Pension Fund Committee

Date **Thursday 6 March 2014**
Time **10.00 am**
Venue **Committee Room 2, County Hall, Durham**

Business

Part A

1. Apologies for Absence
2. The Minutes of the last Meeting held on 5 December 2013 (Pages 1 - 4)
3. Declarations of interest (if any)
4. Graphs showing recent movements of the Stock and Share Indices (Pages 5 - 14)
5. Graphs showing recent movements of the major currencies against sterling (Pages 15 - 18)
6. Performance Measurement Report of Pension Fund Investments to 31 December 2013 (Pages 19 - 28)
7. Overall Value of Pension Fund Investments to 31 December 2013 (Pages 29 - 34)
8. Short Term Investments for the Period Ended 31 December 2013 (Pages 35 - 36)
9. Investment of the Pension Fund's Cash Balances (Pages 37 - 40)
10. Pension Fund Policy Documents - Funding Strategy Statement and Statement of Investment Principles (Pages 41 - 100)
11. Terms of Reference - Annual Review (Pages 101 - 108)
12. Agreement of Accounting Policies for Application in the 2013/2014 Financial Statements of the Pension Fund (Pages 109 - 116)

13. Confirmation of Local Government Pension Scheme 2014 (Pages 117 - 122)
14. Such other business as, in the opinion of the Chairman of the Meeting is of sufficient urgency to warrant consideration
15. 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)

16. The Minutes of the last Meeting held on 5 December 2013 (Pages 123 - 130)
17. Presentation by Fund Custodian J P Morgan
18. Internal Audit Reports (Pages 131 - 152)
19. Report of the Pension Fund Adviser (Pages 153 - 160)
20. Report of BlackRock (Pages 161 - 176)
21. Report of Alliance Bernstein (Pages 177 - 194)
22. Report of CBRE Global Investors (Pages 195 - 204)
23. Report of Royal London Asset Management (Pages 205 - 272)
24. Report of Barings Asset Management (Pages 273 - 280)
25. 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
26 February 2014

To: The Members of the Pension Fund Committee

County Council Members:
Councillors A Turner, W Stelling, C Carr, P Conway, M Davinson, S Forster, I Geldard, J Lethbridge, N Martin, G Richardson and R Todd

Darlington Borough Council Members
Councillor I G Haszeldine
Councillor S Harker

Scheduled Bodies Representative
(vacancy)

Admitted Bodies Representative:
J Norton

Pensioner Representative
(vacancy)

Active Members Representative
(vacancy)

Further Education Colleges Representative
(vacancy)

Advisers: County Council Officers

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

Independent Advisers
P J Williams
R Bowker
D Banks

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

Staff Observers

UNISON	N Hancock
GMB	

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

DURHAM COUNTY COUNCIL

PENSION FUND COMMITTEE

At a Meeting of **Pension Fund Committee** held in Committee Room 2, County Hall, Durham on **Thursday 5 December 2013 at 10.00 am**

Present:

Councillor A Turner (Chairman)

Members of the Committee:
Councillors C Carr, P Conway, M Davinson, N Martin, G Richardson and R Todd

Admitted Bodies Representative
J Norton

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

Independent Advisers
P Williams – P J Williams
R Bowker – PSolve
D Banks – PSolve

Observor
N Hancock - UNISON

1 Apologies for Absence

Apologies for absence were received from Councillors S Forster and I Geldard.

2 Declarations of interest

There were no declarations of interest.

3 Minutes

The Minutes of the meeting held on 5 September 2013 were agreed as a correct record and were signed by the Chairman.

Matter Arising from the Minutes

Call for Evidence on the Future Structure of the Local Government Pension Scheme (LGPS) (Minute No. 10 refers)

Members were informed by Philip Williams, Adviser and Nick Orton, Payroll and Pensions Manager that following the submission of the response to the call for evidence the Government had issued 3 options on the future of the LGPS; 1 Fund for the whole country, 5-10 Funds for the country or 5-10 pooled investment vehicles. The Government had advised that it would take on board responses to the original consultation and firm proposals would be issued for further consultation in the next few months.

Resolved:

That the information given be noted.

4 Graphs showing recent movements of the Stock and Share Indices

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

Philip Williams advised that Asia had underperformed against other developed markets but Japan had performed exceptionally well which was a good indication that Durham Fund's entry into the global and emerging markets would be well-timed.

Resolved:

That the information given be noted.

5 Graphs showing recent movements of the major currencies against sterling

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

In response to a question from Councillor Carr, Philip Williams advised that the dollar and yen were currently weak in comparison to all other major currencies, however the euro had improved over the year. Yields on Government Bonds in Europe had all come down, even in Greece, and as Europe was gradually coming out of recession the outlook was improving, although unemployment in Italy and Spain remained a huge problem.

Resolved:

That the information given be noted.

6 Performance Measurement Report of Pension Fund Investments to 30 September 2013

Consideration was given to the report of the Corporate Director, Resources which gave an overview of the performance of the Fund to 30 September 2013 (for copy see file of Minutes).

The report gave details of the Managers' performance against their benchmarks for the quarter, the year to date and since inception of the Fund.

Don McLure, Corporate Director, Resources updated Members in relation to the recent issues around the Fund's custodian and advised that JP Morgan had been invited to the next meeting of the Committee to provide an update on their role and to assure Members in relation to foreign currency hedging.

Resolved:

That the information given be noted.

7 Overall Value of Pension Fund Investments to 30 September 2013

Consideration was given to the report of the Corporate Director, Resources which informed Members of the overall value of the Pension Fund as at 30 September 2013, and of any additional sums available to the Managers for further investment, or amounts to be withdrawn from Managers (for copy see file of Minutes).

In presenting the report Hilary Appleton, Strategic Finance Manager – Corporate Finance advised that the amount allocated to each Manager was subject to the need to retain money in the Durham County Council Pension Fund bank account to meet the Fund's net cash outflow. It was recommended that £15m be withdrawn from the sums allocated to the Managers for investment in the quarter. To reduce transaction costs pending a full re-balancing upon completion of the review, it was recommended that this amount be withdrawn from the BlackRock Pooled Fund.

Councillor Martin asked if the position had been reached where there should be no further investment of dividend income, in view of the cash flow position per quarter and the need to shift money between Managers. Robbie Bowker, Adviser responded that this could be explored given that new Managers were to be appointed.

In response to a question from Councillor Carr about the impact of a further reduction in the number of employees in the Scheme, Hilary Appleton explained that the Triennial Valuation would take into account the downward trend of contributing employees. It was also pointed out that an increase in the number of employees eligible to claim a pension would have a greater impact on the Pension Fund.

Don McLure added that the cautious and prudent approach taken in the last Triennial Review would have a positive impact this time around.

Resolved:

That the information given be noted and £15m be withdrawn from the BlackRock Pooled Fund for the reasons outlined in the report.

8 Short Term Investments for the Period Ended 30 September 2013

Consideration was given to the report of the Corporate Director, Resources which gave details of the Pension Fund's short term investments for the quarter ended 30 September 2013 (for copy see file of Minutes).

Resolved:

That the information given be noted.

9 Audit Completion Report for the Year Ended 31 March 2013

Consideration was given to the report of the Corporate Director, Resources which informed Members of the completion of the audit of the Pension Fund Accounts and presented the Audit Completion Report for the financial year ended 31 March 2013 (for copy see file of Minutes).

The Auditor had given an unqualified opinion that the financial statements gave a true and fair view of the financial position of the Fund as at 31 March 2013 and that the statements had been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/2013.

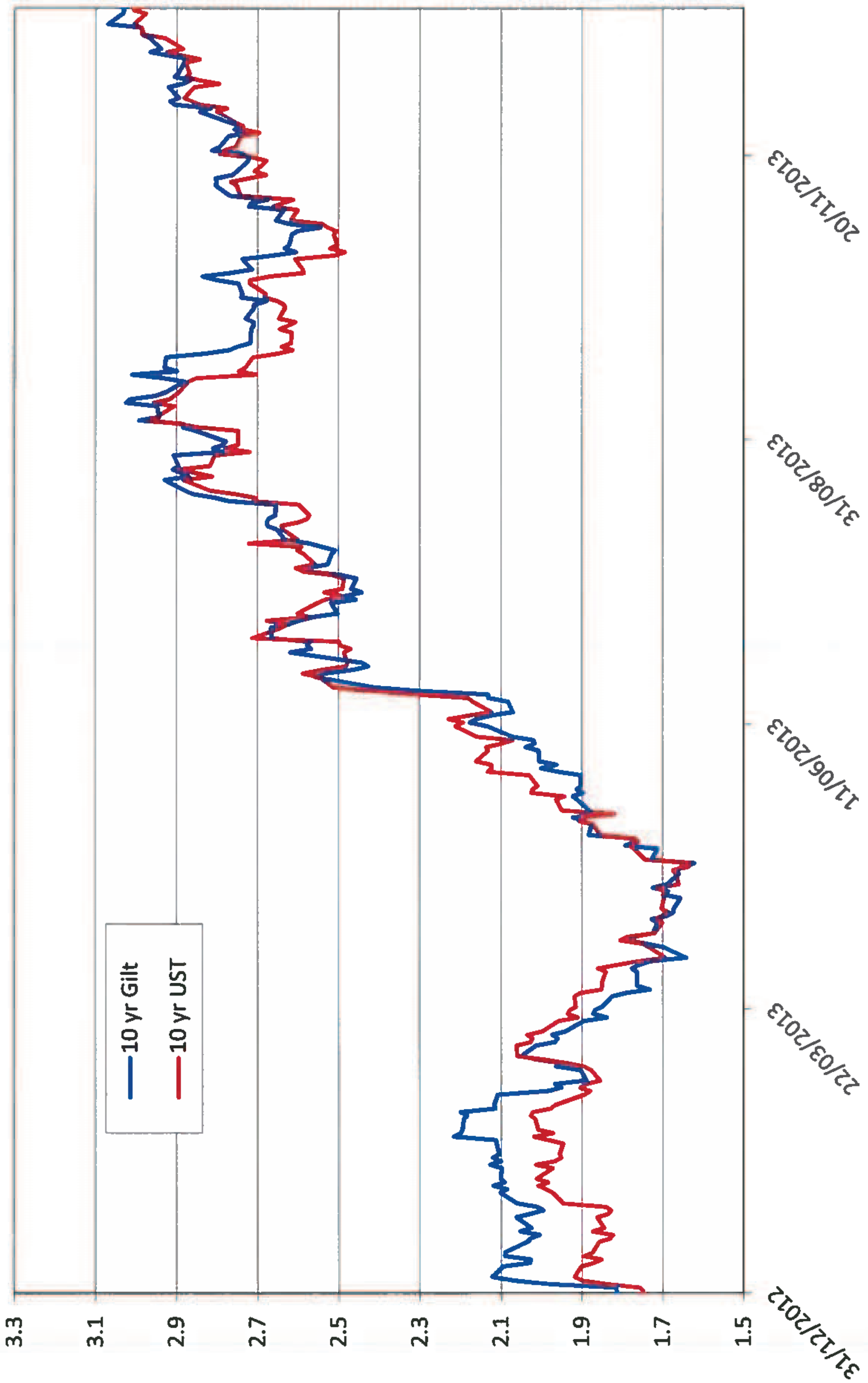
The Director of Mazars LLP had spoken highly of the standard of accounts for the Durham Pension Fund.

Paragraph 9 in the report highlighted some areas for review in 2013/2014 which would be addressed during the closing of accounts process.

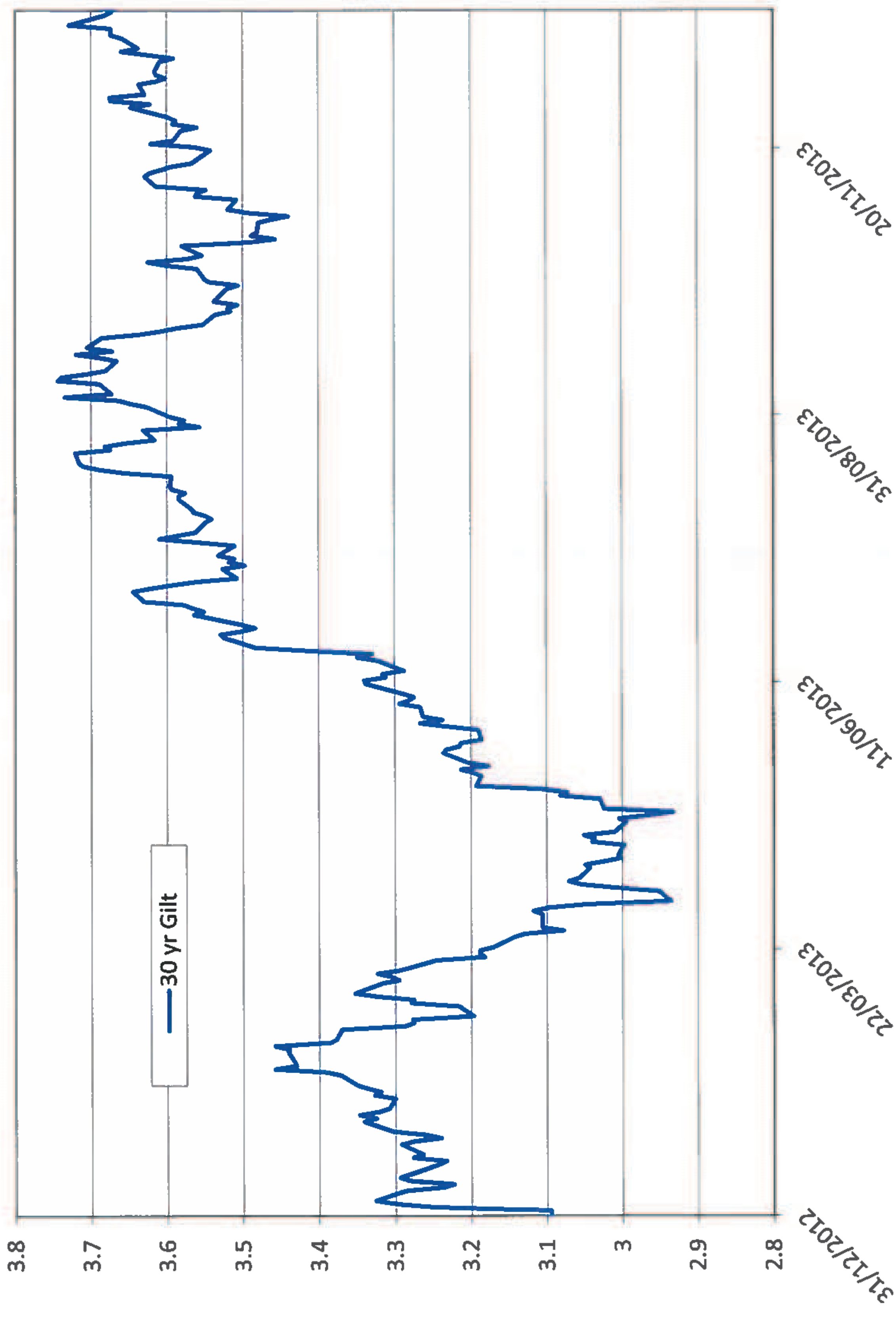
A general discussion ensued about the net amount of £0.81m allocated to loss on sale of investments which represented differences in trades caused by foreign exchanges and other sundry items. It had not been possible to agree this amount to the custodians report as it was spread over a number of accounts. Members were advised that it was not a 'material error' and was a relatively small amount in relation to the size of the Fund, however because of differences in the way figures were presented it would not be feasible to identify in which accounts the amount was located.

Resolved:

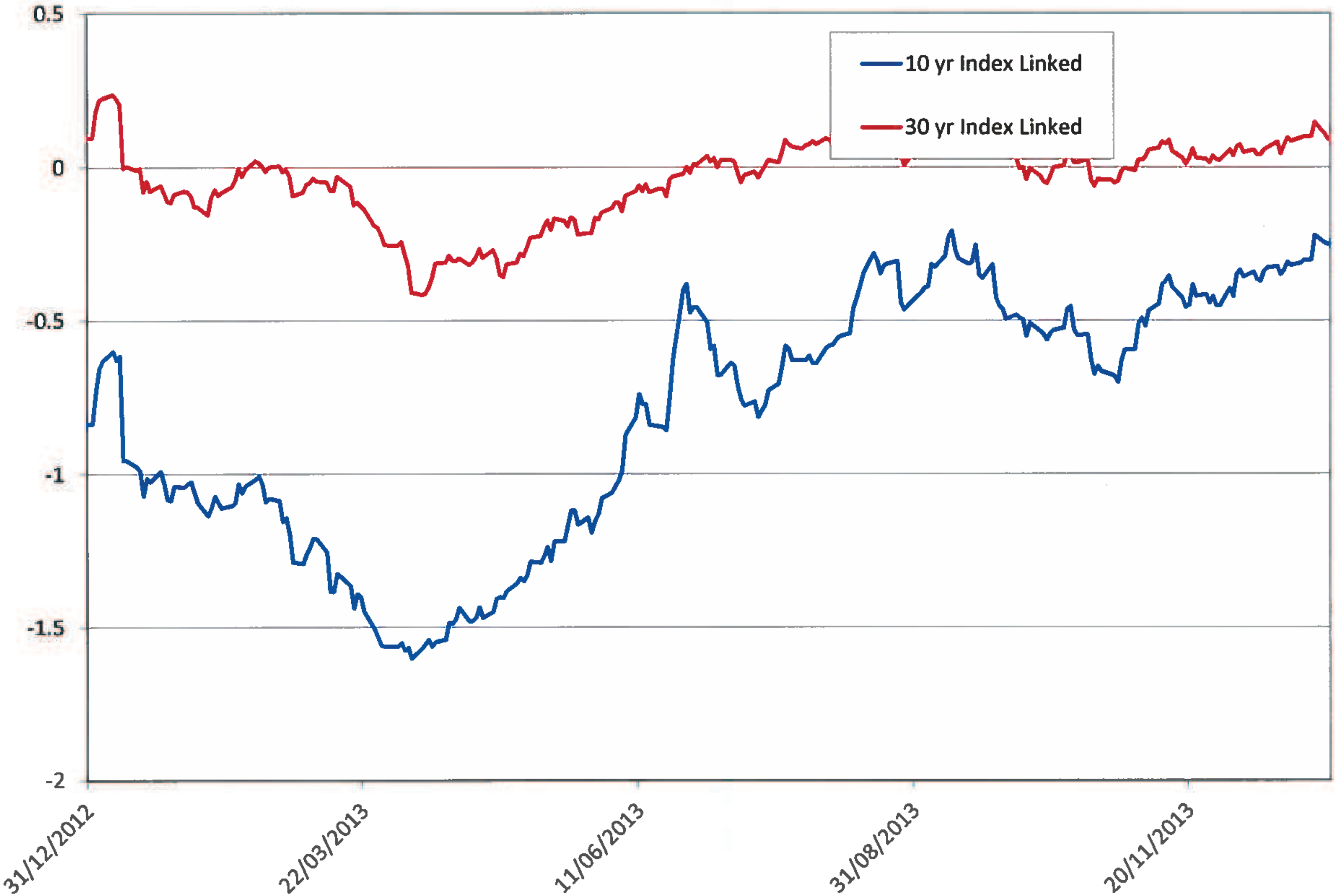
That the information given be noted.



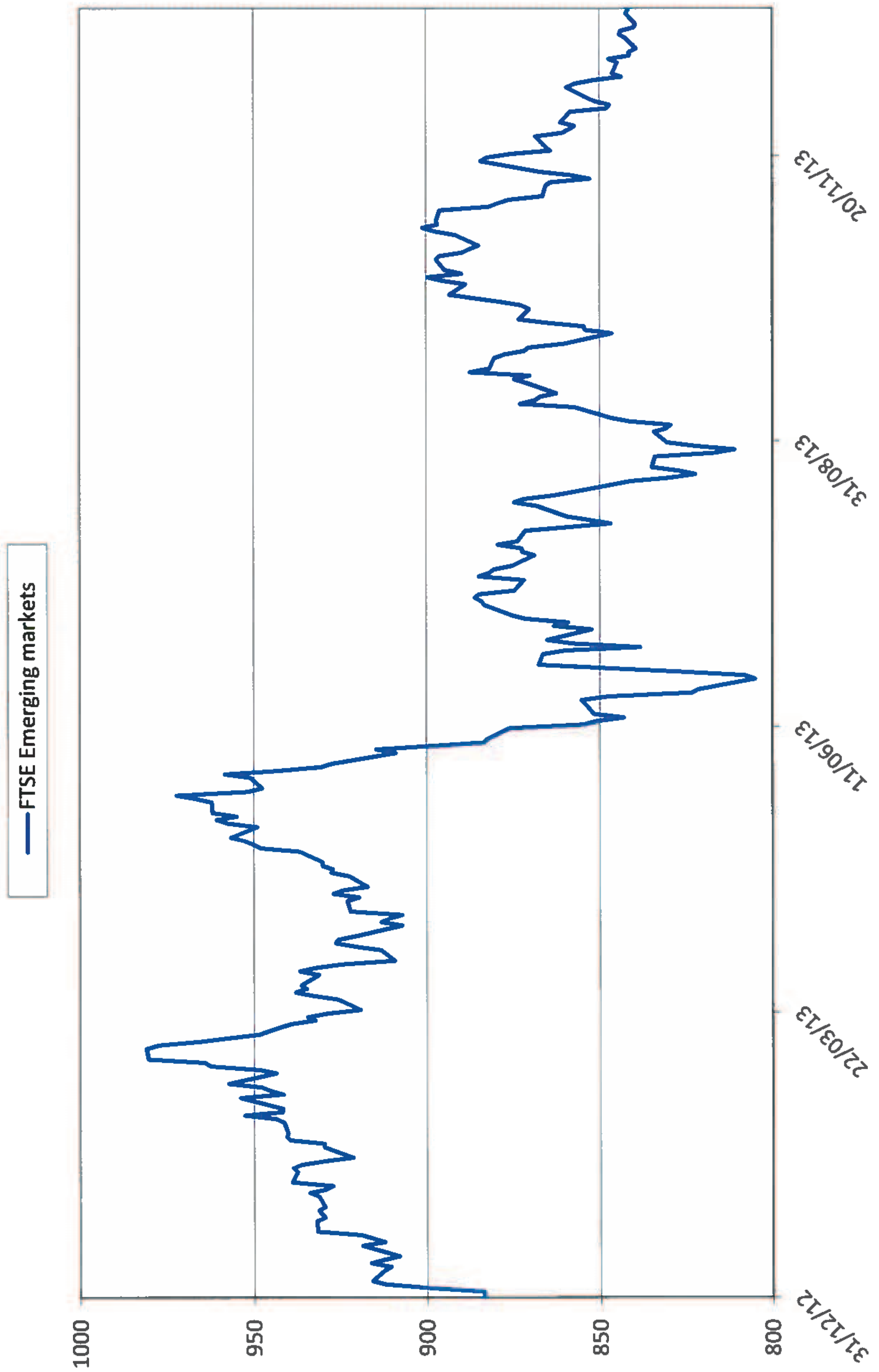
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



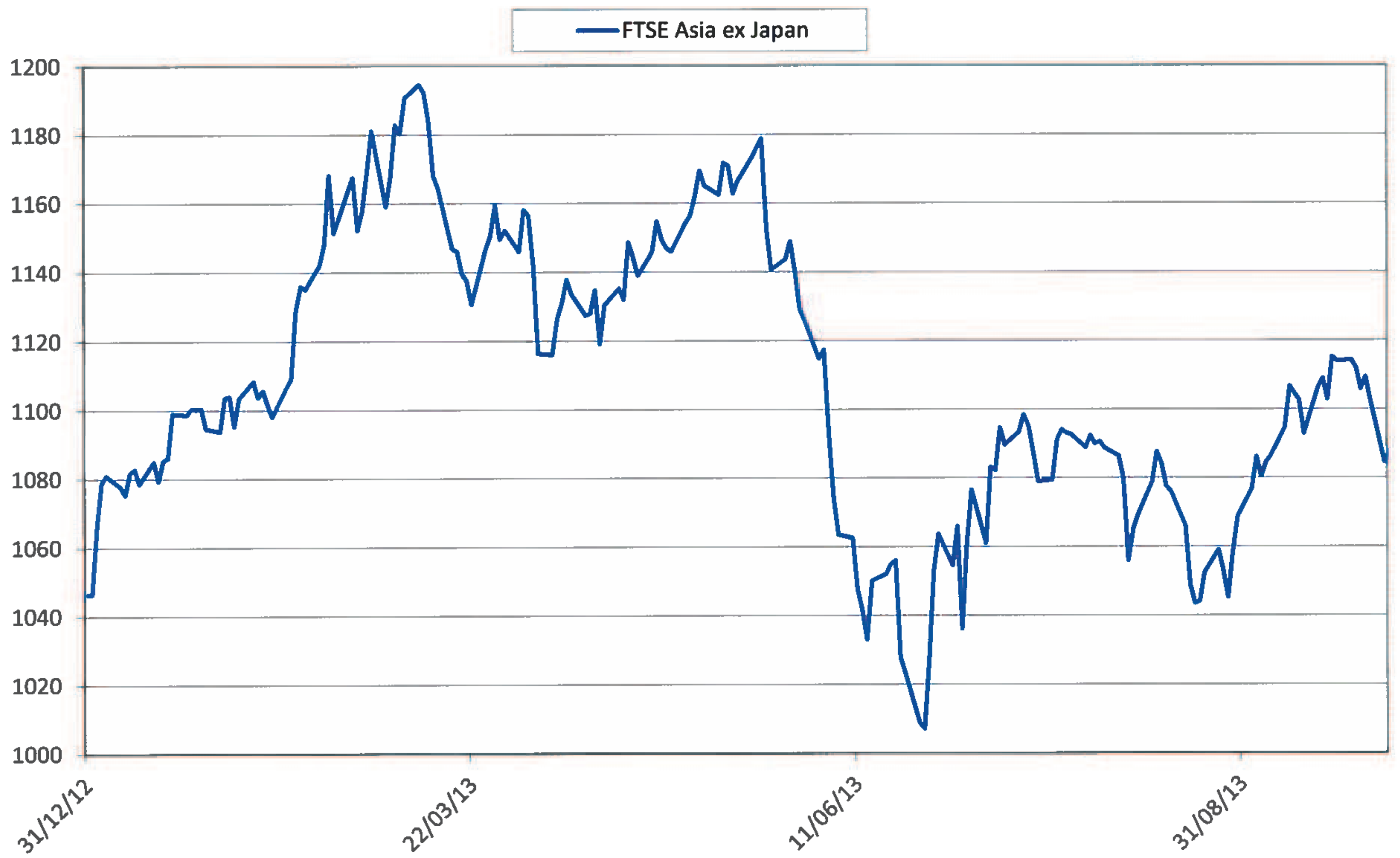
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



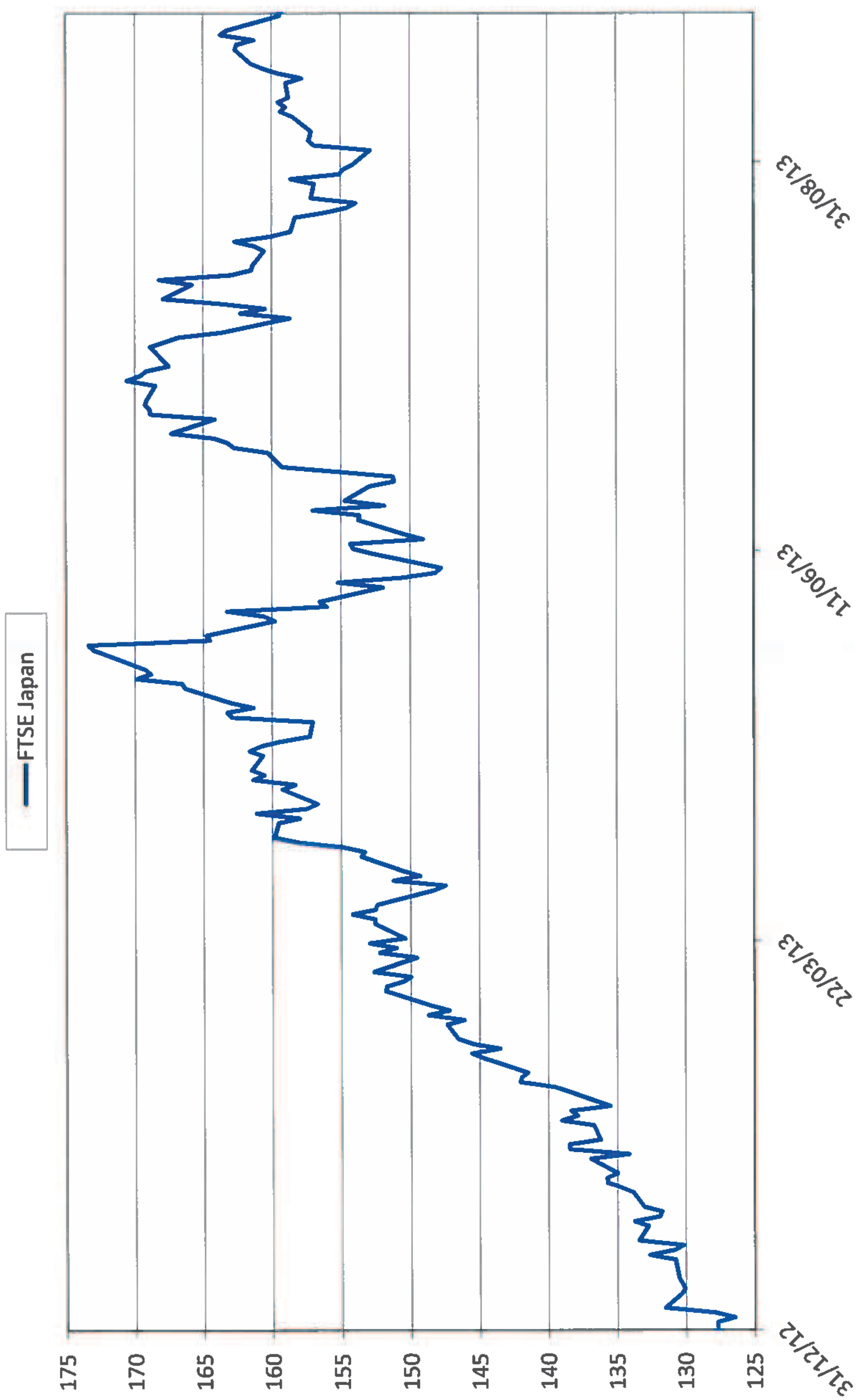
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



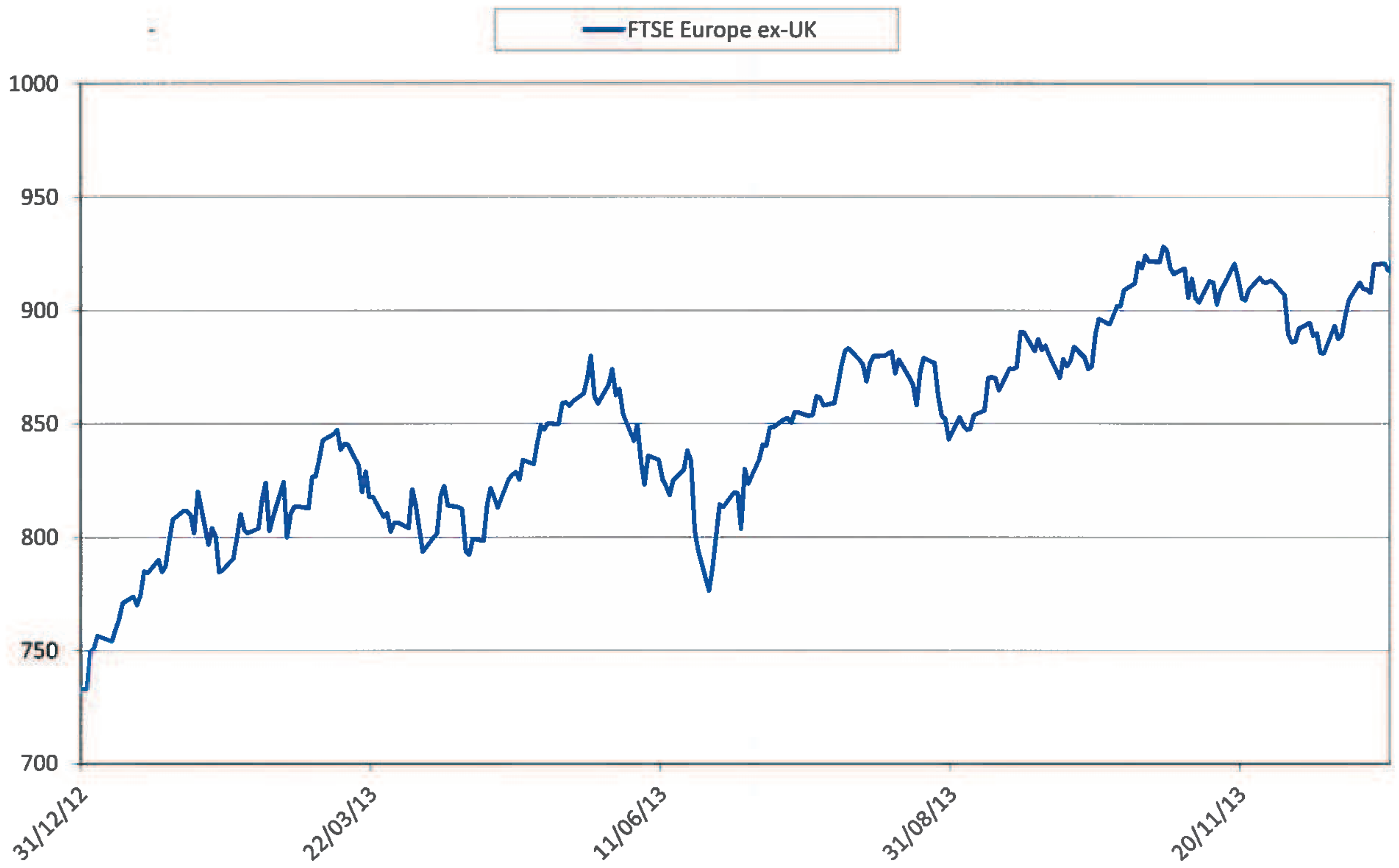
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



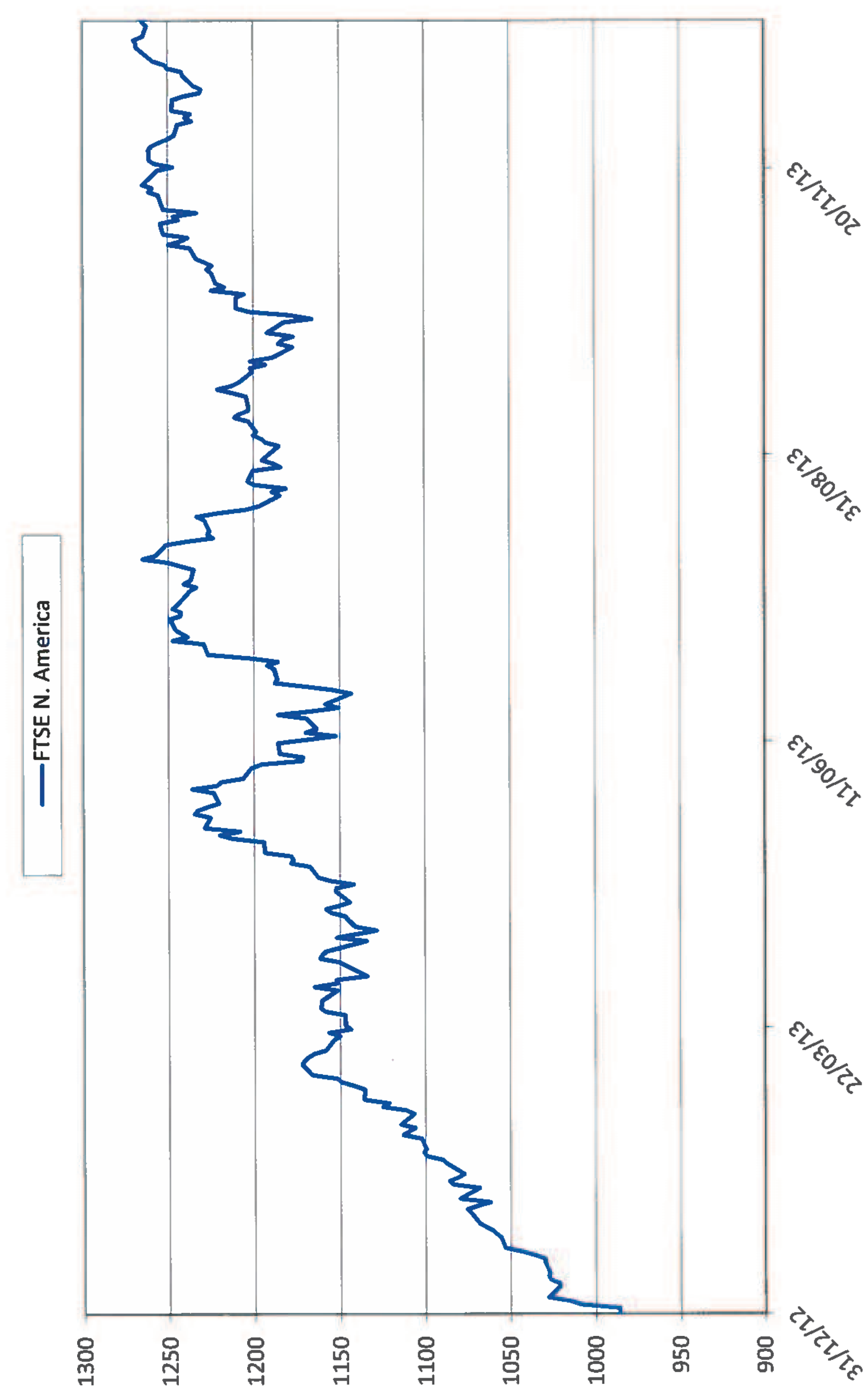
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



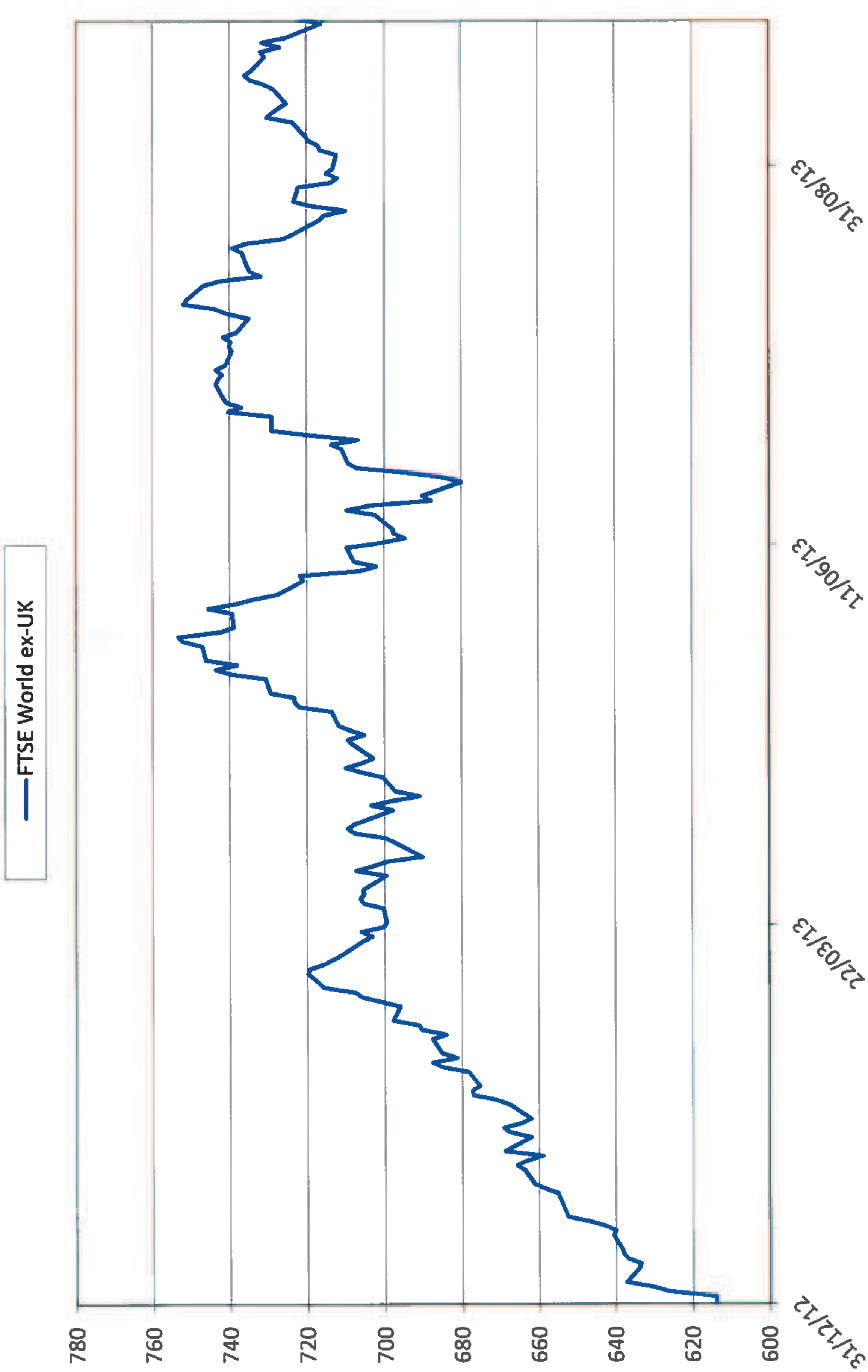
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



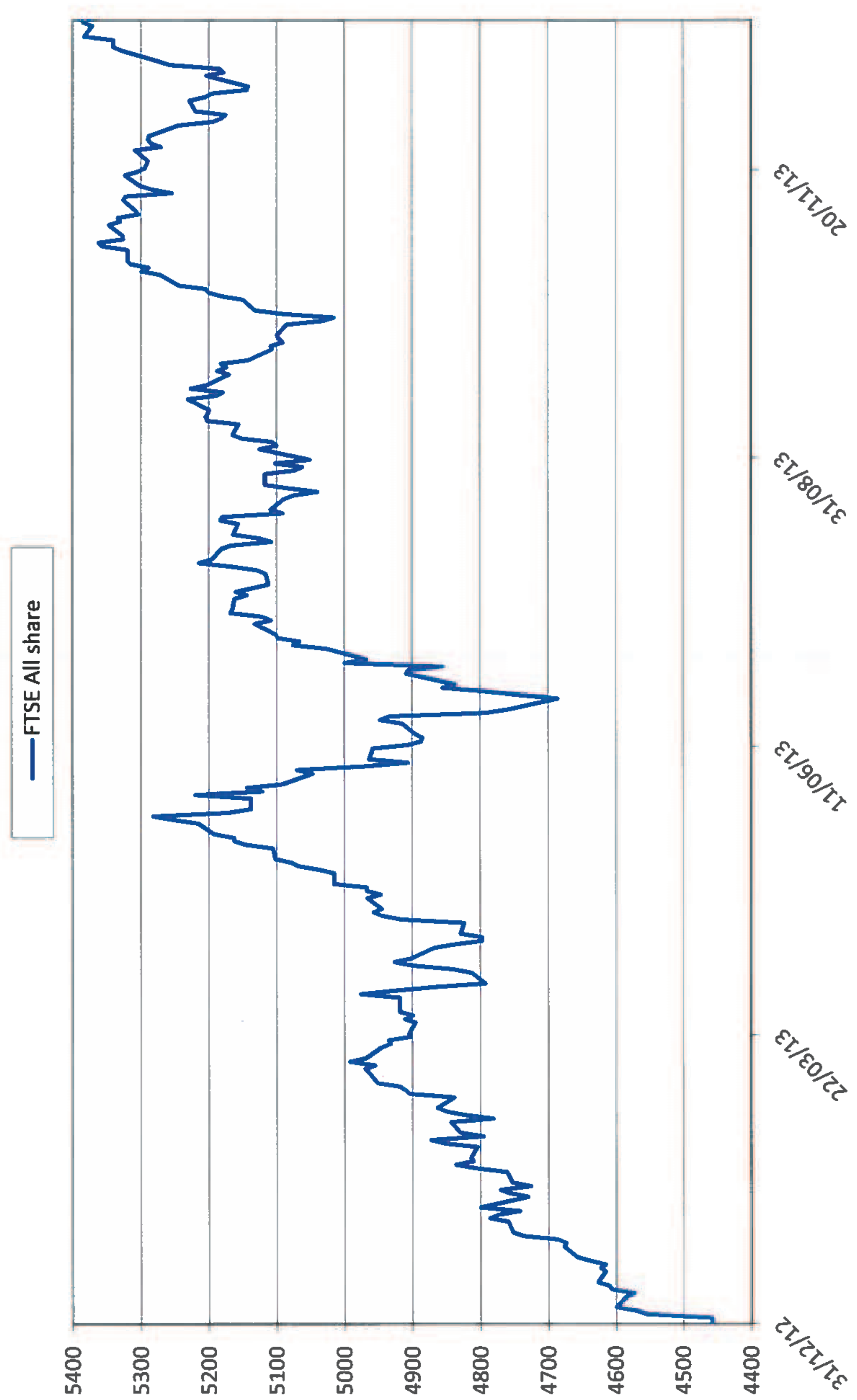
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters

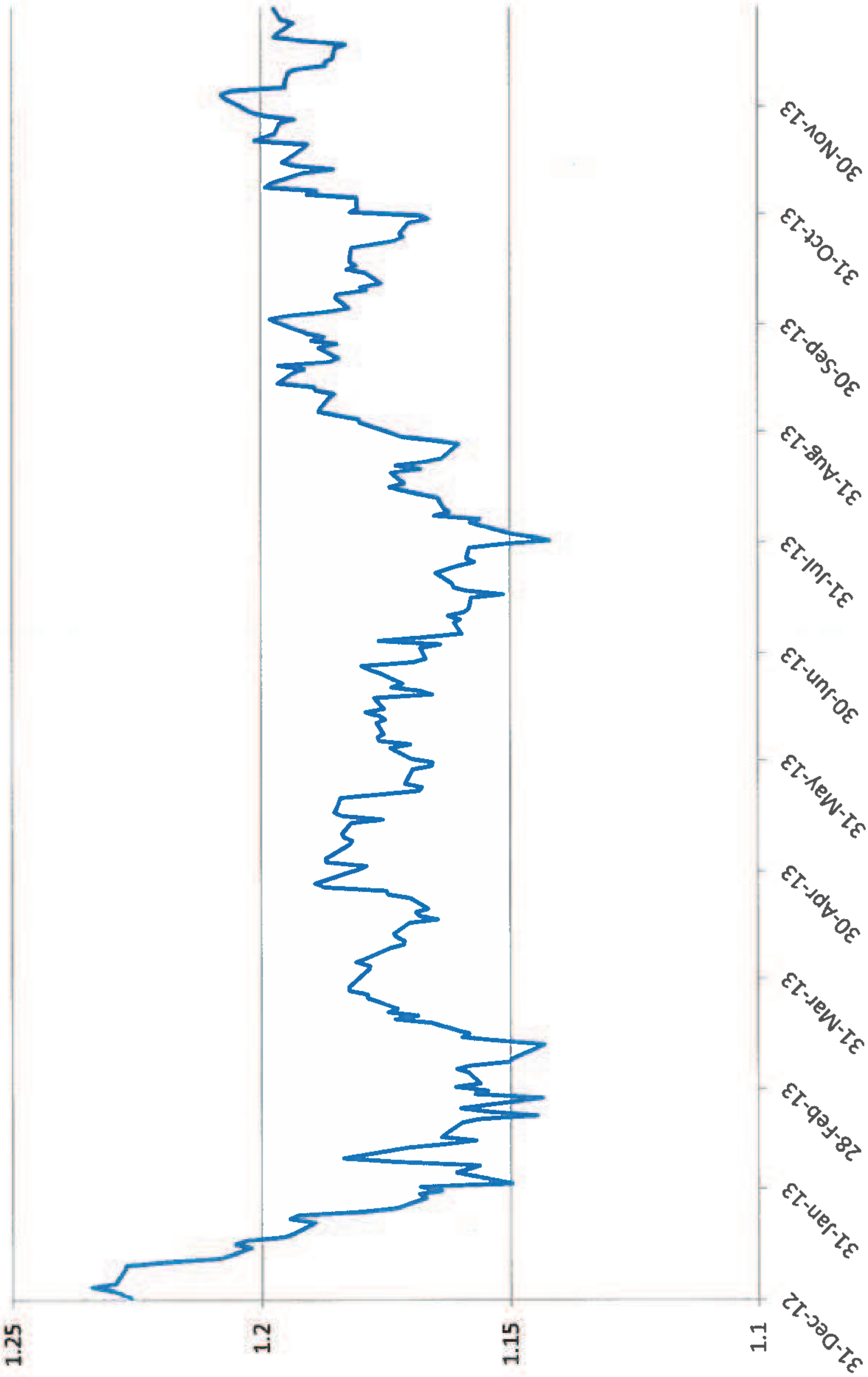


Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters



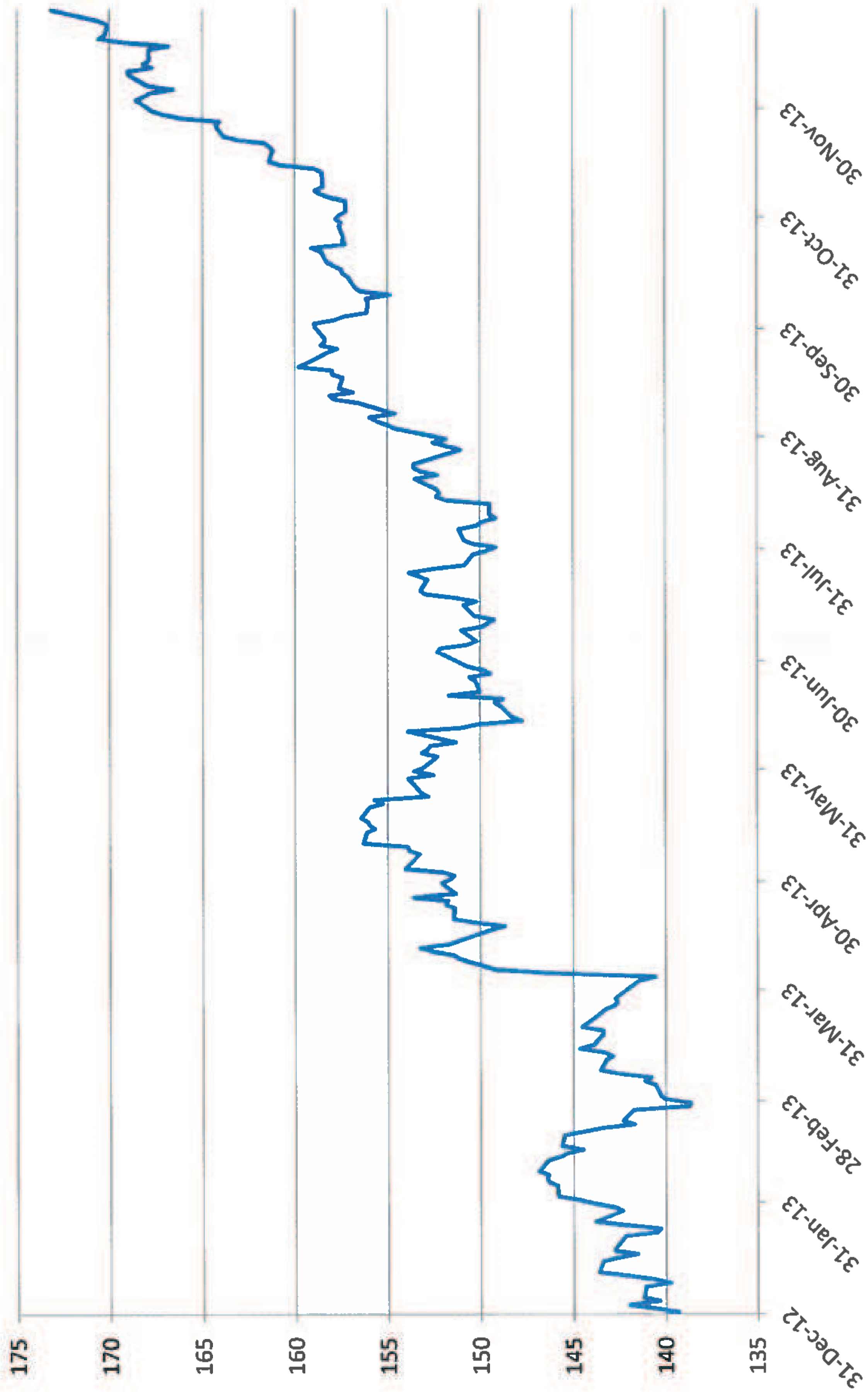
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters

£ vs. €

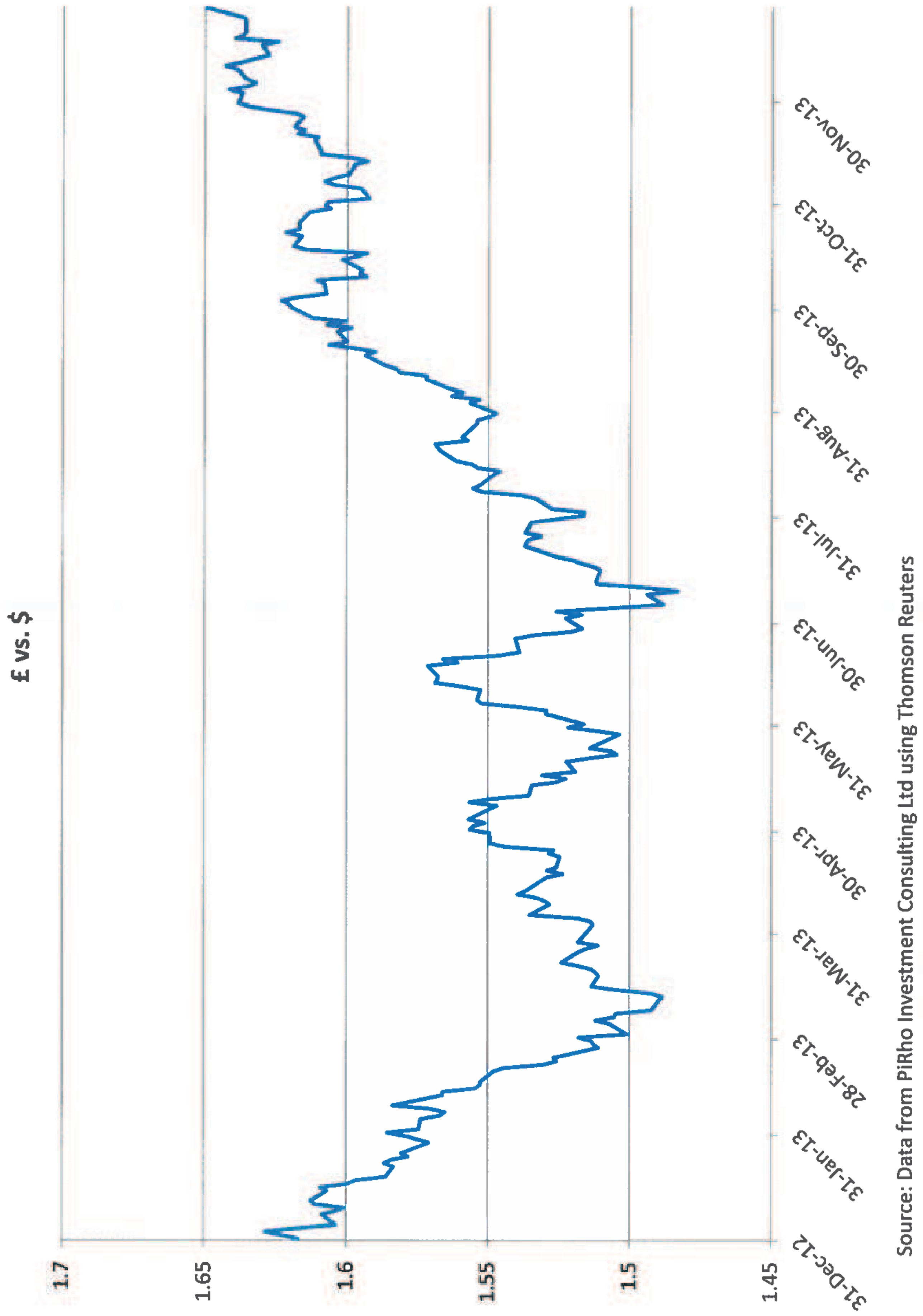


Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters

£ vs. Yen



Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters


£ vs. $
1.7
1.65
1.6
1.55
1.5
1.45
31-Dec-12
31-Jan-13
28-Feb-13
31-Mar-13
30-Apr-13
31-May-13
30-Jun-13
31-Jul-13
31-Aug-13
30-Sep-13
31-Oct-13
30-Nov-13
Source: Data from PiRho Investment Consulting Ltd using Thomson Reuters

This page is intentionally left blank

Pension Fund Committee

6 March 2014

Performance Measurement Report of Pension Fund Investments to 31 December 2013

Don McLure, Corporate Director, Resources

Purpose of the Report

1 The purpose of the report is to provide an overview for Members of the performance of the Fund to 31 December 2013.

Background

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

(a) The Managers benchmarks.

(b) The total Fund performance, for the quarter to 31 December 2013, year to date and since inception.

(c) The Managers' performance in absolute and relative terms against the relevant benchmarks, for the quarter to 31 December 2013, year to date and since inception.

(d) A portfolio comparison for the quarter ended 31 December 2013 and for the period since inception.

Conclusion

3 Members are asked to note the information contained in the attached report produced by JP Morgan.

Contact: Hilary Appleton Tel: 03000 266239

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, 2013

Contents

Page

Benchmark Association Table

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

Executive Summary of Total Plan as at 31/12/2013

Overview

During the quarter the total market value of the Durham County Council Pension Plan increased by +£58.18m to £2,115.27m. There was a total outflow from the plan of -£14,651 in the quarter meaning the plan experienced net gains of +£58.2m.

The performance return for the Plan over the fourth quarter of 2013 was +2.83%, compared to the Plan benchmark return of +2.65. The Plan therefore outperformed the benchmark by +0.18%.

Equity markets were up this quarter with the FTSE All Share (+3% pa) rising +6.24% and the FTSE Aw Developed also up by +5.57% in Sterling terms. Index Linked bonds were down with the FTSE index linked over 5 years index (+0.5% pa) decreasing by -0.95%.

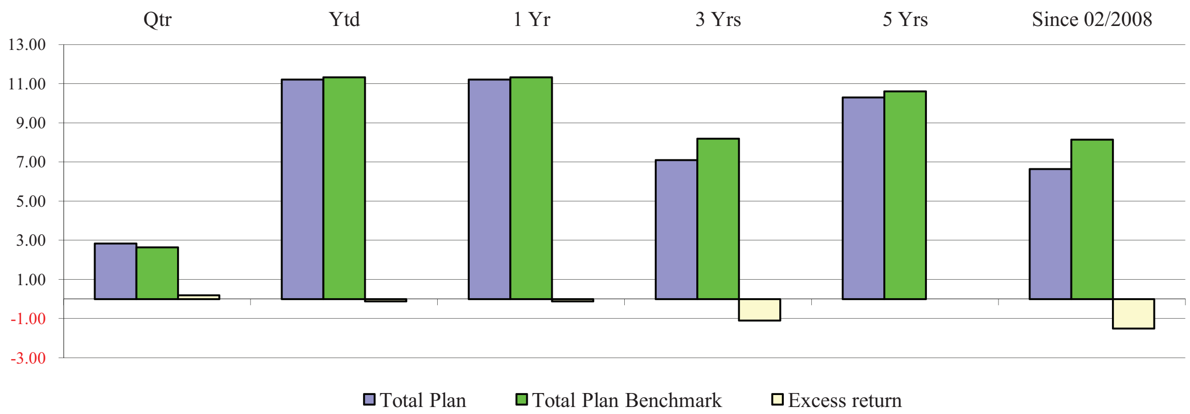
Market Values

	In GBP mil's			
	Qtr 4 - 13	Qtr 3 - 13	Qtr 2 - 13	Qtr 1 - 13
Total Plan	**2,115.27**	**2,057.09**	**2,015.97**	**2,060.34**

Performance

	Performance (%) *					
	Qtr	Ytd	1 Yr	3 Yrs	5 Yrs	Since 02/2008
Total Plan	2.83	11.20	11.20	7.1	10.3	6.63
Total Plan Benchmark	2.65	11.33	11.33	8.2	10.6	8.14
Excess return	*0.18*	*-0.12*	*-0.12*	*-1.10*		*-1.51*

Total Plan Performance

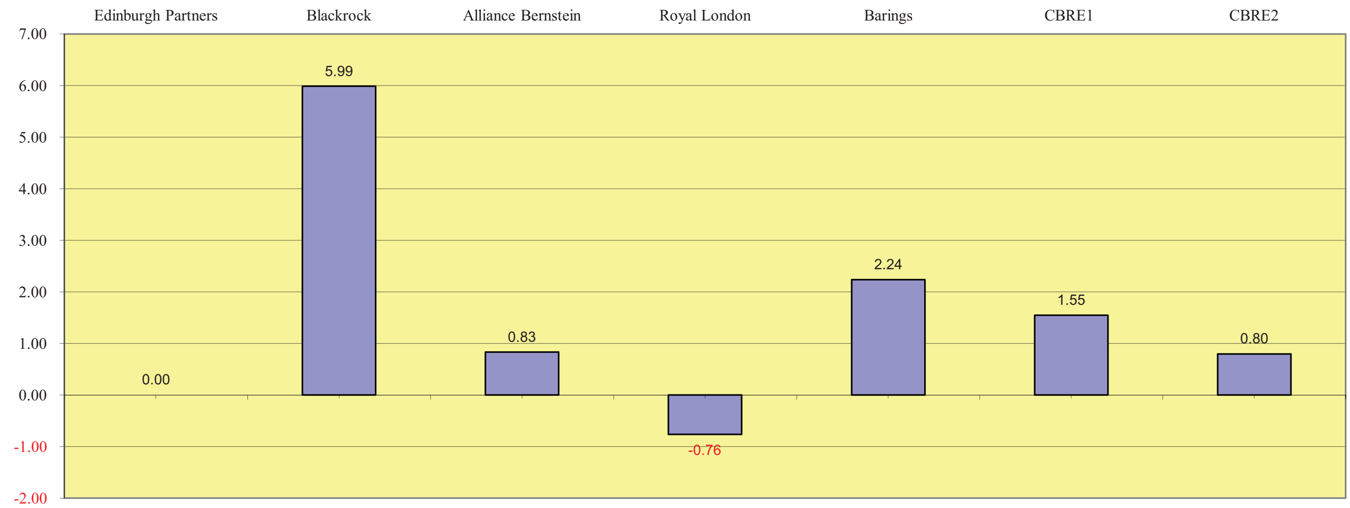


Total Plan Performance Returns as at 31/12/13

Currency GBP		Performance (%) *					
	Mkt. Val. in Mil's	Qtr	Ytd	1 Year	2 Years	3 Years	Since 02/2008
Total Plan	**2115.3**	2.83	11.20	11.20	9.20	7.09	6.63
Total Plan Benchmark		2.65	11.33	11.33	9.43	8.19	8.14
Excess return		0.18	-0.12	-0.12	-0.24	-1.10	-1.51

	Mkt. Val. in Mil's	Qtr	Ytd	1 Year	2 Years	3 Years	Since 02/2008
Edinburgh Partners	**0.3**	0.00	0.00	0.00	0.45	-2.18	1.68
Zero Return - Historically MSCI AC World Index (Gross) +3% pa		0.00	0.00	0.00	3.06	0.88	5.59
Excess return		0.00	0.00	0.00	-2.62	-3.06	-3.91
Blackrock	**355.1**	5.99	19.63	19.63	15.37	9.32	7.66
FTSE All Share (Gross) +3% pa		6.24	24.43	24.43	20.12	12.86	10.33
Excess return		-0.26	-4.80	-4.80	-4.74	-3.53	-2.68
Blackrock (Passive Equity)	**519.6**	5.61	24.70	24.70	-	-	14.76
FTSE-Ftse Aw Developed (Gross)		5.57	24.42	24.42	-	-	14.77
Excess return		0.04	0.29	0.29	-	-	-0.01
Alliance Bernstein	**300.4**	0.83	1.10	1.10	5.06	4.05	4.39
GBP Libor +3% pa		0.87	3.54	3.54	3.69	3.76	4.52
Excess return		-0.04	-2.44	-2.44	1.37	0.29	-0.13
Royal London	**385.3**	-0.76	0.71	0.71	0.93	8.07	7.33
FTSE index Linked >5 years +0.5% pa		-0.95	0.94	0.94	0.97	8.18	7.21
Excess return		0.18	-0.23	-0.23	-0.04	-0.11	0.12
Barings	**411.8**	2.24	9.02	9.02	7.49	5.59	7.43
GBP Libor +4% pa		1.12	4.55	4.55	4.70	4.77	5.53
Excess return		1.12	4.48	4.48	2.78	0.83	1.90
CBRE1	**118.1**	1.55	9.58	9.58	7.81	7.92	0.26
Headline RPI +5% pa		1.83	7.80	7.80	8.01	8.69	8.30
Excess return		-0.28	1.79	1.79	-0.21	-0.76	-8.04
CBRE2	**24.7**	0.80	5.26	5.26	11.47	3.63	3.51
Headline RPI +5% pa		1.83	7.80	7.80	8.01	8.69	8.30
Excess return		-1.03	-2.54	-2.54	3.46	-5.05	-4.79

Manager Quarterly Returns

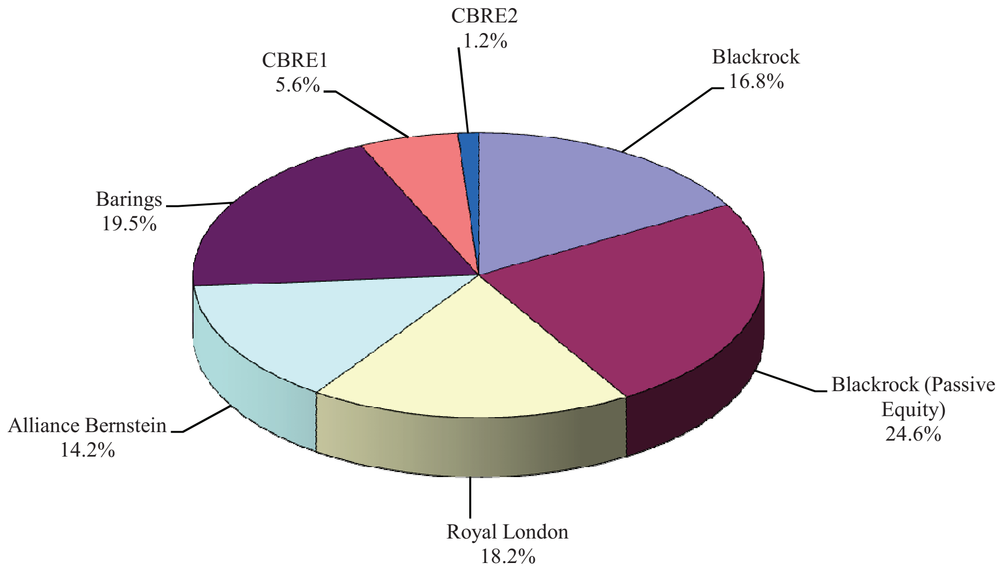


***All Portfolio and Composite returns are Gross of Fees. For time periods in excess of 1 year the performance returns are annualised.**

Portfolio Comparison for Quarter 4, 2013

Portfolio Name	Current Market Value	Portfolio Weight	Portfolio Return (%)	Benchmark Return (%)	Excess Return (%)	Current Contribution to Return
Total Plan	**2,115,274,969**	**100.00%**	**2.83**	**2.65**	**0.18**	**2.83**
Edinburgh Partners	287,759	0.01%	0.00	0.00	0.00	(0.00)
Blackrock	355,108,283	16.79%	5.99	6.24	(0.26)	0.98
Blackrock (Passive Equity)	519,574,449	24.56%	5.61	5.57	0.04	1.34
Royal London	385,262,752	18.21%	(0.76)	(0.95)	0.18	(0.14)
Alliance Bernstein	300,441,790	14.20%	0.83	1.12	(0.28)	0.12
Barings	411,799,564	19.47%	2.24	1.12	1.12	0.44
CBRE1	118,123,063	5.58%	1.55	1.83	(0.28)	0.09
CBRE2	24,684,505	1.17%	0.80	1.83	(1.03)	0.01
JPMSL Transition Account	-7,220	0.00%	0.00	-	-	(0.00)
Transition Account	25	0.00%	0.00	-	-	(0.00)

Manager Allocation



Portfolio Comparison for Year to Date, 2013

Portfolio Name	Current Market Value	Portfolio Weight	Portfolio Return (%)	Benchmark Return (%)	Excess Return (%)	Current Contribution to Return
Total Plan	**2,115,274,969**	**100.00%**	**11.20**	**11.33**	**(0.12)**	**11.20**
Edinburgh Partners	287,759	0.01%	0.00	0.00	0.00	0.00
Blackrock	355,108,283	16.79%	19.63	24.43	(4.80)	3.06
Blackrock (Passive Equity)	519,574,449	24.56%	24.70	24.42	-	5.41
Royal London	385,262,752	18.21%	0.71	0.94	(0.23)	0.14
Alliance Bernstein	300,441,790	14.20%	1.10	4.55	(3.45)	0.17
Barings	411,799,564	19.47%	9.02	4.55	4.48	1.79
CBRE1	118,123,063	5.58%	9.58	7.80	1.79	0.52
CBRE2	24,684,505	1.17%	5.26	7.80	(2.54)	0.09
JPMSL Transition Account	-7,220	0.00%	0.00	-	-	(0.00)
Transition Account	25	0.00%	0.00	-	-	0.00

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 IndexesSM 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 IndexesSM © 2013 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 2013, 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 2013. 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.) 2013 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.

Citigroup is the source of its respective indices.

Hang Seng Indexes Company Limited is the source of its respective indices.

DAX indices are registered trademarks of Deutsche Borse AG.

© TSX Copyright 2013 TSX Inc. All Rights Reserved.

Trust Universe Comparison Service ® and TUCS ®.

Fixed income risk characteristics provided by Blackrock Solutions.

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 of 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 liability.

This page is intentionally left blank

Pension Fund Committee

6 March 2014

Overall Value of Pension Fund Investments to 31 December 2013

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 2013 and of any additional sums available to the Managers for further investment or amounts to be withdrawn from Managers.

Value of the Fund

2. Reports from the five appointed Managers:

   - AllianceBernstein
   - Barings
   - BlackRock
   - CBRE
   - Royal London

   are included in other papers within this agenda. The Value of the Fund at 31 December 2013 was £2,115.270m.

3. The Value of the Fund as at 30 September 2013 was £2,057.090m. The value of the fund therefore increased by £58.200m in the third quarter of 2013/14.

Allocation of New Money

4. New money is allocated to Investment Managers when the Pension Fund has cash which is not needed to be available as a working cash balance, for example for the payment of pensioners or fees.

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

6. Appendix 1 details the working cash balance position of the Pension Fund, cash flow for the last four quarters, and an estimated cash flow for the quarter ending 31 March 2014. 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 £54.469m as at 31 December 2013. .

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

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

Fund Rebalancing

9. Fund rebalancing is the mechanism by which the Pension Fund ensures that the asset allocation to Investment Managers is maintained at the levels agreed by the Pension Fund Committee and set out in the Statement of Investment Principles.

10. Normally 'fund rebalancing' takes place on a quarterly basis, but it has been suspended until the results of the Strategy Review are put into operation.

Cash Flow Forecast 2013/14

11. Appendix 2 shows the forecasted cash flow for the Pension Fund for 2013/14

12. This table shows that the Pension Fund 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.

13. 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.

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

- Income for 2013/14 estimated at £32m based on last year's actual figures to March 2013.

- Income is profiled to be received in the same pattern as last year, that is:

    - Quarter ended 30 June 34%
    - Quarter ended 30 September 27%
    - Quarter ended 31 December 18%
    - Quarter ended 31 March 21%.

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

- ‘Transfers in’ estimated at £0.500m per quarter. It is anticipated that transfers in will continue as LGPS will remain relatively attractive to employees.

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

- Payroll Paysheets are forecast to increase by £0.100m per quarter. This is the line that records payments to pensioners. This line will alter if there are large numbers of retirements in the employing authorities, but it is anticipated that as the County Council’s position has been taken into account, as the largest employer in the Fund, this should not be materially different to forecast.

- Payable Paysheets are forecast at a constant level throughout the year, but this can be the most volatile line. Included in this line are Fund Managers’ fees and payments of lump sums. The assumption here errs on the side of prudence, in that this is an average figure taken from previous quarterly payments.

15. This is an early indication of the likely impact on the Pension Fund’s cash flow forecast over the next year. This will continue to be reviewed each quarter and refined to take into account new information as it becomes available.

Recommendation

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

Contact: **Hilary Appleton** **Tel:** **03000 266239**

Appendix 1

Cash Flow – Estimated and Actual for the period 31 March 2013 to 31 March 2014

Quarter Ended	**31.03.12**		**30.06.13**		**30.09.13**		**31.12.13**		**31.03.14**
(1)	**Estimate** (2)	**Actual** (3)	**Estimate** (4)	**Actual** (5)	**Estimate** (6)	**Actual** (7)	**Estimate** (8)	**Actual** (9)	**Estimate** (10)
	£	£	£	£	£	£	£	£	£
Contributions - DCC	16,000,000	18,102,207	18,500,000	18,650,306	18,500,000	16,500,466	16,500,000	16,437,667	16,500,000
- Other	7,100,000	5,358,443	5,200,000	5,376,269	5,300,000	7,592,559	7,300,000	7,625,486	7,400,000
Pensions Increase	1,200,000	1,150,005	1,000,000	919,281	1,000,000	1,221,180	1,000,000	1,200,710	1,100,000
Transfer Values	500,000	1,008,627	700,000	742,328	500,000	607,420	500,000	663,617	500,000
Month end uncleared items	2,000,000	404,953	400,000	428,496	1,000,000	1,300,000	1,000,000	593,554	1,000,000
Gross Dividend & Interest	65,000	117,192	75,000	78,593	80,000	22,751	23,000	11,545	11,000
Total Income	26,865,000	26,141,427	25,875,000	26,195,273	26,380,000	27,244,376	26,323,000	26,532,579	26,511,000
Payroll Paysheets	20,700,000	20,382,254	20,500,000	20,978,262	21,000,000	21,128,081	21,200,000	21,119,890	21,300,000
Payables Paysheets (incl. Managers' fees)	9,000,000	10,421,168	8,000,000	6,637,706	8,000,000	6,623,383	7,000,000	5,416,178	7,000,000
Total Expenditure	29,700,000	30,803,422	28,500,000	27,615,968	29,000,000	27,751,464	28,200,000	26,536,068	28,300,000
Surplus / (Deficit)	(2,835,000)	(4,661,995)	(2,625,000)	(1,420,695)	(2,620,000)	(507,088)	(1,877,000)	(3,489)	(1,789,000)
Net Capital payments/(receipts)		0		1,600,000		0		0	
Balance at Bank (opening)		24,538,401		21,217,826		14,369,891		12,515,667	
Balance at Bank (closing)		21,217,826		14,369,891		12,515,667		12,377,657	
Money paid/(recovered) to/(from Manager)		0		0		0		0	

Appendix 2

Projected Cash Flow – including dividends received by Fund Managers for the period 31 March 2014 to 31 March 2015

Quarter Ended		**31.03.14**	**30.06.14**	**30.09.14**	**31.12.14**	**31.03.15**
		Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
		£	**£**	**£**	**£**	**£**
Contributions	- DCC	16,500,000	16,400,000	16,500,000	16,500,000	16,500,000
	- Other	7,400,000	7,300,000	7,400,000	7,400,000	7,400,000
Pensions Increase		1,100,000	1,100,000	1,100,000	1,100,000	1,100,000
Transfer Values		500,000	500,000	500,000	500,000	500,000
Month end uncleared items		1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Gross Dividend & Interest		11,000	11,000	11,000	11,000	11,000
Total Income		26,511,000	26,311,000	26,511,000	26,511,000	26,511,000
Payroll Paysheets		21,300,000	21,400,000	21,500,000	21,600,000	21,700,000
Payables Paysheets (incl. Managers' fees)		7,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Total Expenditure		28,300,000	31,400,000	31,500,000	31,600,000	31,700,000
Surplus / (Deficit)		(1,789,000)	(5,089,000)	(4,989,000)	(5,089,000)	(5,189,000)
Dividends Received by Managers		7,350,000	11,900,000	9,450,000	6,300,000	7,350,000
Net Cash Flow Position		5,561,000	6,811,000	4,461,000	1,211,000	2,161,000

This page is intentionally left blank

Pension Fund Committee

6 March 2014

Short Term Investments for the period ended 31 December 2013

Don McLure, Corporate Director Resources

Purpose of Report

1. To provide the Committee with information on the performance of the Pension Fund's short term investments for the 3 month period ended 31 December 2013.

Short Term Investments

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

3. The Pension Fund's surplus cash holding as at 31 December 2013 was £12.378m which was held in the institutions listed in the table below alongside their credit rating at 31 December 2013.

Financial Institution	Rating	Amount Invested £m
Bank Deposit Accounts		
Santander	A	0.026
Natwest Bank	A	3.197
Barclays	A	2.587
Fixed Term Deposits		
Bank of Scotland	A	6.208
UK Local Authorities	N/A	0.078
National Savings & Investments	N/A	0.103
Icelandic Banks	N/A	0.179
Total		**12,378**

4. The following table provides information on the interest earned during the 3 month period, the average daily investment balance and the average return earned in comparison to the average bank base rate:

	Total
Net Interest Earned	£11,172
Average Return Earned	0.397%
Average Bank of England base rate	0.500%
Average Daily Balance of Investments	£14.932m

Recommendation

5. Members are asked to note the position at 31 December 2013 regarding the Pension Fund's short term investments.

Contact: Hilary Appleton Tel: 03000 266239

Pension Fund Committee

6 March 2014

Investment of the Pension Fund's cash balances

Don McLure, Corporate Director Resources

Purpose of Report

1. To update the Committee of the Treasury Management service provided to the Pension Fund and to review the charges for the services and the calculation of interest on short term investments administered by the County Council for 2014/15.

Background

2. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the 2009 Regulations) introduced changes which ended the use of Pension Fund money by the administering authority.

3. As a result of the 2009 Regulations, a report was presented to the Pension Fund Committee in June 2010. At this meeting, the Pension Fund Committee gave its agreement to Durham County Council continuing to invest the cash balances of the Pension Fund in line with the County Council's Treasury Management Policy and Annual Investment Strategy. This agreement was reviewed in 2013 and the County Council continues to invest the balances of the Pension Fund.

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

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

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

Administration of the Treasury Management Function

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

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

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

10. After this main principle the County Council will ensure:

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

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

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

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

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

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

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

15. Currently, an administration fee of 0.1% of the investment made is charged to the Pension Fund for the provision of this service.

16. It is recommended that the fee for this service be amended with effect from 1 April 2014. The current fee varies with the amount of cash being invested. The amount of time that the Treasury Management team spend providing the service does not vary significantly with the value of the investment.

17. A flat fee of £2,500 per quarter is appropriate for the provision of the service and it is recommended that this fee be applied from 1 April 2014. This represents a saving to the Pension Fund based on the current year's fees and is a less costly option to the Pension Fund than undertaking the service.

Calculation of Interest on Cash Balances

18. The interest paid to the Pension Fund in respect of its cash balances is based on LIBID three month rate and it is recommended that this rate continues to be applied in 2014/15 .

19. The LIBID three month rate is the rate at which banks are willing to borrow from other banks, and is the closest to the return that the County Council make on their own short term investments.

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

Investments

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

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

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

24. It is recommended that this arrangement continues.

Recommendation

25. It is recommended that, with effect from 1 April 2014:

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

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

(c) An administration fee of £2,500 per quarter be paid to the County Council for the Treasury Management function being carried out on behalf of the Pension Fund; and

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

Background Papers

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

(b) Pension Fund Committee – 7 March 2013 – Investment of the Pension Fund's Cash Balances

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

Contact: Hilary Appleton Tel: 03000 266239

Pension Fund Committee

6 March 2014

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 2014.

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 :
  1. the guidance issued by CIPFA for this purpose; and
  2. their own Statement of Investment Principles (SIP) for the Fund.
  3. The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

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

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

Review of the FSS and SIP

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

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

8 As the triennial valuation was completed as at 31 March 2014, the FSS has been reviewed by the Pension Fund's Actuary and changes to the FSS are now suggested.

9 The changes, highlighted in the FSS attached as Appendix 1, are as suggested by the Actuary to reflect the 2013 Valuation process and are as follows:

- Changes required as a result of updated CIPFA Guidance produced in October 2012
- Changes to reflect a move to a risk based valuation approach
- Changes to reflect the miscellaneous regulations introduced in 2012 which, amongst other things, introduced the ability to undertake cessation valuations for non-admission bodies

10 Changes as a result of the Local Government Pension Scheme Regulations 2013 that come into force on 1 April 2014 will be included in the FSS when the final detail of the Regulations has been received.

11 The 2009 Regulations also 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.

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

13 As the Pension Fund is finalising the appointments of new Investment Managers for Global Equity and Emerging Markets, the SIP will need to be

updated in the light of the new managers' appointments. This will be done when the legal agreements have been signed.

14 The SIP has been updated from the 2012 version to reflect the current situation and the revised SIP, with changes highlighted, is attached at Appendix 2.

Consultation

15 The Administration Regulations require the Administering Authority to consult with such persons that it considers appropriate, and the 'have regard' to the 2004 CIPFA guidance.

16 Although not mandatory, the 2012 CIPFA Guidance requires consultation with the employers, on both the process to revise the FSS and on the revision to the FSS.

17 In line with Regulations, the FSS and SIP must be the subject of consultation with the Fund's employers before publication. However, as both documents require further updating, it is proposed that consultation be delayed until the final amendments can be made.

18 The final versions will be brought to the next possible Pension Fund Committee for the agreement of the Committee prior to these documents being circulated to all relevant interested parties for comment.

Recommendations

19 It is recommended that:

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

- Consultation to be delayed until the policy documents are updated fully.

Background papers

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

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

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

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

(e) Pension Fund Committee – 7 March 2013 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principle

Contact: Hilary Appleton Tel: 03000 266239

Appendix 1

Durham County Council Pension Fund

Funding Strategy Statement

2014

Version Updated March 2014

Index

As and when the regulations governing the scheme are amended or replaced, references to LGPS Regulations in this Statement should be construed to refer to the amended or replaced regulations.

(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 at the date of writing this Statement 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" and updated guidance published by CIPFA on 3 October 2012.
     - 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 at the date of writing this Statement 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 as part of the triennial valuation as at 31 March 2013

(B) PURPOSE OF THE FUNDING STRATEGY STATEMENT

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

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

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

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

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

(C) PURPOSE AND AIMS OF THE PENSION FUND

5. The purpose of the fund is to:

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

6. The aims of the fund are to:

- **Comply with Regulation 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, which should be assessed in the light of the risk profile of the Fund and risk appetite of the Administering Authority and employers
  - o the requirement to ensure that costs are reasonable to Scheduled Bodies, Admission Bodies, other bodies and to taxpayers (subject to not taking undue risks), , and
  - o maximising return from investments within reasonable risk parameters

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

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

  This can have an effect on employer contribution rates as the funding position of the Pension Fund is measured at the triennial valuations. The impact of this can be reduced by smoothing adjustments at each actuarial valuation. Smoothing adjustments recognise that markets can rise and fall too far.

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

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

- **Manage employers' liabilities effectively**

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

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

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

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

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

  - Taking advice from its professional advisers, e.g. the Fund Actuary, Investment advisers and investment managers
  - Controlling levels of investment in asset classes through the Statement of Investment Principles
  - Limiting default risk by restricting investment to asset classes recognised as appropriate for UK Pension Funds.
  - Analysing the volatility and absolute return risks represented by those asset classes in collaboration with the Investment Adviser and Fund Managers, and ensuring that they remain consistent with the risk and return profiles anticipated in the funding strategy statement.
  - Limiting concentration risk by developing a diversified investment strategy.
  - Monitoring the mismatching risk, i.e. the risk that the investments do not move in line with the Fund's liabilities.

(D) RESPONSIBILITIES OF THE KEY PARTIES

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

8. The administering authority should:

- Administer the Fund

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

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

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

- Invest surplus monies in accordance with the regulations.

- Pay from the Fund the relevant entitlements as set out in the Benefits 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 regularly as part of the on-going monitoring process.

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

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.

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

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

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

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

10. The fund actuary should:

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

- Prepare advice and calculations in connection with bulk transfers, individual benefit-related matters, valuations on the cessation of admission agreements or when an employer ceases to employ any active members and bonds and other forms of security for the Administering Authority against the financial effect on the Fund of the employer's default. Such advice will take account of the funding position and Funding Strategy Statement, as well as other relevant matters when instructed to do so.

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

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

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

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

Risk based approach

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

A risk based approach entails carrying out the actuarial valuation on the basis of the assessed likelihood of meeting the funding objectives, rather than relying on a 'deterministic' approach which gives little idea of the associated risk. In practice, three key decisions are required for the risk based approach:

- what the Solvency Target should be (the funding objective - where the Administering Authority wants the Fund to get to),
- the Trajectory Period (how quickly the Administering Authority wants the Fund wants to get there), and
- the Probability of Funding Success (how likely the Administering Authority wants it to be now that the Fund will actually achieve the Solvency Target by the end of the Trajectory Period).

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

These three terms are considered in more detail below.

Solvency and 'funding success'

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

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

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

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

Probability of Funding Success

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

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

Funding Target

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

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

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

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

Application to different types of body

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

- **Scheduled Bodies and certain other bodies of sound covenant**
  The Administering Authority will adopt a general approach in this regard of assuming indefinite investment in a broad range of assets of higher risk than low risk assets for Scheduled Bodies and certain other bodies which are long term in nature.

- **Admission Bodies and certain other bodies whose participation is limited**
  For Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after cessation 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 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).

Full Funding and Solvency

19. 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.

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

Recovery Periods

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

22. Where a valuation shows the Fund to be in surplus or deficit against the Funding Target, employers' contribution rates will be adjusted to reach the solvent position over a number of years. The Recovery Period in relation to an employer or group of employers is therefore a period over which any adjustment to the level of contributions in respect of a surplus or deficiency relative to the Funding Target used in the valuation is payable. As noted earlier, the valuation method, including the components of Funding Target, future service costs and adjustment for surplus or deficiency simply serve to set a level of contributions payable, which in turn dictates the chance of achieving the Solvency Target at the end of the Trajectory Period. For simplicity, the Trajectory Period for the largest employer (or employer group) in the Fund and the Recovery Period are both set to be the same.

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

24. 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 and Trajectory Periods and has agreed with the Actuary a maximum recovery period of 30 years for both, for employers which are assessed by the Administering Authority as being a long term secure employer. It is the intention of the Administering Authority to agree with employers a Recovery Period of as short a time as possible within this 30 year limit having regard to the affordability of the revised contribution rate in general taking into account the legislative requirements of securing solvency and maintaining as nearly a constant a contribution rate as possible. A period of 18 years has been used for Durham County Council, the largest employer in the Fund. Trajectory and Recovery Periods for other employers or employer groups may be shorter and may not necessarily be the same as each other, in order to suitably balance risk to the Fund and cost to the employer.

25. 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

26. 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

27. 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.

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

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

30. 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

31. 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.

32. 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

33. 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.

34. Further adjustments are made for:

- A notional deduction to meet the expenses paid from the Fund in line with the assumption used at the previous valuation.
- Allowance for any known material internal transfers in the Fund (cash flows will not exist for these transfers). The Fund Actuary will assume an estimated cash flow equal to the value of the liabilities determined consistent with the Funding Target transferred from one employer to the other unless some other approach has been agreed between the two employers.
- Allowance for lump sum death in service and other benefits shared across all employers in the Fund (see earlier)
- An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund which will take into account any gains or losses related to the orphan liabilities.

35. 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.

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

Fund maturity

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

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

39. Where defined capital streams are required, the Administering Authority will review at future valuations whether any new emerging deficiency will give rise to a new, separate, defined stream of contributions, or will be consolidated with any existing stream of contributions into one new defined stream of contributions.

(F) SPECIAL CIRCUMSTANCES RELATED TO CERTAIN EMPLOYERS

Interim reviews

40. Regulation 38(4) of the Administration Regulations provides the Administering Authority with a power to carry out valuations in respect of

employers who are expected to cease at some point in the future, and for the Actuary to certify revised contribution rates, between triennial valuation dates.

41. The Administering Authority's overriding objective at all times in relation to employers is that, where possible, there is clarity over the Funding Target for that body, and that contribution rates payable are appropriate for that Funding Target. However, this is not always possible as any 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.

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

43. Notwithstanding the above guidelines, the Administering Authority reserves the right to request an interim valuation of any employer at any time if Regulation 38(4) applies.

Guarantors

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

- If an employer 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.

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

Bonds and other securitization

46. Regulation 7(3) of the Administration Regulations creates a requirement for a new Admission Body to carry out to the satisfaction of the Administering Authority (and the Scheme Employer in the case of a Transferee Admission Body admitted under Administration Regulation 6(2)(a)) an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.

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

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

- In the case of Transferee Admission Bodies admitted under Regulation 6(2)(b) of the Administration Regulations, or 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, and other Admission Bodies with no Guarantor or where the Administering Authority does not judge the Guarantor to be of sufficiently strong covenant, the Administering Authority must be involved in the assessment of the required level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed the level of bond cover. The Administering Authority will supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer to form a view on what level of bond would be satisfactory. The Administering Authority will also on request supply this to the Admission Body or Guarantor. This should not be construed as advice to the Scheme Employer, Guarantor or Admission Body. The Administering Authority notes that levels of required bond cover can fluctuate and will recommend the relevant Scheme Employer to jointly review the required cover with it regularly, at least once a year.

Subsumed liabilities

49. 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.

50. 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

51. 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.

52. 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.

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

Cessation of participation

54. Where an employer 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.

55. 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.

56. 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

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

General Principles and diversification

58. 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.

59. 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.

60. 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.

61. 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.

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

63. 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

64. 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:

65. Investment

These include:

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

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income - yield curve, credit risks, duration risks and market risks

- alternative assets – liquidity risks, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risk
- macroeconomic risks

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

66. Employer

These include:

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

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

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

67. Liability

These include:

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

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

68. Regulatory

These include:

- Changes to general and LGPS specific regulations, e.g. more favourable benefits package, potential new entrants to the scheme, e.g. part-time employees

- Changes to national pension requirement and/or Inland Revenue rules

The LGPS is currently going through major restructural change. The Administering Authority will keep up to date with all proposed changes and will prepare for LGPS 2014, 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.

69. Liquidity and maturity

These include:

- An increased emphasis on outsourcing and alternative models for service delivery may result in active members leaving the LGPS

- Transfer of responsibility between different public sector bodies

- Scheme changes which might lead to increased opt-outs

- Spending cuts and their implications

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

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

70. 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.

71. Choice of Solvency and Funding Targets

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

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

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

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

72. Smoothing of Assets

These include:

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

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

73. 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.

74. 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

75. 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.

This page is intentionally left blank

Appendix 2

Durham County Council Pension Fund

Statement of Investment Principles

Version Updated March 2014

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 assets allocated to investment managers on a regular basis to ensure that the strategic asset allocation is maintained (rebalancing).

2.2 The investment managers are responsible for:

- The investment of the Pension Fund assets in respect of which they are appointed in compliance with applicable rules and legislation, the constraints imposed by this document and the detailed Investment Management Agreement covering their portion of the Pension Fund's assets;
- Stock selection within asset classes;
- Preparation of quarterly reports, including a review of investment performance;
- Attending meetings of the 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 up to seven 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

Currently, the Pension Fund Committee has appointed five 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.

The Pension Fund is negotiating with three investment managers to replace one of the current managers to manage two revised asset classes.

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%	15%
Global Equities	Global Equities	MSCI All Country World Index (unhedged) in GBP terms +3% MSCI World index +2.5%	30%
Emerging Market Equities	Emerging Market Equities	MSCI Emerging Markets Net Index +2.5%	7%
Dynamic Asset Allocation	**All major asset classes with the ability to take derivative positions**	UK 3-month LIBOR +4.0%	20%
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

The current 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 remaining investment managers an ad-valorem fee is payable.

The new Investment Managers' fees are also based on the value of assets under management and will be payable on an ad-valorem basis.

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 flat fee for the service provided to the Pension Fund.

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 Conduct Authority (FCA) or such other appropriate authority, 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 their Investment Management Agreement.

Quarterly, 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 six principles of investment practice set out in the document published in November 2012 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012", in future, compliance with guidance given by the Secretary of State will be reported.

Principle 1 — Effective decision-making

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

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

Principle 4 – Performance Assessment

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

Principle 5 – Responsible Ownership

Partial compliance: The Pension Fund's policy for socially responsible investing is set out in the Statement of Investment Principles.

Explicit written mandates agreed with all investment managers. Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. Normal practice is to allow the Investment Managers to follow their in-house voting policy unless otherwise instructed by the Pension Fund Committee. The mandates do not specifically incorporate the principle of the US Department of Labor Interpretative Bulletin on activism.

Principle 6 – Transparency and Reporting

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

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

Appendix B - Investment Managers

The Pension Fund Commitee currently has appointed five Investment Managers: 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 Pension Fund is negotiating with three investment managers to replace one of the current managers to manage two revised asset classes.

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

Investment Manager	%	Asset Classes	Investment Style
BlackRock	15	UK Equities	Active
BlackRock	22	Global Equities	Passive
AllianceBernstein	15	Global Bonds	Active
RLAM	20	Investment grade sterling **and non-sterling** bonds	Active
CBRE	8	Global Property	Active
Barings	20	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:

BlackRock

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

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

The benchmark allocation is as follows:

Asset Class	Benchmark
UK Equity	FTSE All-Share Index

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

Portfolio	%
UK Focus approach	100

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

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

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

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

BlackRock

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

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Equity	FTSE All-World Developed Index

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

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

Portfolio	%
Aquila Life World Index Fund	100

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

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

AllianceBernstein

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

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

The benchmark allocation is as follows:

Asset Class	Benchmark
Broad Bonds	UK 3-month LIBOR

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

Portfolio	%
Diversified Yield Plus Fund	100

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

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

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

- 1 month holding period
- 99% confidence level.

The limitations that apply to the investments are detailed below:

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

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

RLAM

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

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

The benchmark allocation is as follows:

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

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

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

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

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

*Includes government and non-government bonds

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

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

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

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

CBRE

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

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

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Property	UK Retail Price Inflation

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

Portfolio	%
CB Richard Ellis RPI +5%	100

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

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

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

Baring Asset Management

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

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

The benchmark allocation is as follows:

Asset Class	Benchmark
DAA	UK 3-month LIBOR

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

Portfolio	%
Extended Risk Solutions	100

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

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

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

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

* Equities and Commodities, aggregate maximum 80%

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

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

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

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

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

.

This page is intentionally left blank

Pension Fund Committee

6 March 2014

Terms of Reference – Annual Review

Don McLure, Corporate Director Resources

Purpose of the Report

1 To review the terms of reference for the Pension Fund Committee.

Background

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

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

- appointment of external investment managers and advisers.

3 The Terms of Reference clarify the the responsibilities of the Pension Fund Committee and ensure that they are clearly defined and understood.

Terms of Reference

4 The current Terms of Reference are attached at Appendix 1.

5 They are intended to provide clarity to the members of the Pension Fund Committee in a number of areas:

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

6 The Terms of Reference determine the future programme of work for the Pension Fund Committee and the frequency of reporting on the individual term of reference is included.

7 It was agreed that the Terms of Reference were to be reviewed at least annually to ensure that they include any changes, particularly with reference to amendments to the Authority delegated from the County Council through the County Council's Constitution.

8 No changes have been made to this delegation of authority and it is recommended that no revisions be made to the Terms of Reference for the Pension Fund Committee.

Recommendations

9 It is recommended that:

- Members accept the Terms of Reference as detailed in Appendix 1; and

- The Terms of Reference continue to be reviewed at least on an annual basis.

Background papers

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

(b) Durham County Council Constitution

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

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

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

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

(g) Pension Fund Committee – 7 March 2013 – Terms of Reference

Contact: Hilary Appleton Tel: 03000 266239

Appendix 1: Pension Fund Committee – Terms of Reference

1. Objectives

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

2. Authority

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

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

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

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

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

- appointment of external investment managers and advisers.

3. Composition

3.1. The Myners' first principle states that decisions should only be taken by persons or organisations with the skills, information and resources necessary to take them effectively. In order to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take. The Fund holds training sessions in advance of decisions being taken, in particular when the investment strategy is considered, presentations on topical issues, related to possible choices of future investment. Further training in time for actuarial valuations is also undertaken.

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

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

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

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

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

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

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

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

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

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

4. Terms of Reference

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

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

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

5. Meetings

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

6. Programme of Work

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

7. Performance and Review

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

This page is intentionally left blank

Pension Fund Committee

6 March 2014

Agreement of Accounting Policies for Application in the 2013/14 Financial Statements of the Pension Fund

Don McLure, Corporate Director Resources

Purpose of the Report

1. The purpose of this report is to inform the Pension Fund Committee of the accounting policies to be applied in the preparation of the 2013/14 Accounts and to seek confirmation from the Committee that appropriate policies are being applied.

Background

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

Accounting Policies

3. It is a requirement of the Local Government Act 2003 and the Accounts and Audit (England) Regulations 2011 for the Statement of Accounts to be produced in accordance with proper accounting practices. The ‘Code of Practice on Local Authority Accounting 2013/14’ (the Code) as published by the Chartered Institute of Public Finance and Accountancy (CIPFA) incorporates these requirements and therefore must be followed in completing the Accounts.

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

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

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

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

7. The proposed accounting policies are in line with those used in the preparation of the 2012/13 accounts and there have been no changes to the Code necessitating a change for 2013/14.

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

Recommendation

9. The Committee is recommended to:

- review the accounting policies;
- approve their use in the preparation of the 2013/14 financial statements for the Pension Fund; and
- authorise the Corporate Director Resources to revise the accounting policies as necessary, and report any significant changes to the Committee.

Contact: Hilary Appleton Tel: 03000 266239

Appendix 1: Accounting Policies for 2013/14

Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these accounts. The accounts have been prepared on the normal accruals basis of accounting.

Fund Account

Contributions Receivable
Contribution income is categorised and recognised as follows:

- Normal contributions, from both members and employers, are accounted for on an accruals basis;
- Employer's augmentation contributions are accounted for in the year in which they become due;
- Employer's other contributions are accounted for in accordance with the terms of the arrangement.

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

Individual transfer values paid and received are accounted for on a cash basis as the amount payable or receivable is not determined until payment is made and accepted by the recipient. Bulk (Group) transfers out and in are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

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

Administrative Expenses
All administration expenses are accounted for on an accruals basis. All costs of the pensions administration team and a proportion of the costs of the pension fund accounting team are charged to the Pension Fund as administrative expenses.

Investment Income
Investment income is accounted for as follows:

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

Taxation
The fund is a registered public service scheme under Section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax would normally be accounted for as a fund expense as it arises, however when investment managers are not able to supply the necessary information, no taxation is separately disclosed in the fund account.

Investment Management Fees
All investment management fees are accounted for on an accruals basis. Fees of the external investment managers are agreed in the respective mandates governing their appointments. Where an investment manager’s fee note has not been received by the balance sheet date, an estimate based upon the market value of their mandate as at the end of the financial year is used for inclusion in the fund account.

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

A proportion of the costs of the pension fund accounting team and treasury management team are charged to the Pension Fund for investment management activities.

Net Assets Statement

Valuation of Investments

Investments are included in the accounts at their fair value as at the reporting date. Fair value is the price for which an asset could reasonably be exchanged, or a liability settled, in an arm's length transaction. In the case of marketable securities fair value is equal to market value. Market value is the bid price quoted in an active market for securities and unitised investments.

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

An investment asset is recognised in the Net Assets Statement on the date the Fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes to the fair value of the asset are recognised by the Fund.

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

- Quoted equity securities which are traded on an exchange are accounted for on a bid market price basis, where Investment Managers provide valuations in this manner;
- Fixed interest securities that are traded on an exchange are accounted for at bid market price where Investment Managers provide valuations in this manner;
- Index linked securities are valued at bid market value where Investment Managers provide valuations in this manner;
- Unitised securities are valued at the closing bid price if bid and offer prices are reported by the relevant exchange and in the Investment Manager's valuation report. Single priced unitised securities are valued at the reported price;
- Unquoted equity investments are included based on an estimated price of the investments held. Valuation techniques are used to establish a price at the year end date based on an arm's length exchange given normal business considerations;
- Derivative contracts outstanding at the year end are included in the Net Assets Statement at fair value (as provided by Investment Managers) and gains and losses arising are recognised in the Fund Account as at

31 March. The value of foreign currency contracts is based on market forward exchange rates at the reporting date. The value of all other derivative contracts is determined using exchange prices at the reporting date.

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

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

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

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

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

Financial liabilities
The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net assets statement on the date the Fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised by the Fund.

Actuarial Present Value of Promised Retirement Benefits
The actual present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 19 and relevant actuarial standards. As permitted under IAS 26 the Pension Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the accounts.

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

If, however, AVCs are used to purchase extra years' service from the Pension Fund, this is recognised as contribution income in the Fund's accounts on an accruals basis.

This page is intentionally left blank

Pension Fund Committee

6 March 2014

Confirmation of Local Government Pension Scheme 2014

Report of Don McLure, Corporate Director, Resources

Purpose of the Report

1 To provide Members with confirmation of the known changes to date being made to the Local Government Pension Scheme (LGPS) from 1 April 2014.

Background

2 The Coalition Government agreement included a commitment to review and reform public sector pensions. Lord Hutton chaired a commission on this subject and following publication of his report on 10 March 2011 changes were proposed to all the main public sector pension schemes including the LGPS.

3 In December 2011 the Government agreed that the Local Government Association (LGA) and main local government unions (Unison, GMB and Unite) could put forward a proposal for a new LGPS that met government objectives.

4 On 31 May 2012 the LGA and trade unions announced the outcome of their negotiations on new LGPS proposals (for England and Wales) to take effect from 1 April 2014

5 Regulations putting into effect the new LGPS were produced in September 2013. However, further regulations are required to provide further detail on how the LGPS will operate including, for example, how the entitlements and expectations an individual has under the existing LGPS will be affected by the introduction of the new regulations. We are still waiting for the final version of these ‘transitional regulations’ to be produced, although we have been provided with a ‘final draft’ version on 31January 2014.

LGPS 2014

6 The main provisions of the LGPS from 1 April 2014 are as follows:

- Career Average Revalued Earnings (CARE) scheme structure

- Accrual rate of 49ths
- Revaluation rate of CPI (Consumer Prices Index – the Government's preferred measure for inflation)
- Normal Retirement Age linked to State Pension Age (SPA)
- Member contribution rates increased for those earning above £43,000, with potentially reductions for part-time members as contribution rates will be based on actual rather than full time equivalent pay (however, the average member rate is expected to remain at 6.5%). All overtime will be pensionable.
- A two year vesting period – anyone joining the LGPS from 1 April 2014 who leaves the scheme with less than 2 years membership will get a refund of their contributions (less tax and NI adjustment) instead of a deferred pension benefit. Since 2004 deferred benefits have been payable after 3 months.
- Introduction of a "50/50 option" where member can elect to pay half the member contribution rate for half the accrual rate, although dependant pensions, ill-health pensions and death lump sums will be unaffected if individuals choose the "50/50 option".
- Pre April 2014 benefits protected and calculated by reference to final salary and current retirement ages
- An underpin will apply for members within 10 years of age 65 in April 2012, such that on retirement these members get a pension "at least equal" to that which they would have received in the 2008 Scheme
- Limits on future employer costs to manage future changes in costs from certain causes (though details are not fully specified yet, and will form part of the next phase of the project)
- Scheme members who are compulsorily transferred will be able to retain membership of the scheme. At present this protection is restricted to transfers in specific circumstances from certain categories of employer.
- Scheme members will be able to retire and draw their pension benefits between ages 55 and 75. At present, anyone retiring between ages 55 and 59 needs their (ex) employer's consent to draw their pension benefits. Under the new LGPS regulations an individual will be able to leave work and draw their pension benefits between ages 55 and 59 without needing their (ex) employer's consent, however they will suffer early retirement reductions to all their benefits if they choose to do this, unless their (ex) employer decides to waive some or all of these reductions.

7 Appendix A contains a comparison between the main features of the current (2008) LGPS and the new LGPS from 1 April 2014.

Outstanding issues

8 There are a number of areas where clarification is required, either through publication of the final regulations governing the LGPS from April 2014, or through production of factor tables and guidance from the Government Actuary's Department. These areas include:

- Confirmation of whether (and how) Councillors can participate in the new LGPS

- Details of the early retirement reduction factors that will apply in the new LGPS

- Details of the cost of buying extra pension in the new LGPS – this is relevant for individuals taking authorised unpaid leave as they will have the option to buy back any pension lost as a consequence of taking that leave – if they choose to buy back the pension within 30 days of returning to work their employer meets two thirds of the cost.

- Official confirmation of changes to the way Additional Voluntary Contributions (AVCs) will be dealt with in future. The latest draft regulations show that anyone starting an AVC Fund on or after 1 April 2014 will only be able to take a maximum of 25% of their AVC Fund as tax-free cash on retirement (currently up to 100% can be taken).

- Details of how the LGPS will interact with other public sector pensions as part of the Public Sector Transfer Club – this is relevant when individuals transfer service to or from the LGPS and other public sector schemes.

Next Steps

9 All active Scheme members will be written to with details of the new LGPS in April. All pensioners have been advised in the latest newsletter that the changes to the LGPS will not affect them.

10 More information on the new LGPS can be found at the following website: http://www.lgps2014.org/

Recommendation

11 Members are asked to note this report.

Contact: Nick Orton Tel: 03000 269798

Appendix A – Comparison of main provisions of the new scheme (LGPS 2014) with the current scheme (LGPS 2008)

<table>
<tr><th></th><th>LGPS 2014 (New)</th><th>LGPS 2008 (Current)</th><th></th></tr>
<tr><td>Basis of Pension</td><td>Career Average Revalued Earnings (CARE)</td><td>Final Salary (FS)</td><td></td></tr>
<tr><td>Accrual Rate</td><td>1/49th</td><td>1/60th</td><td></td></tr>
<tr><td>Revaluation Rate</td><td>Consumer Price Index (CPI)</td><td>Based on final salary</td><td></td></tr>
<tr><td>Pensionable Pay</td><td>Pay including non-contractual overtime and additional hours for part time staff</td><td>Pay excluding non-contractual overtime and non-pensionable additional hours</td><td></td></tr>
<tr><td>Employee Contribution Rate – Average 6.5% in both LGPS 2008 and LGPS 2014</td><td>Gross Rate LGPS 2014</td><td>Gross Rate LGPS 2008</td><td>Increase in Gross rate in LGPS 2014</td></tr>
<tr><td>Up to £13,500</td><td>5.50%</td><td>5.50%</td><td>0.00%</td></tr>
<tr><td>£13,501 to £15,800</td><td rowspan="3">5.80%</td><td>5.80%</td><td>0.00%</td></tr>
<tr><td>£15,801 to £20,400</td><td>5.90%</td><td>-0.10%</td></tr>
<tr><td>£20,401 to £21,000</td><td rowspan="2">6.50%</td><td>-0.70%</td></tr>
<tr><td>£21,001 to £34,000</td><td>6.50%</td><td>0.00%</td></tr>
<tr><td>£34,001 to £43,000</td><td>6.80%</td><td rowspan="2">6.80%</td><td>0.00%</td></tr>
<tr><td>£43,001 to £45,500</td><td rowspan="2">8.50%</td><td>1.70%</td></tr>
<tr><td>£45,501 to £60,000</td><td rowspan="3">7.20%</td><td>1.30%</td></tr>
<tr><td>£60,001 to £85,000</td><td>9.90%</td><td>2.70%</td></tr>
<tr><td>£85,001 to £85,300</td><td rowspan="2">10.50%</td><td>3.30%</td></tr>
<tr><td>£85,301 to £100,000</td><td rowspan="3">7.50%</td><td>3.00%</td></tr>
<tr><td>£100,001 to £150,000</td><td>11.40%</td><td>3.90%</td></tr>
<tr><td>Over £150,000</td><td>12.50%</td><td>5.00%</td></tr>
<tr><td>Contribution rate for part-timers</td><td>Based on actual pay</td><td>Based on full-time equivalent pay</td><td></td></tr>
<tr><td>Contribution Flexibility</td><td>Yes, members can pay 50% contributions for 50% of the pension benefit</td><td>No</td><td></td></tr>
<tr><td>Normal Pension Age</td><td>Equal to the individual member’s State Pension Age (minimum 65)</td><td>65</td><td></td></tr>
<tr><td>Lump Sum Trade Off</td><td>Trade £1 of pension for £12 lump sum</td><td>Trade £1 of pension for £12 lump sum</td><td></td></tr>
<tr><td>Death in Service Lump Sum</td><td>3 x pensionable pay</td><td>3 x pensionable pay</td><td></td></tr>
<tr><td>Death in Service Survivor Benefits</td><td>1/160th accrual based on Tier 1 ill health pension enhancement</td><td>1/160th accrual based on Tier 1 ill health pension enhancement</td><td></td></tr>
</table>

Continued…

Appendix A – Comparison of main provisions of the new scheme (LGPS 2014) with the current scheme (LGPS 2008)

	LGPS 2014 (New)	**LGPS 2008 (Current)**
Ill Health Provision	Tier 1 - immediate payment with service enhanced to Normal Pension Age Tier 2 - immediate payment of pension with 25% service enhancement to Normal Pension Age Tier 3 - temporary payment of pension for up to 3 years	Tier 1 - immediate payment with service enhanced to Normal Pension Age (65) Tier 2 - immediate payment of pension with 25% service enhancement to Normal Pension Age (65) Tier 3 - temporary payment of pension for up to 3 years
Indexation of Pension in Payment	CPI	CPI (RPI applied for increases before 2011)
Vesting Period	2 years	3 months

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.

Agenda Item 22

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 24

Document is Restricted

This page is intentionally left blank