Pension Fund Committee

Date Monday 5 March 2012
Time 10.00 am
Venue Committee Room 2, County Hall, Durham

Business

Part A

1. Declarations of interest (if any)

2. The Minutes of the last Meeting held on 6 December 2011 (Pages 1 - 4)

3. Graphs showing recent movements of the Stock and Share Indices (Pages 5 - 14)

4. Graphs showing recent movements of the major currencies against sterling (Pages 15 - 20)

5. Performance Measurement Report (Pages 21 - 30)

6. Pension Fund Investments (Pages 31 - 34)

7. Pension Fund Policy Documents - Funding Strategy Statement and Statement of Investment Principles (Pages 35 - 90)

8. Academy Schools - Risks from Participation in the Pension Fund (Pages 91 - 102)

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

10. 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)

11. The Minutes of the last Meeting held on 6 December 2011 (Pages 103 - 110)

12. Verbal Report of the Pension Fund Advisor

13. Report of Blackrock (Pages 111 - 122)

14. Report of Alliance Bernstein (Pages 123 - 162)

15. Report of CB Richard Ellis (Pages 163 - 188)

16. Report of Edinburgh Partners (Pages 189 - 232)

17. Report of Royal London Asset Management (Pages 233 - 304)

18. Report of Barings Asset Management (Pages 305 - 312)

19. Internal Audit Progress Report (Pages 313 - 348)

20. Transition of Global Equities - Verbal Update

21. 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
24 February 2012

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 Hazeldine
(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
Principal Finance Officer – Strategic Finance	H Appleton

Independent Advisers
P J Williams
H Prior

Investment Managers
Alliance Bernstein
Barings Asset Management
Blackrock
CBRE
Edinburgh Partners

Staff Observors

UNISON	N Hancock
GMB	

Contact: Jill Errington **Tel: 0191 370 6250**

This page is intentionally left blank

DURHAM COUNTY COUNCIL

PENSION FUND COMMITTEE

At a Meeting of **Pension Fund Committee** held in Committee Room 2 - County Hall, Durham on **Tuesday 6 December 2011 at 10.00 am**

Present:

Councillor N Martin (Chair)

Members of the Committee:
Councillors C Carr, J Chaplow, A Hopgood, D Morgan, R Ord, G Richardson and R Todd

Admitted Bodies Representative:
K Tallintire

Apologies:
Apologies for absence were received from Councillors Andy Turner, P Jopling and J Lethbridge, and O Brown and D Sanders

Also Present:
Advisers:
Durham County Council Officers:

Principal Finance Officer – Strategic Finance:	H Appleton
Litigation Manager	B Smith
Payroll and Pensions Manager	N Orton

Independent Advisers:

P J Williams	P Williams
P Solve Asset Solutions	H Prior

A Wallage	Internal Audit and Risk Manager
S Newitt	PwC
R Auty	PwC

1 Declarations of interest (if any)

There were no declarations of interest received.

2 The Minutes of the Last Meeting held on 29 September 2011

The Minutes of the meeting held on 29 September 2011, were agreed as a correct record, subject to the following amendment to minute no.2 relating to the actuarial valuation as at 31 March 2010;-

'N Orton stated that the latest proposal from the employer's side suggested an increase in employee contributions. Employees could elect not to pay the additional amount but would earn a lower accrual rate. Only FTE employees on an annual salary of less than £15k would be protected.'

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, copies of which had been circulated.

Additional graphs were provided showing recent movements in overseas equity markets and UK markets. With regard to UK markets P Williams pointed out that index linked UK government bond prices were rising yet bond yields were falling. This had a negative impact on the valuation of pension fund liabilities but he hoped that this was a temporary situation.

RESOLVED

That the information given, be noted.

4 Graphs showing recent movements of the major currencies against sterling

Consideration was given to graphs showing recent movement in the major currencies against sterling, a copy of which had been circulated.

RESOLVED

That the information given, be noted.

5 Performance Measurement Report

Consideration was given to the report of the Corporate Director, Resources which provided an overview of the Pension Fund to date, a copy of which had been circulated.

The report gave details of the performance of the six Managers against benchmarks.

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 2011, of the additional sums available to the Managers for further investment and of the latest Fund Rebalancing (for copy see file of Minutes).

Members discussed the report and referred to the deficit cash flow at the quarter ended 30 September 2011 and estimated for the quarter ended 31 December 2011. Increased levels of retirements and a reduction in the number of staff across the Authority as a result of savings identified in the MTFP, which meant fewer contributions to the scheme, had impacted on the cash flow situation. In addition government proposals were likely to have an impact in the longer term. Members felt that there was a need to understand the longer term impact on the Pension Fund and therefore asked Officers to undertake a ‘modelling exercise’. This would help to ensure that the scheme was able to manage future issues.

RESOLVED

That the information given, be noted and Officers undertake a ‘modelling exercise’ to assess future issues for the Pension Fund.

7 Government Consultation on Changes to the Local Government Pension Scheme

Consideration was given to the report of the Corporate Director, Resources which provided information on the Government’s consultation on changes to the Local Government Pension Scheme, including details of recently published plans for longer term reform (for copy see file of Minutes).

RESOLVED

That the information given, be noted.

8 Academy Schools in the Pension Fund

Consideration was given to the report of the Corporate Director, Resources which provided information on the way Pension Fund assets and liabilities were allocated and employer pension contribution rates were set for Academy Trusts when schools converted to academy status (for copy see file of Minutes).

Discussion ensued with regard to how academies were to be treated in the Scheme. Academy Schools were to be treated in the same way as scheduled body employers and the comment was made by K Tallintire, that in view of the minimal risk of insolvency that they be treated as an admitted body.

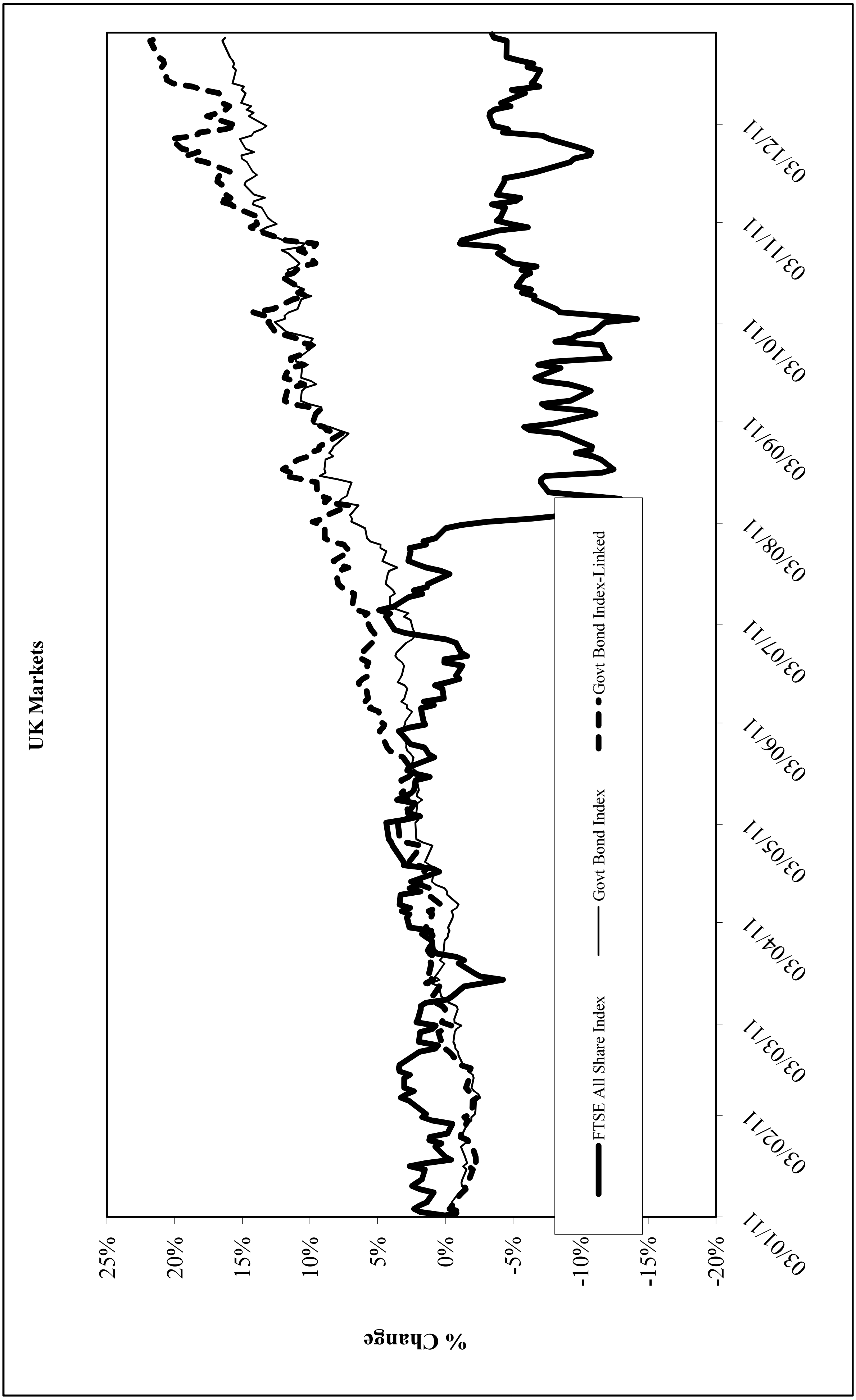
N Orton responded that under the Regulations Academy Trusts were scheduled body employers and as such did not have to apply to be members of the scheme. However there was some flexibility in how academies were admitted to the scheme and the summary in the report outlined the approach recommended which was considered to be fair to all parties.

Members considered that there was a need to understand the potential risks involved and asked Officers to submit a further report to the Committee.

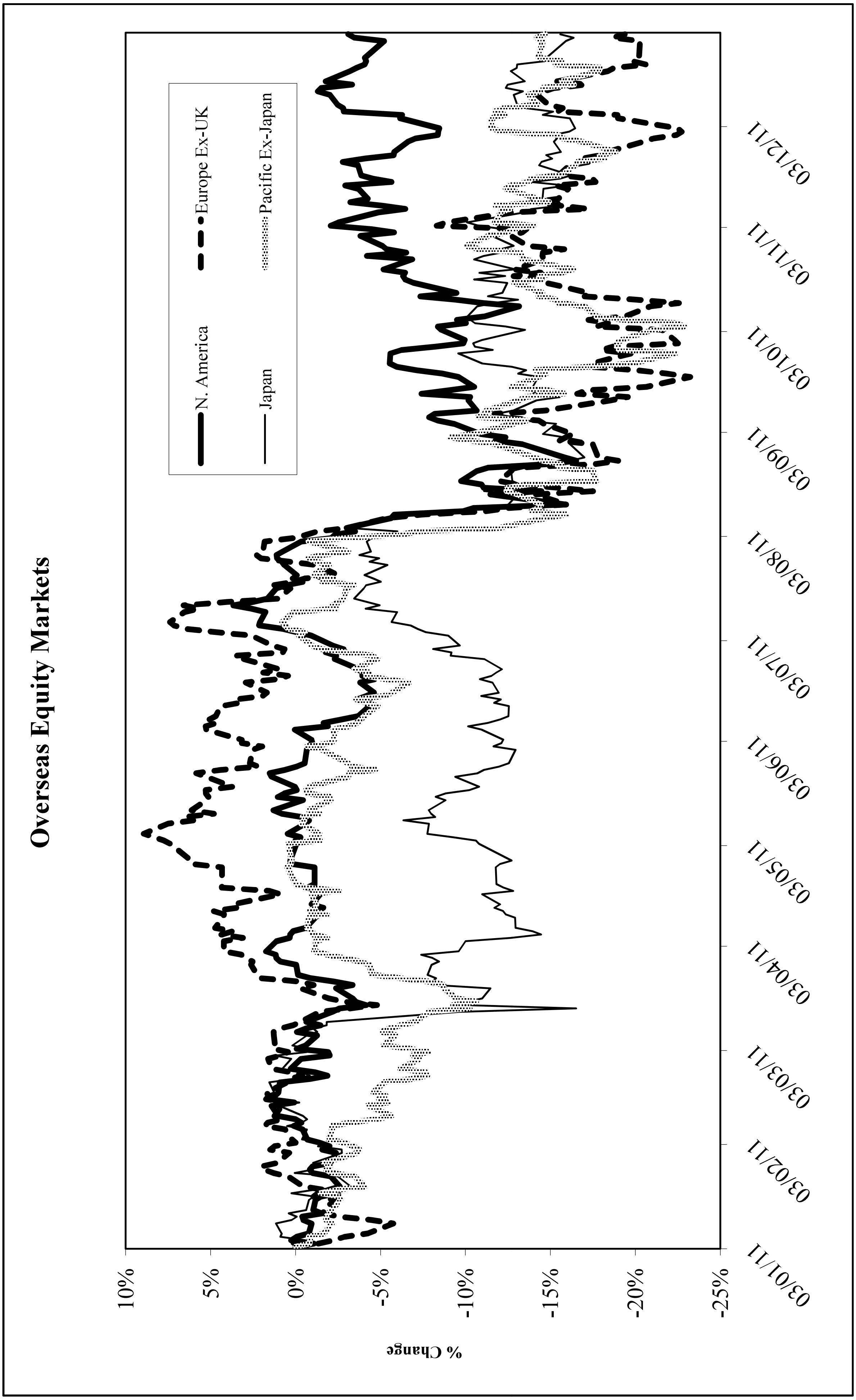
With regard to a later query about free schools, N Orton advised that these would be treated as a scheduled body employer as they were entitled to be in the scheme as of right.

RESOLVED

That the information given, be noted and a report outlining the potential risks be submitted to the next meeting of the Committee.

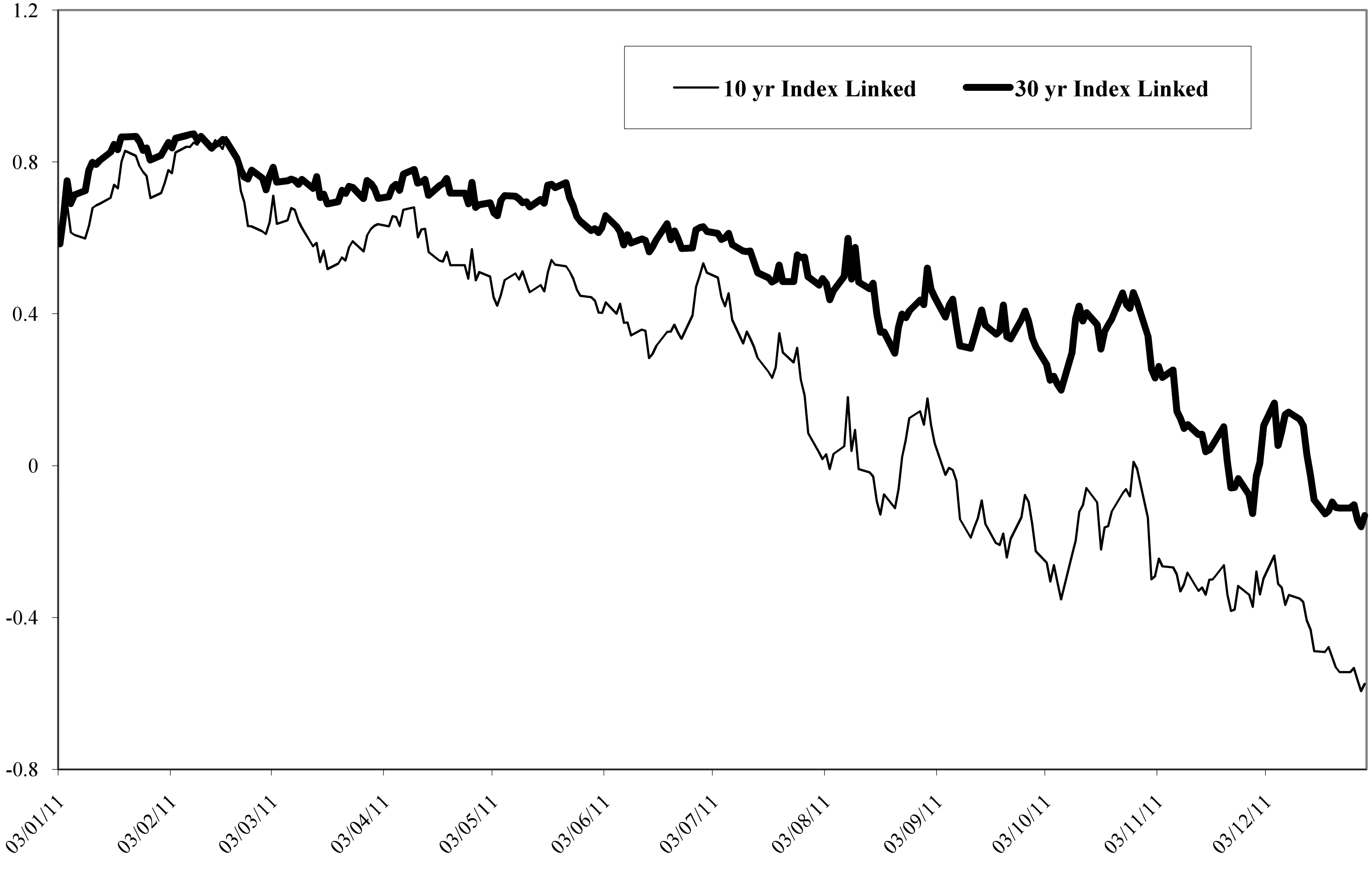

UK Markets
% Change
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
-20%
03/01/11
03/02/11
03/03/11
03/04/11
03/05/11
03/06/11
03/07/11
03/08/11
03/09/11
03/10/11
03/11/11
03/12/11
FTSE All Share Index
Govt Bond Index
Govt Bond Index-Linked

This page is intentionally left blank


Overseas Equity Markets
N. America
Europe Ex-UK
Japan
Pacific Ex-Japan
% Change
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
03/01/11
03/02/11
03/03/11
03/04/11
03/05/11
03/06/11
03/07/11
03/08/11
03/09/11
03/10/11
03/11/11
03/12/11

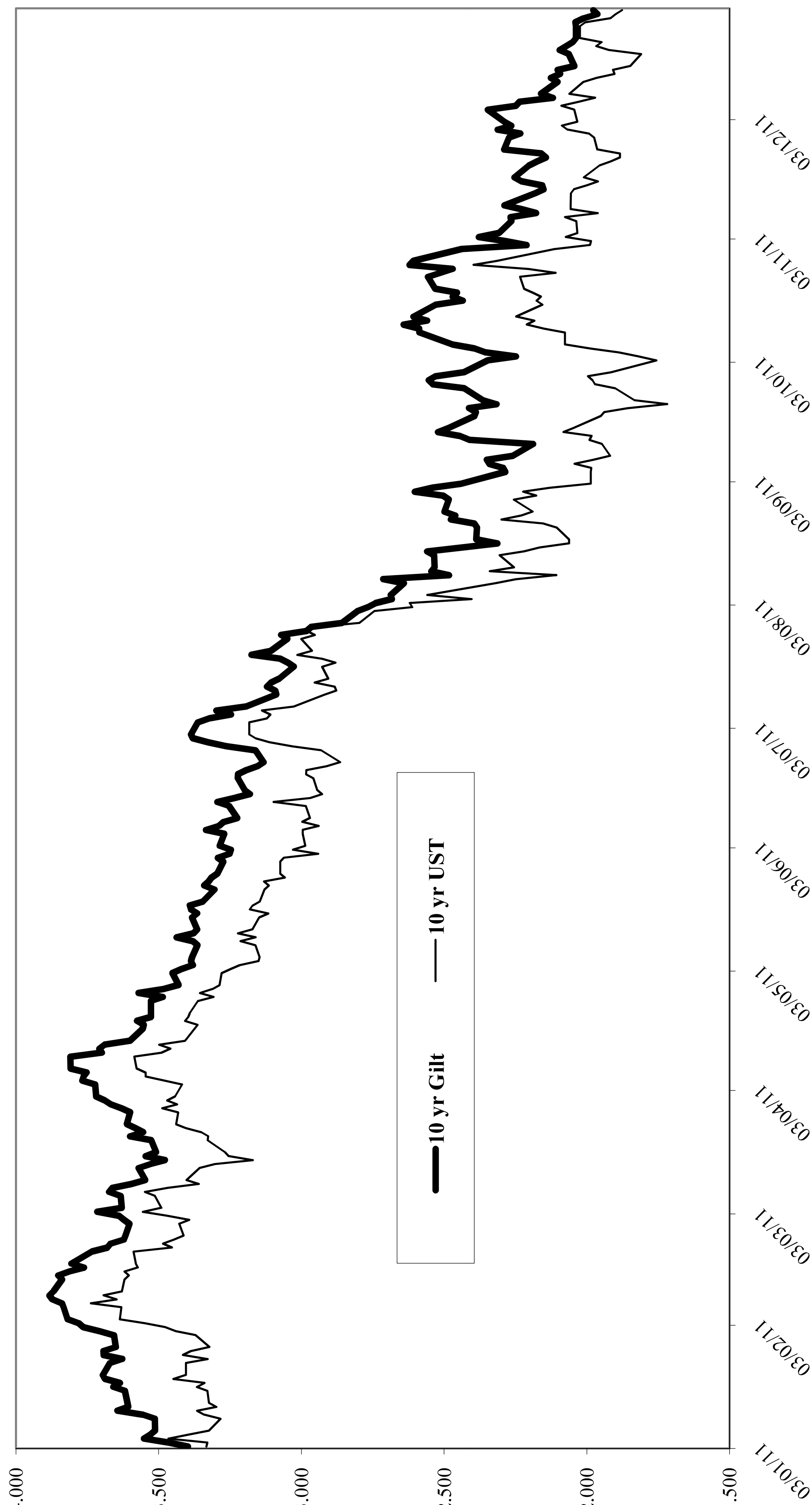
This page is intentionally left blank

UK Index Linked Yields

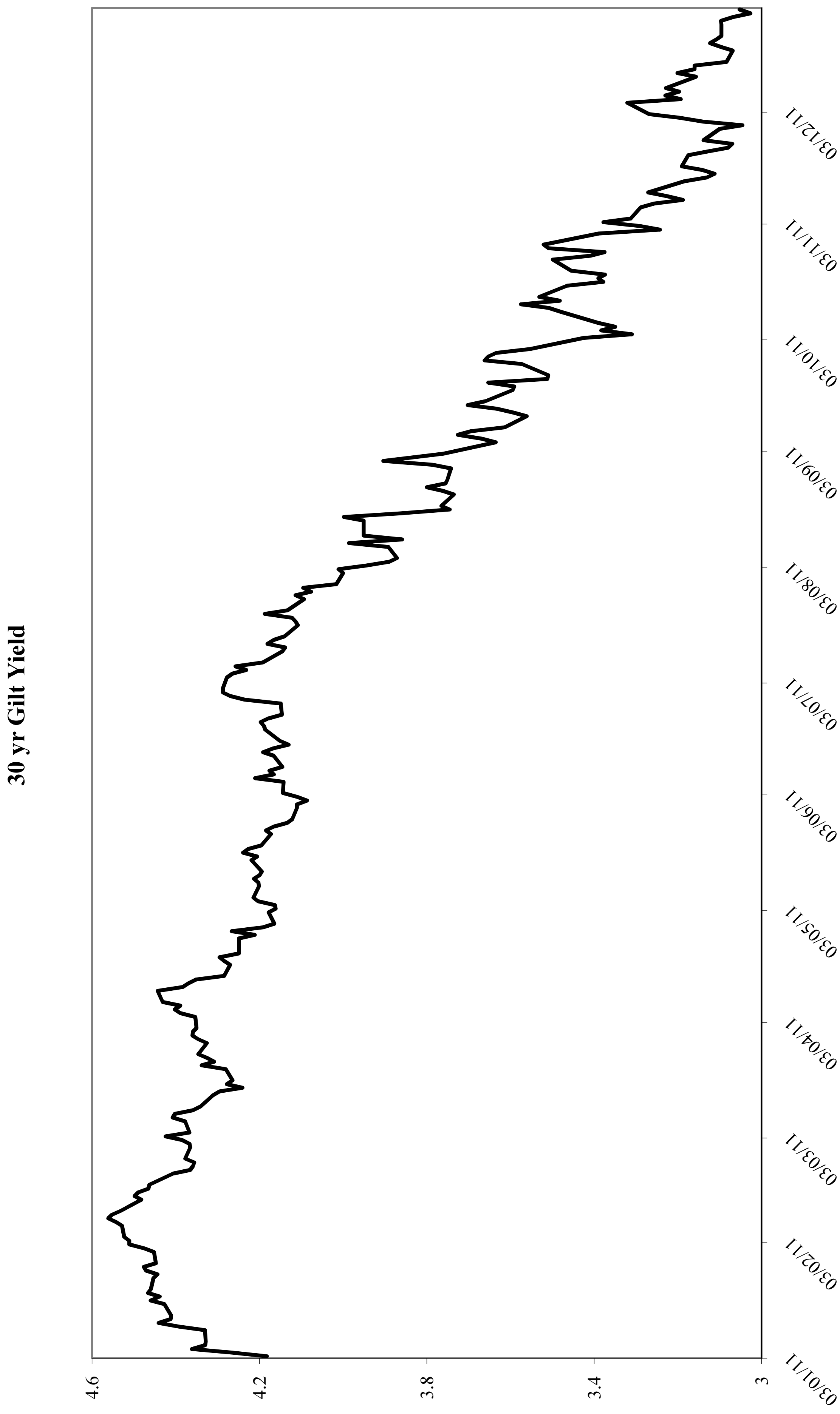


This page is intentionally left blank

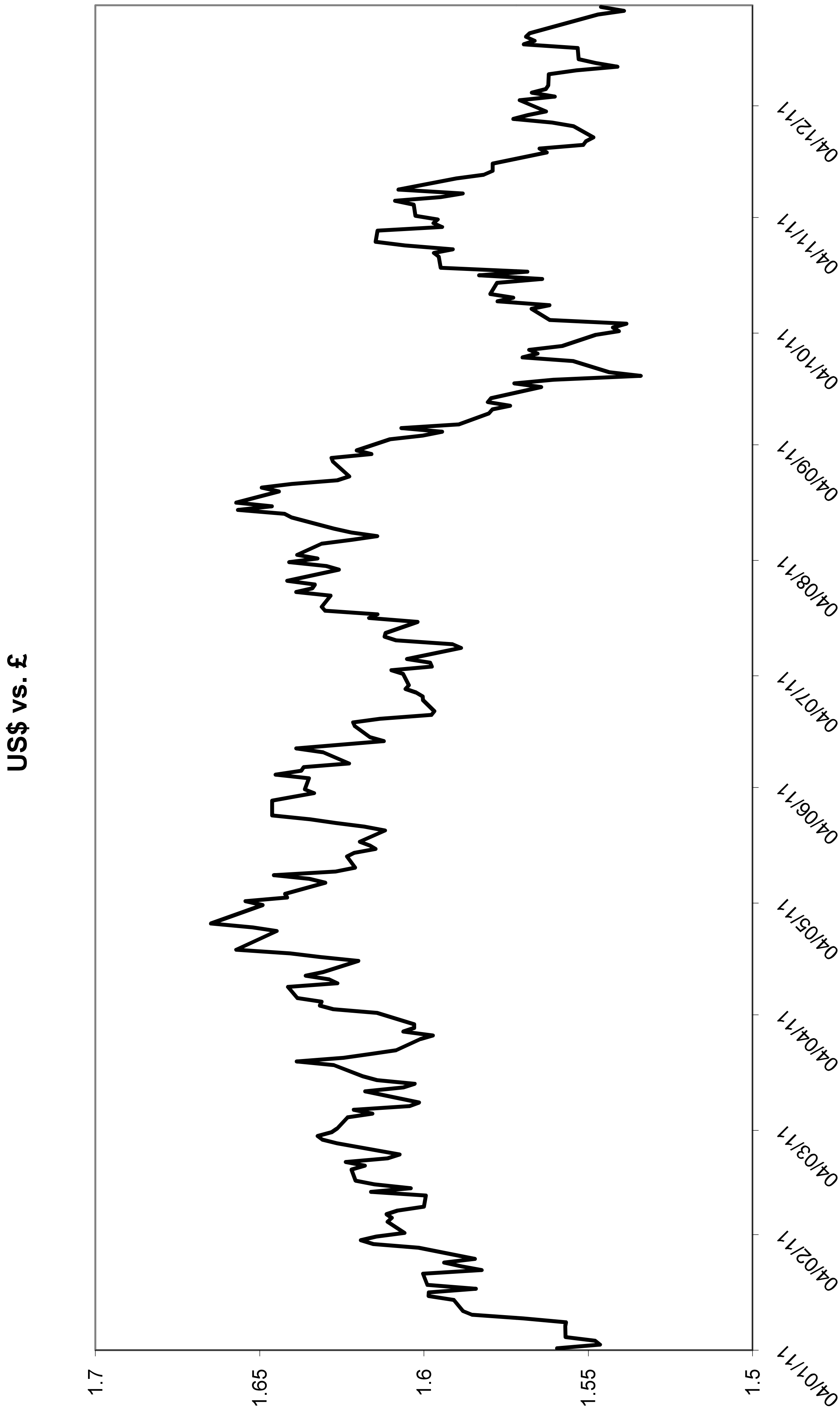
10 yr Govt. Bond Yields



This page is intentionally left blank

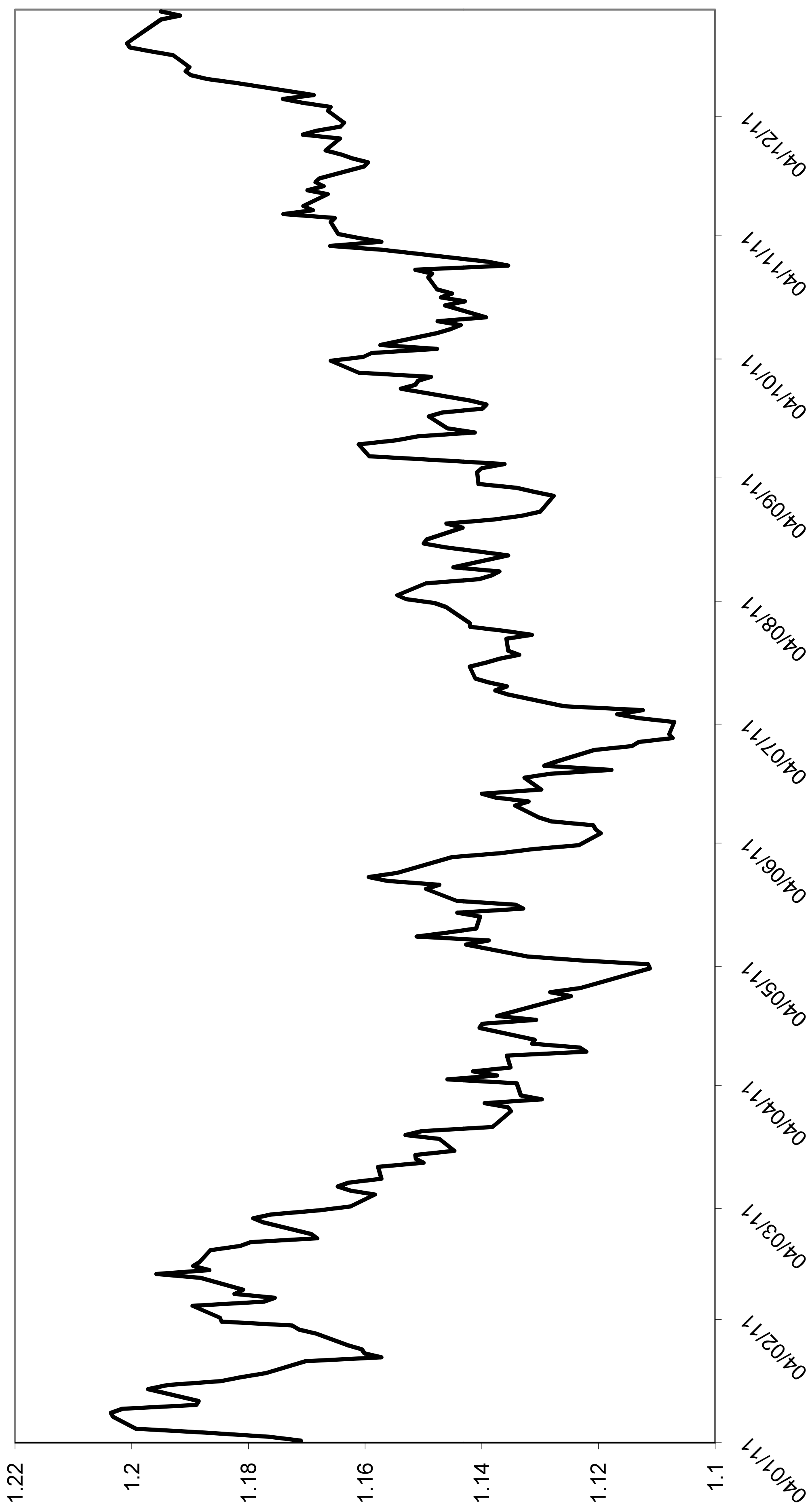

30 yr Gilt Yield
4.6
4.2
3.8
3.4
3
03/01/11
03/02/11
03/03/11
03/04/11
03/05/11
03/06/11
03/07/11
03/08/11
03/09/11
03/10/11
03/11/11
03/12/11

This page is intentionally left blank


US$ vs. £
1.7
1.65
1.6
1.55
1.5
04/01/11
04/02/11
04/03/11
04/04/11
04/05/11
04/06/11
04/07/11
04/08/11
04/09/11
04/10/11
04/11/11
04/12/11

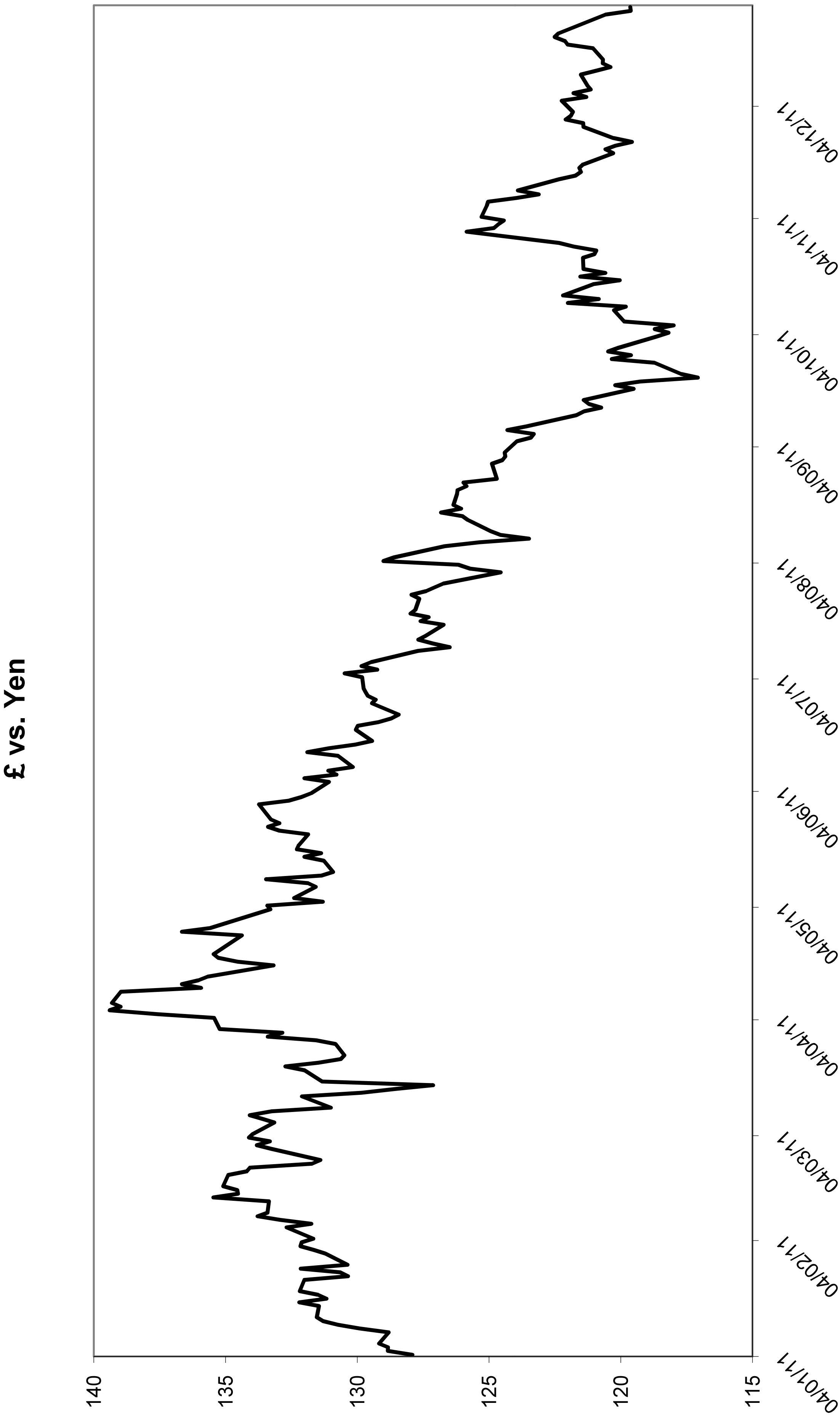
This page is intentionally left blank

€ vs. £



1.22
1.2
1.18
1.16
1.14
1.12
1.1
04/01/11
04/02/11
04/03/11
04/04/11
04/05/11
04/06/11
04/07/11
04/08/11
04/09/11
04/10/11
04/11/11
04/12/11

This page is intentionally left blank


£ vs. Yen
140
135
130
125
120
115
04/01/11
04/02/11
04/03/11
04/04/11
04/05/11
04/06/11
04/07/11
04/08/11
04/09/11
04/10/11
04/11/11
04/12/11

This page is intentionally left blank

Pension Fund Committee

5 March 2012

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 date.

Background

2 The performance of the six 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 2011 and for the period since inception.

Recommendation

3 Members note the information contained in this report.

Contact: Hilary Appleton Tel: 0191 3833544

This page is intentionally left blank

J.P.Morgan

Worldwide Securities Services

Performance Measurement Report
for
Durham County Council Pension Fund

for period ending
December 31, 2011

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
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 31/12/2011

Overview

During the quarter the total market value of the Durham County Council Pension Plan increased by £113.51m to £1,796.67m. There were contributions into the plan totalling £7.71m over the quarter, so net gains were therefore £105.80m.

The performance return for the Plan over the fourth quarter of 2011 was 6.28%, compared to the Plan benchmark return of 6.62%. The Plan therefore underperformed the benchmark by -0.34%.

Equity markets were up over this quarter with the FTSE All Share (+3%) rising 9.20% and the MSCI AC World index (+3%) also up by 8.36% in Sterling terms. Index Linked bonds were up with the FTSE index linked over 5 years index (+0.5%) increasing by 9.90%.

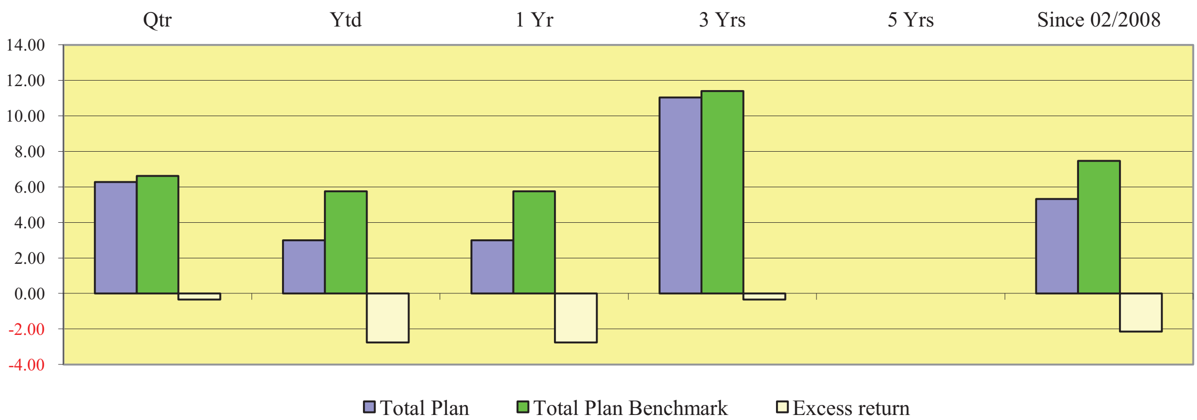
Market Values

	In GBP mil's			
	Qtr 4 - 11	Qtr 3 - 11	Qtr 2 - 11	Qtr 1 - 11
Total Plan	**1,796.67**	**1,683.16**	**1,784.05**	**1,751.57**

Performance

	Performance (%) *					
	Qtr	Ytd	1 Yr	3 Yrs	5 Yrs	Since 02/2008
Total Plan	6.28	3.00	3.00	11.0	-	5.31
Total Plan Benchmark	6.62	5.76	5.76	11.4	-	7.47
Excess return	*-0.34*	*-2.76*	*-2.76*	*-0.35*		*-2.15*

Total Plan Performance

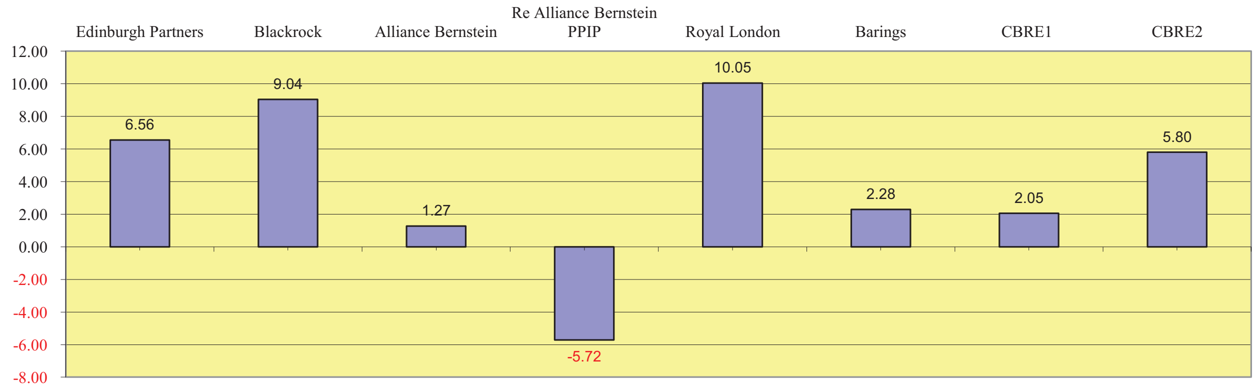


Total Plan Performance Returns as at 31/12/11

Currency GBP	Mkt. Val. in Mil's	Performance (%) * Qtr	Ytd	1 Year	2 Years	3 Years	Since 02/2008
Total Plan	**1796.7**	6.28	3.00	3.00	7.41	11.0	5.31
Total Plan Benchmark		6.62	5.76	5.76	9.46	11.4	7.47
Excess return		-0.34	-2.76	-2.76	-2.06	-0.35	-2.15

	Mkt. Val. in Mil's	Qtr	Ytd	1 Year	2 Years	3 Years	Since 02/2008
Edinburgh Partners	**460.5**	6.56	-7.23	-7.23	0.22	6.0	2.33
MSCI AC World Index (Gross) +3% pa		8.36	-3.35	-3.35	7.81	13.0	6.93
Excess return		-1.80	-3.87	-3.87	-7.59	-6.99	-4.60
Blackrock	**341.0**	9.04	-1.84	-1.84	9.02	17.3	3.84
FTSE All Share (Gross) +3% pa		9.20	-0.37	-0.37	8.41	16.4	5.55
Excess return		-0.16	-1.47	-1.47	0.61	0.95	-1.71
Alliance Bernstein	**263.1**	1.27	2.06	2.06	4.66	10.2	4.03
GBP Libor +3% pa		1.00	3.88	3.88	3.80	3.9	4.95
Excess return		0.27	-1.83	-1.83	0.87	6.24	-0.92
Re Alliance Bernstein PPIP	**22.4**	-5.72	-11.48	-11.48	7.32	-	7.25
GBP Libor +3% pa		1.00	3.88	3.88	3.80	-	3.79
Excess return		-6.72	-15.36	-15.36	3.53	-	3.46
Royal London	**444.7**	10.05	23.90	23.90	16.56	13.1	10.84
FTSE index Linked >5 years +0.5% pa		9.90	24.18	24.18	16.66	13.0	10.62
Excess return		0.15	-0.28	-0.28	-0.10	0.06	0.22
Barings	**145.9**	2.28	1.91	1.91	6.30	11.6	7.41
GBP Libor +4% pa		1.24	4.89	4.89	4.80	5.0	5.97
Excess return		1.04	-2.98	-2.98	1.49	6.60	1.44
CBRE1	**89.4**	2.05	8.15	8.15	9.06	1.40	-3.47
Headline RPI +5% pa		1.87	10.04	10.04	10.01	9.2	8.45
Excess return		0.17	-1.89	-1.89	-0.96	-7.77	-11.92
CBRE2	**29.6**	5.80	-10.43	-10.43	3.06	16.2	-0.42
Headline RPI +5% pa		1.87	10.04	10.04	10.01	9.2	8.45
Excess return		3.93	-20.47	-20.47	-6.96	7.08	-8.87

Manager Quarterly Returns

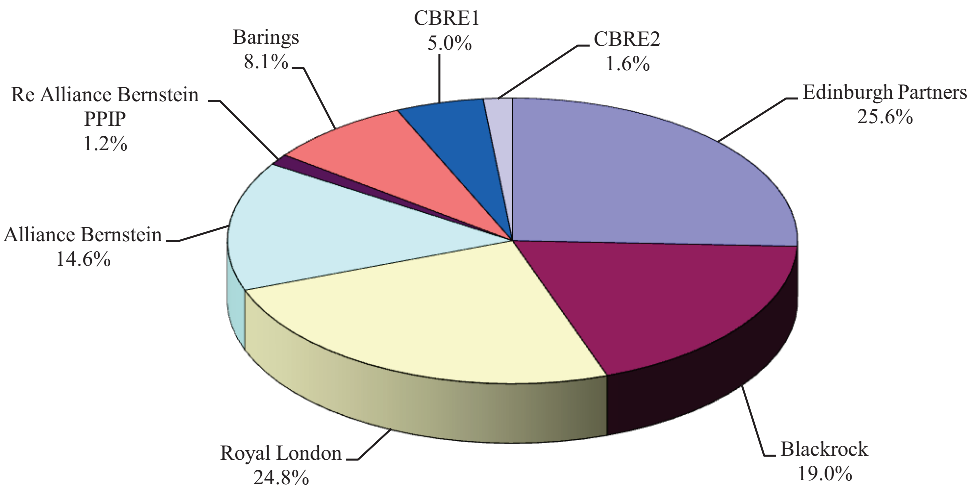


***All Portfolio and Composite returns are Gross of Fees. For time periods in excess of 1 year the performance returns are annualised.**

Portfolio Comparison for Quarter 4, 2011

Portfolio Name	Current Market Value	Portfolio Weight	Portfolio Return (%)	Benchmark Return (%)	Excess Return (%)	Current Contribution to Return
Total Plan	**1,796,673,045**	**100.00%**	**6.28**	**6.62**	**(0.34)**	
Edinburgh Partners	460,479,970	25.63%	6.56	8.36	(1.80)	1.69
Blackrock	341,040,518	18.98%	9.04	9.20	(0.16)	1.67
Royal London	444,711,165	24.75%	10.05	9.90	0.15	2.31
Alliance Bernstein	263,100,010	14.64%	1.27	1.00	0.27	0.19
Re Alliance Bernstein PPIP	22,374,050	1.25%	(5.72)	1.00	(6.72)	(0.08)
Barings	145,903,431	8.12%	2.28	1.24	1.04	0.19
CBRE1	89,419,597	4.98%	2.05	1.87	0.17	0.10
CBRE2	29,644,305	1.65%	5.80	1.87	3.93	0.10

Manager Allocation



Portfolio Comparison for Year to Date, 2011

Portfolio Name	Current Market Value	Portfolio Weight	Portfolio Return (%)	Benchmark Return (%)	Excess Return (%)	Current Contribution to Return
Total Plan	**1,796,673,045**	**100.00%**	**3.00**	**5.76**	**(2.76)**	
Edinburgh Partners	460,479,970	25.63%	(7.23)	(3.35)	(3.87)	(1.93)
Blackrock	341,040,518	18.98%	(1.84)	(0.37)	(1.47)	(0.21)
Royal London	444,711,165	24.75%	23.90	24.18	(0.28)	4.87
Alliance Bernstein	263,100,010	14.64%	2.06	3.88	(1.83)	0.29
Re Alliance Bernstein PPIP	22,374,050	1.25%	(11.48)	3.88	(15.36)	(0.16)
Barings	145,903,431	8.12%	1.91	4.89	(2.98)	0.15
CBRE1	89,419,597	4.98%	8.15	10.04	(1.89)	0.32
CBRE2	29,644,305	1.65%	(10.43)	10.04	(20.47)	(0.19)

Disclaimer

Copyright ©2011 JPMorgan Chase & Co. All rights reserved.

This report is provided exclusively for the purpose of assisting the customer in monitoring the investment performance of its accounts. J.P. Morgan is providing a reporting service to the customer to assist it in the management of the accounts and, in doing so, is not acting in a fiduciary capacity for the accounts. J.P. Morgan has no responsibility for the selection, monitoring or termination of any investment manager with respect to any of the accounts. The reports are not intended to be considered the rendering of investment advice or in any way to influence any investment decisions or the selection of any investment managers for the accounts. The customer assumes sole responsibility for its use of the reports.

This report contains information that is the property of J.P. Morgan and/or its content providers, and is intended for use by the investment officers of our institutional clients. This report may not be copied, published, or used in whole or in part with third-parties for any purposes other than expressly authorized by J.P. Morgan.

The information furnished in this report may contain data obtained from third-party sources that J.P. Morgan believes to be reliable. However, J.P. Morgan makes no warranty, express or implied, concerning the accuracy or completeness of third-party data. Where J.P. Morgan relies on accounting, pricing and associated security data – or instructions for what accounts comprise composites – by the customer or its third party administrators, J.P. Morgan takes no responsibility for the accuracy of such information.

Third-party data is the intellectual property of those vendors and is subject to restrictions contained in the licenses, which J.P. Morgan cannot unilaterally change. If the third party supplier adds additional restrictions to data use, J.P. Morgan shall use reasonable efforts to notify the customer of such changes in writing. Customer's continued use of the report after receipt of notice shall constitute customer's acceptance of the revised usage provision.

The information contained in this report may be subject to change from time to time without prior notice to the Customer, for reasons including, but not limited to, the subsequent restating of accounting information or index returns.

The information furnished in this report does not constitute the provision of ‘financial product advice’ as defined under the *Corporations Act 2001* (Cth) and does not take into account the financial situation, needs or objectives of individuals in Australia.

The information furnished in this report is available in New Zealand solely to persons who are wholesale clients for the purposes of the Financial Advisers Act 2008. If you do not meet this criterion, you are not entitled to this report.

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of Morgan Stanley Capital International Inc. ("MSCI") and Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") and is licensed for use by The JPMorgan Chase & Co. and its wholly owned subsidiaries. Neither MSCI, S&P, nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

Standard and Poor's including its subsidiary corporations ("S&P") is a division of the McGraw-Hill Companies, Inc. Reproduction of S&P Index Alerts in any form is prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P sources, S&P or others, S&P does not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P gives not express or implied warranties, including, but not limited to, any warranties or merchantability or fitness for a particular purpose or use. In no event shall S&P be liable for any indirect, special or consequential damages in connection with subscribers or others' use of S&P Index Alerts.

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

FTSE ® is a trade mark of London Stock Exchange Plc and The Financial Times Limited and is used by FTSE under license. All rights in the FTSE Indices vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE Indices or underlying data.

The Industry Classification Benchmark is a joint product of FTSE International Limited and Dow Jones & Company, Inc. and has been licensed for use. "FTSE" is a trade and service mark of London Stock Exchange and The Financial Times Limited. "Dow Jones" and "DJ" are trade and service marks of Dow Jones & Company Inc. FTSE and Dow Jones do not accept any liability to any person for any loss or damage arising out of any error or omission in the ICB.

The Dow Jones Wilshire Indexes℠ are calculated, distributed and marketed by Dow Jones & Company, Inc. pursuant to an agreement between Dow Jones and Wilshire and have been licensed for use. All content of the Dow Jones Wilshire Indexes℠ © 2011 Dow Jones & Company, Inc. & Wilshire Associates Incorporated.

Frank Russell Company ("FRC") is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto. The presentation may contain confidential information and unauthorized use, disclosure, copying, dissemination or redistribution is strictly prohibited. This is a USER presentation of the Russell Index data. Frank Russell Company is not responsible for the formatting or configuration of this material or for any inaccuracy in USER's presentation thereof.

The Merrill Lynch Indices are used with permission. Copyright 2011, Merrill Lynch, Pierce, Fenner & Smith Incorporated. All rights reserved. The Merrill Lynch Indices may not be copied, used, or distributed without Merrill Lynch's prior written approval. Merrill Lynch does not guarantee the quality, accuracy and/or completeness of the Merrill Lynch indices or any data included therein or derived therefrom and shall not be liable to any third party in connection with their use.

© UBS 2011. All rights reserved. The name UBS Global Convertible Bond Index and the names of the related UBS AG sub-indices (together the “UBS Indices”) are proprietary to UBS AG (“UBS”). UBS and MACE Advisers Ltd (the UBS Global Convertible Bond Index Calculation Agent) are together the “Index Parties”.

© IPD (Investment Property Databank Ltd.) 2011 All rights conferred by law of copyright, by virtue of international copyright conventions and all other intellectual property laws are reserved by IPD. No part of the Mercer / IPD Australian Pooled Property Fund Index - Wholesale Core may be reproduced or transmitted, in any form or by any means, without the prior written consent of IPD. This index is neither appropriate nor authorized by IPD for use as a benchmark for portfolio or manager performance, or as the basis for any business decision. IPD gives no warranty or representation that the use of this information will achieve any particular result for you. Neither Mercer nor IPD has any liability for any losses, damages, costs or expenses suffered by any person as a result of any reliance on this information.

The NZX indices referred to in this report are the property of NZX Limited (“NZX”). Any adaptation, reproduction or transmittance of the data or contents of the NZX indices in any form or by any means other than for private use is prohibited without the prior written permission of NZX. NZX and its affiliates, directors, officers, agents or employees do not make any warranty of any kind, either express or implied, as to the accuracy of the content of the NZX indices or fitness for a particular purpose or use. NZX hereby disclaims all liability to the maximum extent permitted by law in relation to the NZX indices. Neither NZX, its subsidiary companies, nor their directors, officers, agents or employees shall, under any circumstances, be liable to any person for any direct, indirect, consequential, incidental, special or punitive damages, howsoever arising (whether in negligence or otherwise), out of or in connection with the content, any omission from the content, any use of the content or any actions taken or reliance by any person thereon.
Barclays Capital is the source of its respective indices.
DAX indices are registered trademarks of Deutsche Borse AG.
Fixed income risk characteristics provided by Blackrock Solutions.
Citigroup is the source of its respective indices.
© TSX Copyright 2011 TSX Inc. All Rights Reserved.
Hang Seng Indexes Company Limited is the source of its respective indices.
Trust Universe Comparison Service ® and TUCS ®.

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.

The information furnished in this report may be based in part on services provided by Algorithmics (U.S.), Inc. and/or its affiliates (“Algorithmics”). Algorithmics does not make any express or implied warranty or representation regarding its services or contributions to this report, including any warranty of originality, accuracy, completeness, merchantability or fitness for a particular purpose, nor shall its services or contributions to this report be construed as providing any financial advice, auditing, accounting, appraisal, regulatory or compliance services. Algorithmics is not responsible for the data or assumptions that are processed through Algorithmics’ services nor can Algorithmics guarantee the accuracy or validity of data received from third parties that enables the service to generate the information contained in this report. In no event shall Algorithmics have any liability for any direct, indirect, special, punitive, consequential or any other damages arising out or relating to its services or contributions to this report, or your reliance thereon. By accepting this report, the recipient is agreeing to the foregoing limitations on Algorithmics’ responsibility and

This page is intentionally left blank

Agenda Item 6

Pension Fund Committee

5 March 2012

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 2011, of the additional sums available to the Managers for further investment, and of the latest Fund Rebalancing.

Value of the Fund

2. Reports from the six appointed Managers AllianceBernstein, Barings, BlackRock, CBRE, Edinburgh Partners and Royal London are included in the papers, but for information the Value of the Fund as at 31 December 2011 was £1,796,670,000. The Value of the Fund at 30 September was £1,683,160,000, an increase of £113,510,000.

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 2012. 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 £35,755,958.

4. In determining the amount of cash to be allocated to Managers at the quarter ended 31 March 2012, 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 was decided 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 decided to suspend this quarter’s rebalancing so that the effect of the transfer of stock between Edinburgh Partners and BlackRock can be accurately measured.

Cash Flow Forecast 2012/13

7. Table 2 shows the forecasted cash flow for the Pension Fund for 2012/13.

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 2012/13 estimated as at £30m based on current year actual figures to December 2011.

- Income is profiled to be received in the same pattern as the current year i.e.
  - Quarter ended 30.06.12 34%
  - Quarter ended 30.09.12 27%
  - Quarter ended 31.12.12 18% and
  - Quarter ended 31.03.13 21%.

- Increases in contributions in line with the Actuarial Valuation are included.

- 'Transfers in' estimated at £1m per quarter transfers in will continue as LGPS will remain a better Fund.

- Pensions increase will be at broadly the same level as 2011/12.

- 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, this should not be materially different to forecast.

- Payable Paysheets are forecast at a constant level throughout the year, but 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.

Contact: Hilary Appleton Tel: 0191 3833544

TABLE 1

Quarter Ended	31.03.11		30.06.11		30.09.11		31.12.11		31.03.12
(1)	Estimate (2)	Actual (3)	Estimate (4)	Actual (5)	Estimate (6)	Actual (7)	Estimate (8)	Actual (9)	Estimate (10)
	£	£	£	£	£	£	£	£	£
Contributions - DCC	17,400,000	18,610,070	18,000,000	18,944,056	19,000,000	16,901,541	16,653,000	16,562,149	16,600,000
- Other	7,300,000	10,702,319	7,300,000	7,268,047	7,300,000	6,241,530	6,500,000	6,945,284	6,600,000
- Sedgefield Borough Homes									2,000,000
Pensions Increase	1,100,000	1,196,199	1,100,000	1,197,002	1,200,000	1,135,903	1,130,000	1,210,532	1,200,000
Transfer Values	2,000,000	3,651,384	2,700,000	1,448,215	1,200,000	3,674,295	1,500,000	2,698,949	2,000,000
Miscellaneous & Queries	500,000	969,306	500,000	11,016,068	300,000	280,367	300,000	446,666	900,000
Gross Dividend & Interest	0	61,406	40,000	43,395	51,000	51,389	40,000	39,745	36,000
Total Income	28,300,000	35,190,684	29,640,000	39,916,783	29,051,000	28,285,025	26,123,000	27,903,325	29,336,000
Payroll Paysheets	18,000,000	17,824,676	18,000,000	18,683,588	18,000,000	18,998,613	19,000,000	19,229,113	19,300,000
Payables Paysheets (incl. Managers' fees)	8,500,000	12,775,665	11,000,000	15,843,630	11,000,000	11,181,760	10,000,000	7,087,332	8,000,000
Total Expenditure	26,500,000	30,600,341	29,000,000	34,527,218	29,000,000	30,180,373	29,000,000	26,316,445	27,300,000
Surplus / (Deficit)	1,800,000	4,590,343	640,000	5,389,565	51,000	(1,895,348)	(2,877,000)	1,586,880	2,036,000
Net Capital payments/(receipts)		0		5,289,382		7,705,584		7,033,969	
Balance at Bank (opening)		22,235,857		26,176,601		25,206,084		14,341,669	
Balance at Bank (closing)		26,176,601		25,206,084		14,341,669		7,444,969	
Money paid/(recovered) to/(from Manager)		0		0		0		0	

TABLE 2

Quarter Ended	31.03.12	30.06.12	30.09.12	31.12.12	31.03.13
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£	**£**	**£**	**£**	**£**
Contributions - DCC	16,600,000	16,900,000	16,900,000	16,900,000	16,900,000
- Other	6,600,000	6,656,000	6,656,000	6,656,000	6,656,000
- Sedgefield Borough Homes	2,000,000				
Pensions Increase	1,200,000	1,100,000	1,100,000	1,100,000	1,100,000
Transfer Values	2,900,000	1,000,000	1,000,000	1,000,000	1,000,000
Gross Dividend & Interest	36,000	40,000	40,000	40,000	40,000
Total Income	29,336,000	25,696,000	25,696,000	25,696,000	25,696,000
Payroll Paysheets	19,300,000	19,400,000	19,500,000	19,600,000	19,700,000
Payables Paysheets (incl. Managers' fees)	8,000,000	11,000,000	11,000,000	11,000,000	11,000,000
Total Expenditure	27,300,000	30,400,000	30,500,000	30,600,000	30,700,000
Surplus / (Deficit)	2,036,000	(4,704,000)	(4,804,000)	(4,904,000)	(5,004,000)
Dividends Received by Managers	5,670,000	10,200,000	8,100,000	5,400,000	6,300,000
Net Cash Flow Position	7,706,000	5,496,000	3,290,000	496,000	1,290,000

Pension Fund Committee

5 March 2012

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 2012.

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. As the triennial valuation was completed at 31 March 2011, changes to the FSS are now required.

7 The changes are as suggested by the Actuary to reflect the 2010 Valuation process and are as follows:

Section	**Change**
Statutory background and key issues	Updated references for current regulations
Purpose and aims of the Fund	Moved the purpose of the Fund to the beginning of the section and revised wording. Additional wording has been included in relation to matching of liabilities and the consideration of smoothing mechanisms for Admission Bodies' contribution rates.
Funding targets, solvency and notional sub-funds	Additional Sections included.
Recovery Periods and Stepping	The limits for these have been retained.
Grouping	Additional information included.
Sub-funding and other practicalities of funding calculations	A number of new sections have been included.
Special considerations for admission bodies	A new section dealing with admission bodies has been added.
Guarantors and underwriting of admission bodies	The previous FSS did not include any explicit provision for admission bodies to be underwritten, except to the extent that it is in the Administration Regulations.

8 The revised FSS is attached at Appendix 1.

9 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.

10 The SIP has been reviewed and changes made to reflect the introduction of a passive equity investment with BlackRock into the asset allocation.

11 The revised SIP is attached at Appendix 2.

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

Consultation

13 In line with Regulations, the FSS and SIP must now be the subject of consultation with the Fund's employers before publication. Subject to the agreement of the Committee, these documents will be circulated to all relevant interested parties for comment.

Recommendations

14 It is recommended that:

- Members note the contents of the revised Pension Fund's policy documents.

- the documents are circulated to all relevant interested parties to consult on their contents.

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 – 28 February 2011 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

Contact: Hilary Appleton Tel: 0191 383 3544

This page is intentionally left blank

Appendix 1

Durham County Council Pension Fund

Funding Strategy Statement

2012

Version Updated February 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:

    - 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".
    - 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 and property. 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.

Scheduled Bodies and Admission Bodies with guarantors agreeing to subsume assets and liabilities following cessation

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).

Admission Bodies and other bodies whose liabilities are expected to be orphaned

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).

Orphan liabilities

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

Pension Fund

Statement of Investment Principles

Version Updated February 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 derivative overlay	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 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 – mainly index-linked securities with a specified range of +/- 2 years duration of the benchmark	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 on at least 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.

.

This page is intentionally left blank

Pension Fund Committee

5 March 2012

Academy Schools – Risks from Participation in the Pension Fund

Report of Don McLure, Corporate Director, Resources

Purpose of the Report

1 The purpose of the report is

- to provide Members with an explanation of the risks involved for Academy Schools, and for other employers in the participation of Academy Schools within the Fund

- to advise members of the Government's recent proposed method for dealing with Academy School participation in the Local Government Pension Scheme and to ask for approval to consider adopting this method.

Background

2 The Pension Fund Committee considered a report in December 2011 outlining how Academy Schools were participating in the Fund. Members asked for a further report setting out the risks involved in Academy Schools participating in the Fund.

3 Since the last meeting Communities and Local Government and the Department for Education issued a joint letter setting out their guidance that Pension Funds should consider allowing Academy Schools to be pooled with their original local authority for the purposes of setting employer contribution rates in the Local Government Pension Scheme (see Appendix A). The letter promises further supporting guidance will be issued shortly on the pooling proposal.

4 This report considers the risks involved in the Fund's current approach for Academy Schools participating in the Fund compared with the risks involved in the suggested 'pooling' approach.

Current approach: Summary of treatment of Academy Trusts within the Durham County Council Pension Fund

5 The Council, working with the actuary, has considered a range of possible options for dealing with Academy Trusts within the Pension Fund and has decided on the following approach:

- From the date of conversion a new academy is established as a separate employer in the Pension Fund with (notional) separate assets and liabilities.
- The (notional) asset transfer to a new academy is determined after initially ensuring the original Council's non-active liabilities are 'fully funded' as at the last valuation date (31 March 2010) and applying an adjustment to take account of changes to the overall funding level of the Pension Fund since the last valuation.
- The transfer of pension liabilities to the new academy is based solely on the pension liabilities of the transferring employees.
- The assumptions used in setting the new academy's employer contribution rate are the same as those used for other Scheduled Body employers in the Fund.
- The deficit recovery period used for the new academy is nineteen years.
- The method set out above will be subject to review at the next valuation (due as at 31 March 2013, with any contribution changes applying from 1 April 2014).

Advantages and risks associated with the current approach

6 Under the current approach, the Academy School has its own separately calculated ongoing employer contribution rate based on the profile of the employees that transfer to the school, and a deficit contribution rate based on the size of the deficit transferred to the academy when it is established.

7 An advantage of this approach for the Academy School is that its employer contribution rate will not be affected in future by the actions of its former local authority (as would be the case with a 'pooled' approach). Similarly, an advantage for the original Council of this approach is that going forwards the Academy School is responsible for its own pension liabilities. Any employer action that affects pension costs (such as increasing employees' pay above actuary assumptions) will be the responsibility of the Academy School.

8 There are some risks involved in the current approach for both parties: For the Academy School the following risks are relevant:

- There is significant uncertainty about future employer pension costs. Actuarial work is required (with a typical cost of around £2,000) before the costs can be determined.
- Market conditions at the time the academy is established can have a significant impact on employer pension costs.
- With a small overall pensionable payroll the Academy School will have a much more volatile employer contribution rate than a larger employer. So, for example a small number of ill-health retirements at an Academy School could have a significant impact on the employer contribution rate.

For the original Council the following risk is relevant:

- The actuary allows a reduction in the deficit contributions for the original Council equal to the level of deficit contributions paid by the Academy School. When an Academy School is set up as a separate employer this reduction in deficit contributions may be lower than the original Council anticipates, meaning the original Council's deficit contributions increase as a proportion of its overall pensionable payroll. This can have a real impact on the original Council's financial position.

Suggested revised approach: Summary of proposed 'pooling' approach to Academy Trusts within the Durham County Council Pension Fund

9 The Government has recommended that all Academy Schools (existing and future) be given the option to have their LGPS pension liabilities 'pooled' with their former Council so giving them a shared employer contribution rate. There is little detail of how this would operate but from discussions with the Fund actuary it is anticipated that the following approach would apply:

- Following conversion the Academy School would continue to pay the same ongoing employer contribution rate as their former Council.
- The deficit contribution amount would be determined by comparing the payroll size of the Academy School with the size of their former Council's payroll and allocating an appropriate proportion of the deficit contributions to the Academy School.
- Work would be required to understand how a pooling arrangement would be reflected within the pension figures within the accounts of both the Academy School and the original Council.

- After subsequent valuations the same approach would be adopted, the Academy School would have the same ongoing employer contribution rate as its former Council and would be responsible for a proportion of the deficit contributions based on the relative size of their payroll compared to other employers in the pool.

Advantages and risks associated with the suggested 'pooling' approach

10 The main advantages of the suggested pooling approach are simplicity and initial certainty of contribution costs. An Academy School would have the advantage of knowing its employer contribution rate would be broadly similar to the rate it paid as a maintained school and the rate it was asked to pay would not depend on market conditions at the time of conversion.

11 Going forwards, the Academy School's employer contribution rate in a pooled arrangement would be less volatile as the impact of experience (such as salary changes and ill-health retirement) would be shared across all the employers in the pool.

12 For the original Council the advantage of the pooled approach would be that the reduction in its deficit contributions (which would equal the deficit contributions paid by the Academy School) would probably be higher than under the existing approach.

13 From the perspective of the Administering Authority, a pooled approach would have the advantage of protecting all of the employers in the Fund who are not in the pool from the impact of an insolvency / failure of an Academy School. Under the current approach, as a separate Scheme employer if an Academy School were to fail any unmet pension liabilities would fall on all the other employers in the Fund, whereas under a 'pooled' approach they would fall on the other employers in the pool.

14 There are a number of risks associated with adopting a pooled approach compared with the current method. For the original Council and for the Academy School there is a cross-subsidy risk. So, for example, if one of the employers in the pool increased its pension liabilities significantly by perhaps increasing salaries above assumptions, all the employers in the pool would have to fund this. Similarly, if one of the participants significantly reduced its pensionable payroll, perhaps through a large outsourcing exercise, the other employers in the pool would pick up a bigger share of any deficit payments (which are apportioned according to relative pensionable payroll).

15 One risk for the original Council is that it (and other employers in the pool) would bear all the cost of unmet pension liabilities in the

event of an Academy School insolvency. Under the current arrangement any cost would be spread across all Fund employers. However, the Department for Education has previously written to the Council to emphasise its commitment to academy schools, to confirm that academy funding agreements are open-ended and to express the view that any insolvency risk is minimal.

16 One further complexity for all participants in a pooling arrangement is the presentation of pension figures in the accounts of the Academy School and the original Council. Organisations that are involved in a pooling arrangement will probably need to consult with their auditors to ensure the pension figures are appropriately represented within their accounts.

Recommendation

17 Pooling will not be compulsory but would be another option for Councils and Academy Schools to consider when determining how Academy Schools will participate in the Fund. Members are asked to agree to pooling arrangements potentially being established between the original Councils (either Durham County Council or Darlington Borough Council) and an Academy School, provided both parties agree to the arrangements.

Contact: Nick Orton Tel: 0191 383 4429

This page is intentionally left blank

Department for Education

Communities and Local Government

A note from the Secretaries of State for Education and Communities and Local Government

To Local Authority Leaders and Chief Executives in England

copied: Local Government Pension Scheme administering authorities

Academies and the Local Government Pension Scheme (LGPS).

Academies in all their forms are central to improving education. They promote innovation and diversity in the school system, give power and freedom back to heads and teachers and raise school standards across the board. The Academy conversion programme ensures that the highest performing institutions help the weakest to improve. Where maintained schools are performing poorly the Government is encouraging their conversion to Academy status with the help of an outstanding school or experienced sponsor. The Government is committed to expanding the Academy programme. There are now 1,463 Academies across England, with many more schools wishing to convert. In addition, the first Free Schools opened in September 2011 and the range and choice of education provision is changing rapidly across the country. Free Schools, University Technical Colleges (UTCs) and Studio Schools are being opened as Academies in direct response to parental demand and will drive up standards in the communities they serve.

We are, therefore, writing to set out in further detail an approach to pooling that we recommend be adopted. The clear aim is that there is a consistency of approach across Local Government Pension Scheme (LGPS) administering authorities so that an Academy in one part of the country is not treated in a different manner to one in another and no Academy pays unjustifiably higher employer pension contributions to the LGPS compared to maintained schools in the local area. This applies to existing Academies as well as those yet to convert or open, including Free Schools, University Technical Colleges and Studio Schools.

Many LGPS administering authorities have worked hard to help those schools becoming Academies resolve issues but we know that some administering authorities have been uncertain about how to treat Academies in their fund with some Academies being set employer pension contributions significantly more than maintained schools in the local area. Where a maintained school converts to Academy status it is Government's intention that the overall costs for the Academy as a participant in the Scheme should not increase. Like maintained schools, all forms of Academy continue to receive their funding from the public purse and, consequently, should not be treated in the LGPS less favourably than maintained schools.

Some converting Academies have been discussing with their LGPS administering authority the wish to be pooled with the local authority that formerly maintained the school.

Pooling arrangements between employers are permissible within the LGPS regulatory framework and we strongly recommend that where an Academy wishes to be pooled, administering authorities positively consider this. Academies would then pay the same LGPS employer contribution rate as maintained schools in the local area which includes an element for accrued past service liabilities. If it is found that inconsistencies or unjustifiably high employer pension contributions to the LGPS remain, consideration will be given to what other steps, including regulatory changes, would be needed.

MICHAEL GOVE **ERIC PICKLES**

December 2011

Academy arrangements and the Local Government Pension Scheme - pooling of Academy arrangements with local authorities

Legal and financial status of Academy arrangements

1. Academies set up under the Academies Act 2010 are independent schools but they are publicly funded. Governance arrangements are agreed with the Department for Education and the Funding Agreement entered into with the Secretary of State sets out clear and robust financial and accounting requirements. Under the Funding Agreement the Academy Trust (the legal entity that runs the Academy Trust), has to ensure that its accounts are audited annually by independent auditors and it must allow access by the Secretary of State to its accounts and related records.

2. Section 1 of the Academies Act 2010 contains provisions that allow for the Secretary of State for Education to enter into an Academy arrangement with any person to establish and maintain and to carry on, or provide for the carrying on of, an Academy. The Act enables existing maintained schools to convert to Academy status and for Academy arrangements to be entered into with an Academy Trust that is replacing a maintained school. Additionally, the Act allows the creation of new schools (i.e. schools that do not replace a converting or closing maintained school), including Free Schools, University Technical Colleges and Studio Schools. These new schools are also Academies set up under Academy arrangements under Section 1 of the Academies Act 2010.

3. Funding Agreements made between the Secretary of State for Education and the Academy Trust are not signed for a set or limited period of time, rather they are open-ended.

The Local Government Pension Scheme and pooling Academy arrangements with the relevant local authority

4. A proprietor of an Academy[1] who has entered into Academy arrangements, is a Scheme employer in the Local Government Pension Scheme (LGPS) and is listed in paragraph 21 of Part 1 of Schedule 2 to the LGPS (Administration) Regulations 2008 (as amended). This means that the non-teaching staff employed by Academies are automatically eligible for membership of the Scheme and existing members in a maintained school retain eligibility when a school becomes an Academy. The change in legal status, when a former maintained school is replaced by an Academy, means that the Academy Trust becomes an LGPS employing authority in its own right. Academy Trusts for new provision, such as Free Schools, Studio Schools and UTCs will also be LGPS employers.

5. While there is no express regulatory provision in the LGPS for the pooling of employers in the Scheme, Regulation 36 of the LGPS (Administration) Regulations 2008 is considered a sufficiently broad power to enable employers (if they wish) to enter into joint arrangements with the Scheme funds, as already happens in some cases, that will

[1] Commonly referred to as an "Academy Trust": A qualifying Academy Trust proprietor is a charity under section 12 of the Academies Act 2010. This includes Academies that opened prior to the 2010 Act.

facilitate the setting of harmonised employer contribution rates under pooled arrangements.

6. Where an Academy pools with the local authority it is intended that this should result in the Academy Trust having the same employer contribution rate as the local authority would have in respect of its maintained schools. This is because the assumptions used to set the rate will be common to the Academy and local authority. Actuarial assumptions are shared across the pool and all participants in the pool are responsible for meeting the cost of the full past service deficit relating to those in the pool and share the same deficit recovery period.

7. It is recognised that consideration has to be given about the risk to the fund should a school or Academy fail. Should a maintained school ever be wound up it will be the function of the local authority to transfer pupils to another educational institution. Pension liabilities would be managed within the local authority's employer contribution rate.

8. Equally, if the Secretary of State for Education considered that an Academy was performing poorly, he would review the position, broker support and, where necessary, take steps either to replace the Academy Trust sponsors (the members of the Academy Trust) or the Academy Trust. If either party to the Academy arrangements ever decided that those arrangements should be brought to an end, it would have to give notice to the other party. The education provision for the affected children and young people would need to continue in an appropriate educational establishment.

9. The Government would be bound to consider all available options for dealing with an Academy's outstanding LGPS pension liabilities including, but not limited to, the assignment of assets and liabilities to a new or an existing educational establishment where this was the desired outcome.

10. This note is intended to clarify the position regarding Academy funding and the Secretary of State for Education's role should there be any question about the performance or continued operation of an Academy. This clarification has been provided to remove the uncertainty for administering authorities about the treatment of Academies in their fund and also allow requests, from an Academy to be pooled with the local authority for LGPS purposes, to be positively considered. The clear aim is that there is a consistency of approach across LGPS administering authorities so that an Academy in one part of the country is not treated in a different manner to one in another and no Academy pays unjustifiably high employer pension contributions to the LGPS compared to maintained schools in the local area. If it is found that inconsistencies or high employer pension contributions remain, consideration will be given to what other steps, including regulatory changes, would be needed following discussions with LGPS experts, including Scheme actuaries.

11. The preferred approach in this note is recommended to apply to all Academies, including existing Academies as well as those yet to convert or open, including Free Schools, University Technical Colleges and Studio Schools.

12. To help practitioners in both educational establishments and LGPS administering authorities, supporting guidance is being developed and will be issued shortly covering

Academy arrangements and the LGPS both for existing Academies and those schools considering conversion to Academy status. It will also cover how to manage an existing Academy's employer contributions for those who wish to join a pooling arrangement but have not been treated this way previously.

13. Communications about this note should be addressed to either:

Department for Education
Claire de Charmant
Academies Policy & School Organisation Group
Sanctuary Buildings
Great Smith Street
London SW!P 3BT

Department for Communications and Local Government
Robert Ellis
Workforce, Pay & Pensions
Local Government Finance Directorate
5/F5
Eland House
Bressenden Place
London
SW1E 5DU

From: the Department for Education and Department for Communities and Local Government

Date: December 2011

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Agenda Item 13

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Agenda Item 16

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank