Pension Fund Committee

Date Thursday 3 March 2016

Time 10.00 am

Venue Committee Room 2, County Hall, Durham

Business

Part A

1. Apologies for Absence
2. Declarations of interest (if any)
3. The Minutes of the Meeting held on 15 December 2015 (Pages 1 - 6)
4. Graphs showing recent movements of the Stock and Share Indices (Pages 7 - 26)
5. Graphs showing recent movements of the major currencies against sterling (Pages 27 - 32)
6. Overall Value of Pension Fund Investments to 31 December 2015 (Pages 33 - 38)
7. Short Term Investments for the Period Ended 31 December 2015 (Pages 39 - 40)
8. Investment of the Pension Fund's Cash Balances (Pages 41 - 44)
9. Pension Fund Policy Documents - Funding Strategy Statement and Statement of Investment Principles (Pages 45 - 100)
10. Agreement of Accounting Policies for Application in the 2015/2016 Financial Statements of the Pension Fund (Pages 101 - 108)
11. Terms of Reference - Annual Review (Pages 109 - 116)
12. Local Government Pension Scheme Investment Regulations (Pages 117 - 122)

13. Local Government Pension Scheme: Pooling Update (Pages 123 - 142)
14. Procurement of Professional Services (Pages 143 - 146)
15. Internal Audit Plan 2016/2017 (Pages 147 - 148)
16. Such other business as, in the opinion of the Chairman of the Meeting is of sufficient urgency to warrant consideration
17. Any resolution relating to the exclusion of the public during the discussion of items containing exempt information

Part B

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

18. The Minutes of the Meeting held on 15 December 2015 (Pages 149 - 156)
19. Report of the Pension Fund Adviser (Pages 157 - 160)
20. Report of BNY Mellon Investment Management (Pages 161 - 170)
21. Report of Aberdeen Asset Management (Pages 171 - 196)
22. Report of Mondrian Investment Partners (Pages 197 - 226)
23. Report of AB (Pages 227 - 232)
24. Report of CBRE Global Investment Partners (Pages 233 - 240)
25. Report of Royal London Asset Management (Pages 241 - 296)
26. Report of BlackRock (Pages 297 - 312)
27. Capital North East No.1 Limited Partnership (Pages 313 - 316)
28. Such other business as, in the opinion of the Chairman of the meeting, is of sufficient urgency to warrant consideration

Colette Longbottom
Head of Legal and Democratic Services

County Hall
Durham
24 February 2016

To: The Members of the Pension Fund Committee

County Council Members:
Councillors A Turner, W Stelling, J Alvey, C Carr, M Davinson, I Geldard, B Kellett, J Lethbridge, N Martin, J Shuttleworth and H Smith

Darlington Borough Council Members
Councillor S Harker
Councillor I G Haszeldine

Scheduled Bodies Representative
(vacant)

Admitted Bodies Representative:
J Norton

Pensioner Representative
D Ford

Active Members Representative
(vacant)

Further Education Colleges Representative
(vacancy)

Advisers: County Council Officers

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

Independent Advisers
P Williams - P J Williams
R Bowker - P-Solve
D Banks - P-Solve

Investment Managers
BNY Mellon Investment Management
Aberdeen Asset Management
Mondrian Investment Partners
AB
CBRE Global Investment Partners
Royal London Asset Management
BlackRock

Staff Observers

UNISON	N Hancock
GMB	

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

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DURHAM COUNTY COUNCIL

PENSION FUND COMMITTEE

At a Meeting of **Pension Fund Committee** held in Committee Room 1A, County Hall, Durham on **Tuesday 15 December 2015 at 10.00 am**

Present:

Councillor A Turner (Chairman)

Members of the Committee:
Councillors M Davinson, B Kellett, J Lethbridge, N Martin, J Shuttleworth and H Smith

Admitted Bodies Representative
J Norton

Pensioner Representative
D Ford

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

Independent Advisers
P Williams – P J Williams
R Bowker – P-Solve

1 Apologies for Absence

Apologies for absence were received from Councillors Alvey, Carr and Geldard.

2 Declarations of interest

There were no declarations of interest.

3 Minutes

The Minutes of the Meeting held on 10 September 2015 were agreed as a correct record and were signed by the Chairman.

Members were advised that training of new Members of the Committee had taken place on 14 December 2015. One to one sessions would be arranged for those who had been unable to attend.

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).

Members were informed by the Advisers that following a year of volatility the graphs showed that UK Equity and World Ex-UK shares had returned to the same levels of a year ago.

Resolved:

That the information given be noted.

5 Graphs showing recent movements of the major currencies against sterling

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

Members were informed that sterling had performed well against the major asset currencies with the exception of the US dollar but had weakened slightly in recent months. According to financial commentators this was because of talks surrounding the European referendum.

Resolved:

That the information given be noted.

6 Overall Value of Pension Fund Investments to 30 September 2015

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 2015, 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).

Hilary Appleton reported that the Fund's custodian had been unable to provide the Performance Measurement Report as one Fund Manager had entered into a new investment which was not included in J P Morgan's quality system. This therefore prevented the custodian from providing figures relating to overall performance for the quarter. Officers were working closely with J P Morgan to resolve the matter and the information would be circulated to Members as soon as it became available.

Members expressed concern and disappointment that J P Morgan had been unable to fulfil its role as the Fund's Custodian.

Resolved:

That the information contained in the report be noted.

7 Short Term Investments for the Period Ended 30 September 2015

Consideration was given to the report of the Corporate Director Resources which provided the Committee with information on the performance of the Pension Fund's short term investments as at 30 September 2015 (for copy see file of Minutes).

Councillor Davinson noted that at 0.46% the average return earned was close to the base rate.

Resolved:

That the position at 30 September 2015 regarding the Pension Fund's short term investments where £70,908 net interest was earned in the three month period be noted.

8 Internal Audit Progress Report to 30 September 2015

Consideration was given to the report of the Chief Internal Auditor and Corporate Fraud Manager which outlined progress made in delivering the 2015/2016 internal audit plan relevant to the Pension Fund Committee (for copy see file of Minutes).

Councillor Shuttleworth noted the two final reports issued in the previous quarter which had been given an assurance opinion of moderate. Members felt that it would be useful if progress reports could include issues and actions carried out in audit areas where controls were needed to effectively manage risks.

Resolved:

That the work undertaken by Internal Audit during the period ending 30 September 2015 and the assurance on the control environment provided, be noted.

9 Local Government Pension Scheme Investment Regulations

Consideration was given to the report of the Corporate Director Resources which informed Members of Government consultation on the revocation and replacement of the Local Government Pension Scheme (Investment and Management of Funds) Regulations 2009 (for copy see file of Minutes).

In response to a question from Councillor Lethbridge, Nick Orton advised that the proposed de-regulation would align the LGPS with other major funded pension schemes and relaxed constraints placed on Investment Managers in terms of asset classes and proportions.

Following a question from David Ford, Philip Williams advised that the proposals did not present a huge risk for the Durham Fund. Any pool would have to demonstrate sound governance and have good professional independent advice. This should be borne in mind by Officers and the Committee when determining which authorities to pool with.

The Chairman advised that a meeting had been arranged for the Chair and Vice-Chair of Pension Fund Committee to meet with the respective Chairs and Vice-Chairs of Teesside, Northumberland and Tyne and Wear authorities the following day to discuss options for a north east collaboration. Councillor Turner, Chairman and Councillor Martin in the absence of the Vice-Chairman were to attend with Officers.

Resolved:

That authority be granted to the Corporate Director Resources in consultation with the Chairman and Vice-Chairman of the Committee to respond to the consultation, after taking advice from the investment advisers.

10 Local Government Pension Scheme: Investment Reform Criteria and Guidance

Consideration was given to the report of the Corporate Director Resources which provided Members with information on the Local Government Pension Scheme (LGPS): Investment Reform Criteria recently published by the Government, which gave details of how LGPS funds would be expected to pool their investments (for copy see file of Minutes).

In discussing the report Councillor Davinson noted that some Authorities had already made progress towards formalising their arrangements with other authorities in advance of the 15 July 2016 deadline for submissions. Councillor Martin made the point that each scheme had different investment strategies and different risk appetites and at this stage it was difficult to appreciate how these would be managed in a pooled arrangement.

Philip Williams confirmed that there were a number of uncertainties that the proposals did not address, including how Funds could work with others that had different strategies and profiles. For example it was not clear how this would affect Durham's Dynamic Asset Allocation. The Fund's decision to invest in global real estate had been prudent and had performed better than UK real estate. He considered that like-minded Funds should be able to collaborate irrespective of who they were pooled with.

Following a question from Councillor Davinson, Members were advised that it was expected that each Fund would have equal representation on a pool Board.

Reference was made to management costs by Councillor Kellett who was informed that where assets were internally managed, overall investment management costs should be reduced.

Resolved:

That the Corporate Director Resources, in consultation with the Chairman and Vice-Chairman of the Committee, be authorised to provide an initial response to Government on which pool the Durham Pension Fund may be prepared to join, after taking appropriate advice.

11 Audit Completion Report for the Year Ended 31 March 2015

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 2015 (for copy see file of Minutes).

Members were informed of the retirement of Catherine Banks from Mazars LLP the External Auditor. Members asked that the Committee's thanks be recorded for the service and support the Officer had given.

Resolved:

That the contents of the report be noted.

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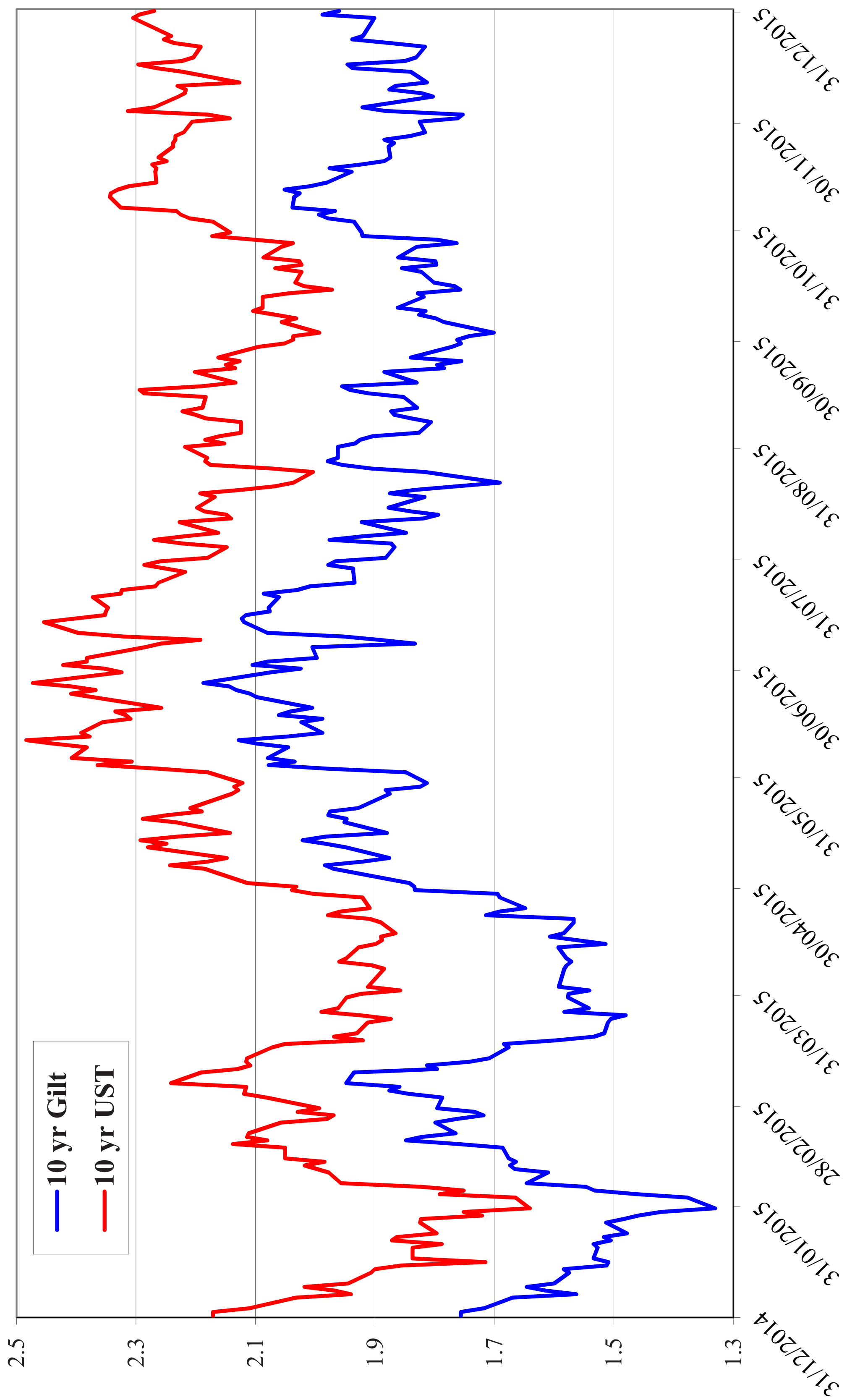
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2.5
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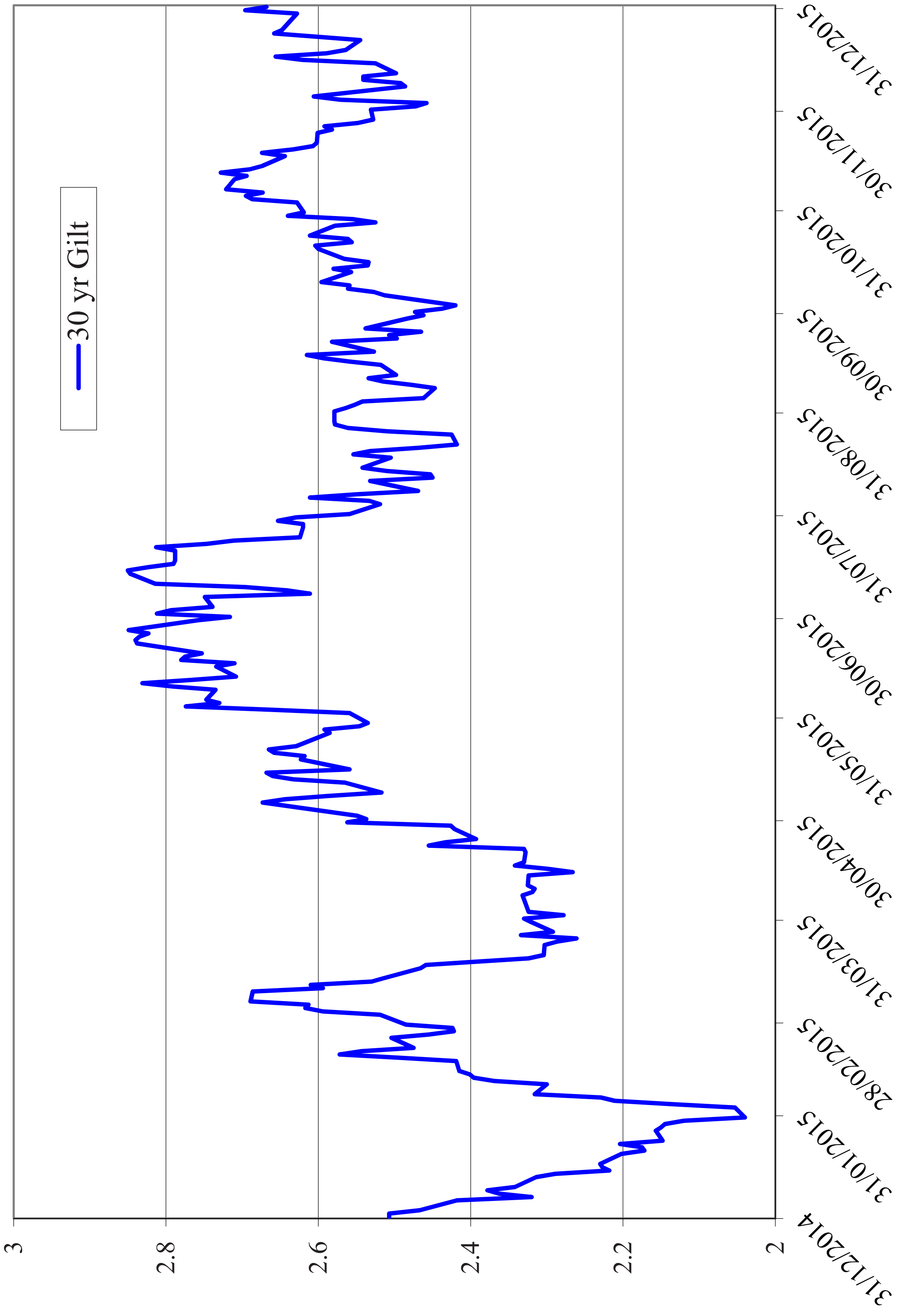
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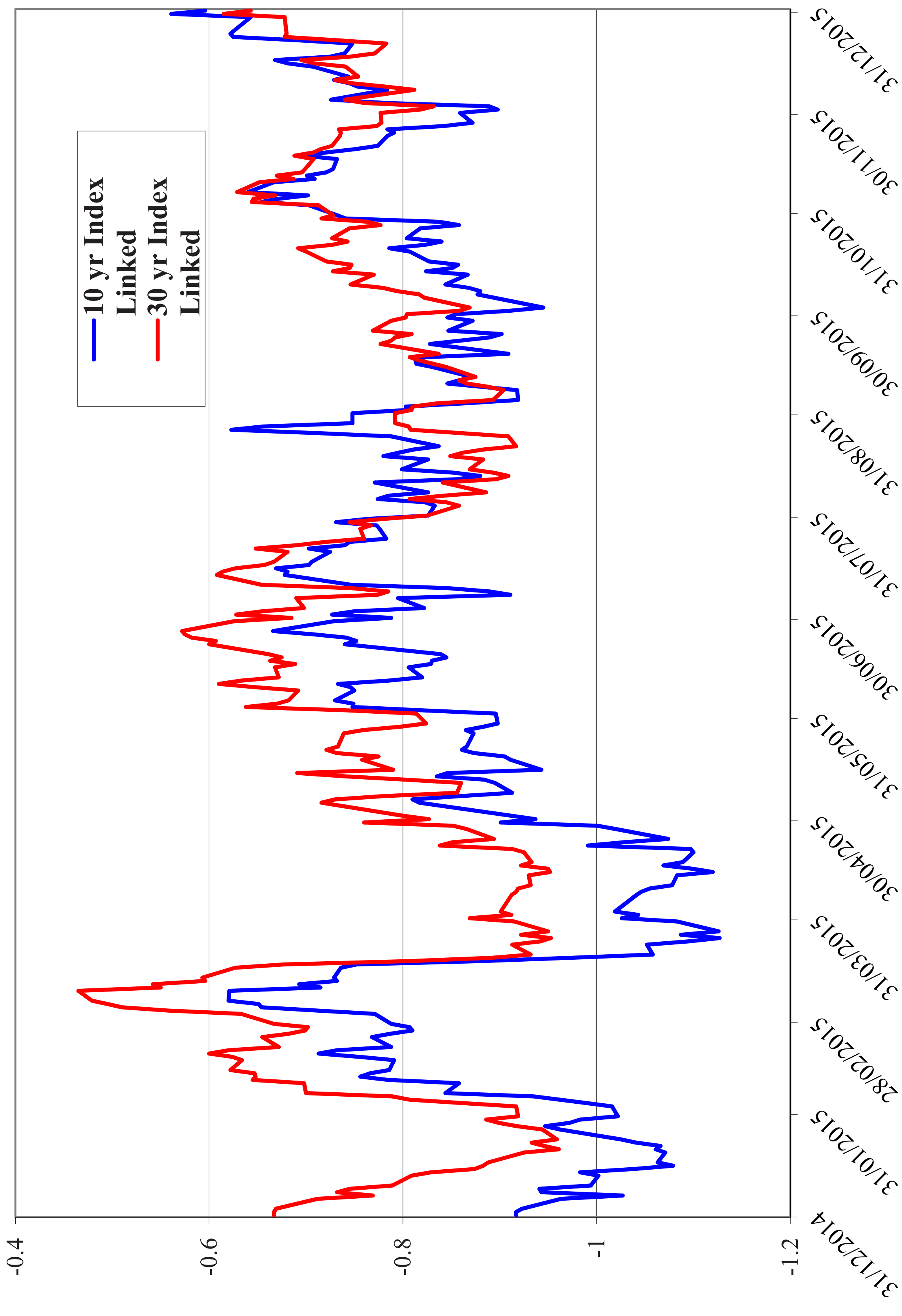
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30 yr Index Linked
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-1
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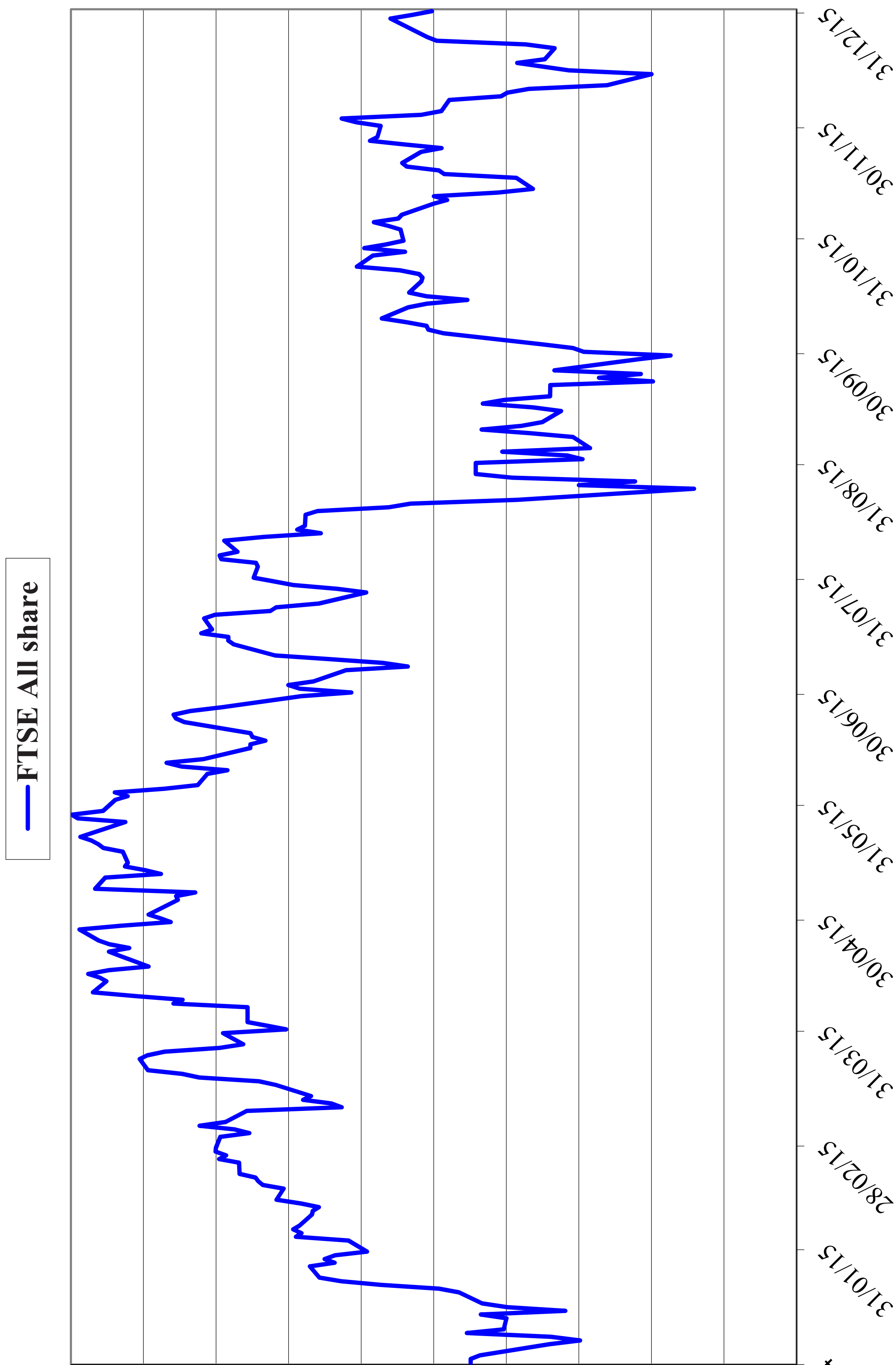
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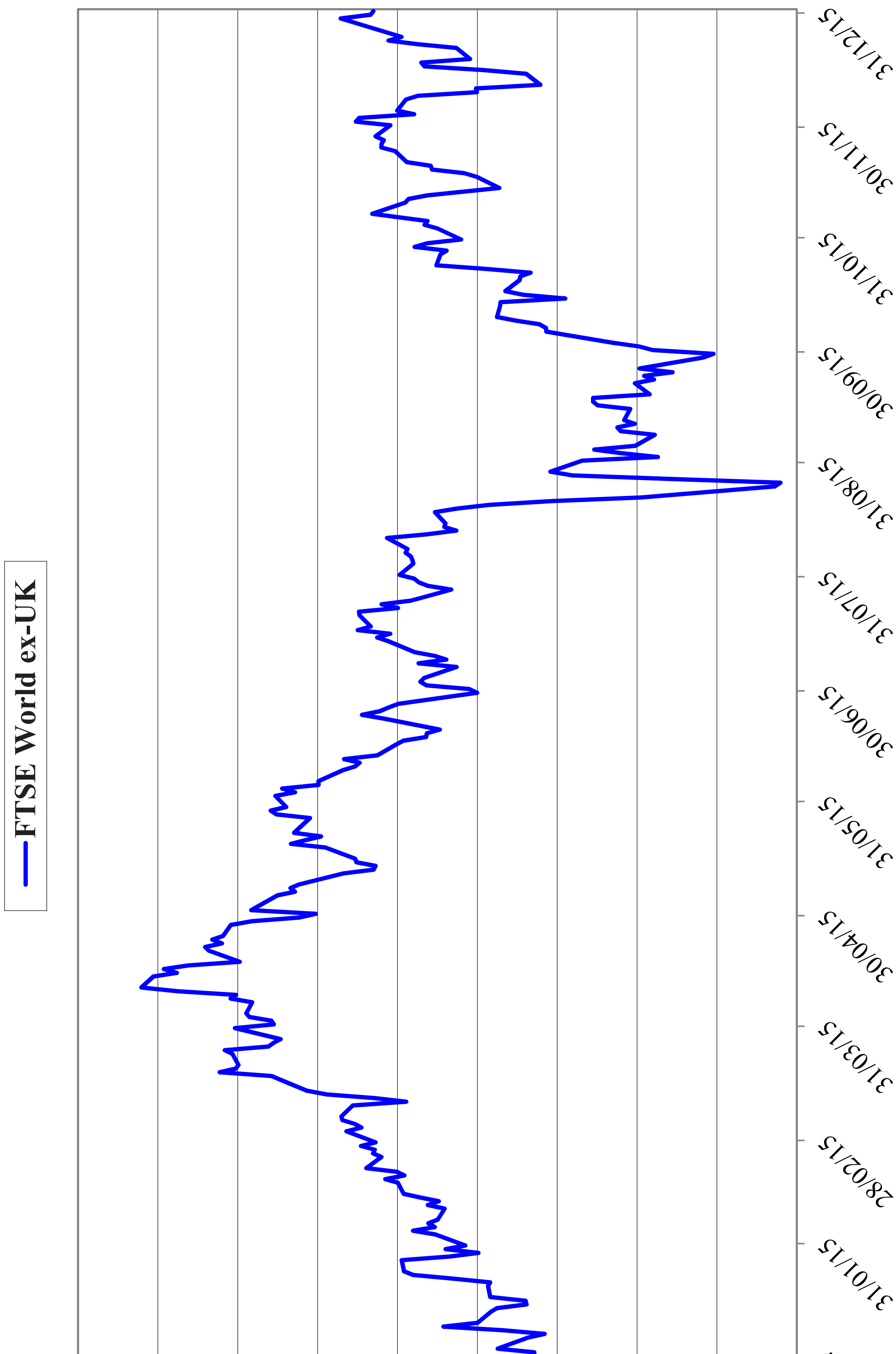
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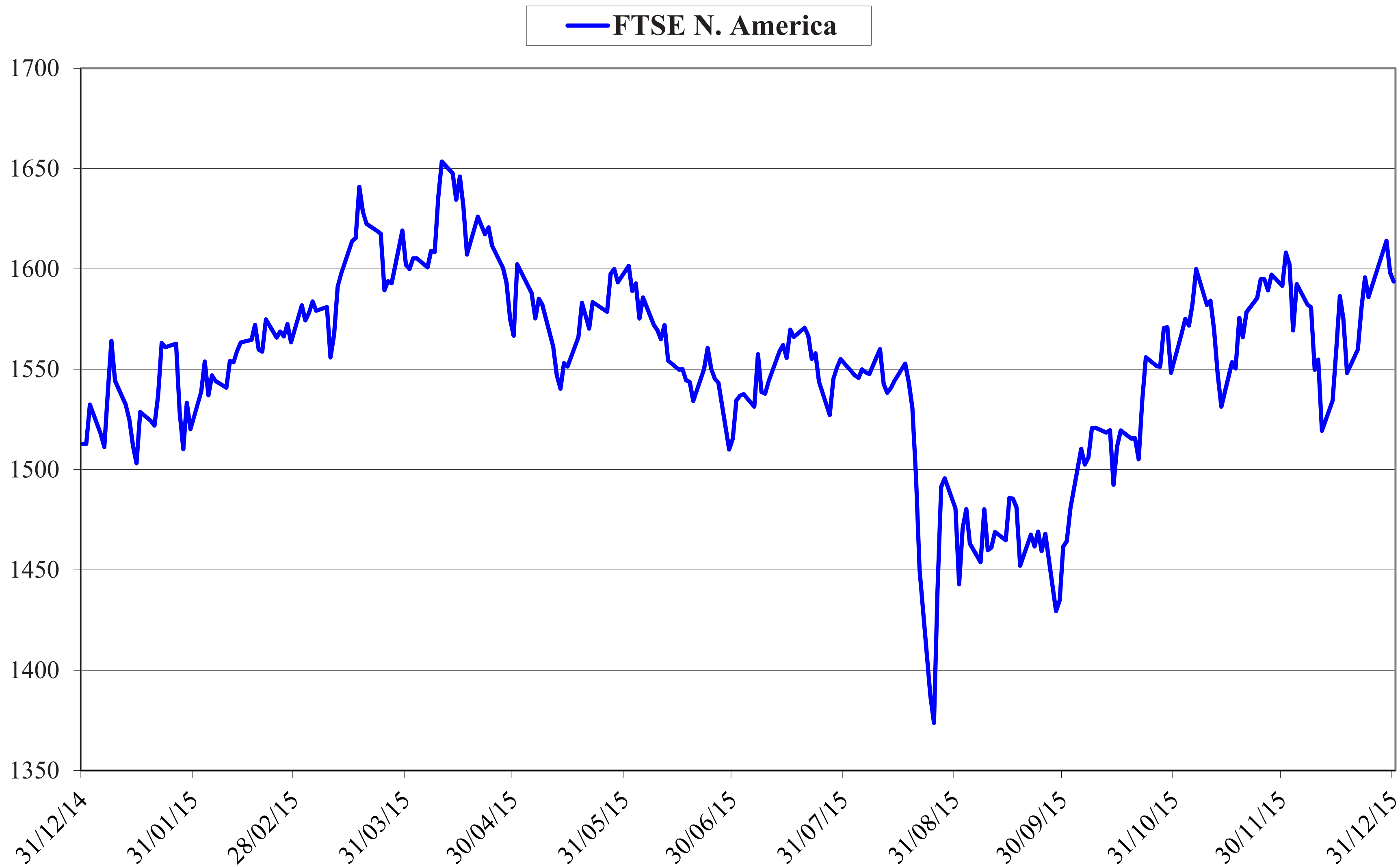
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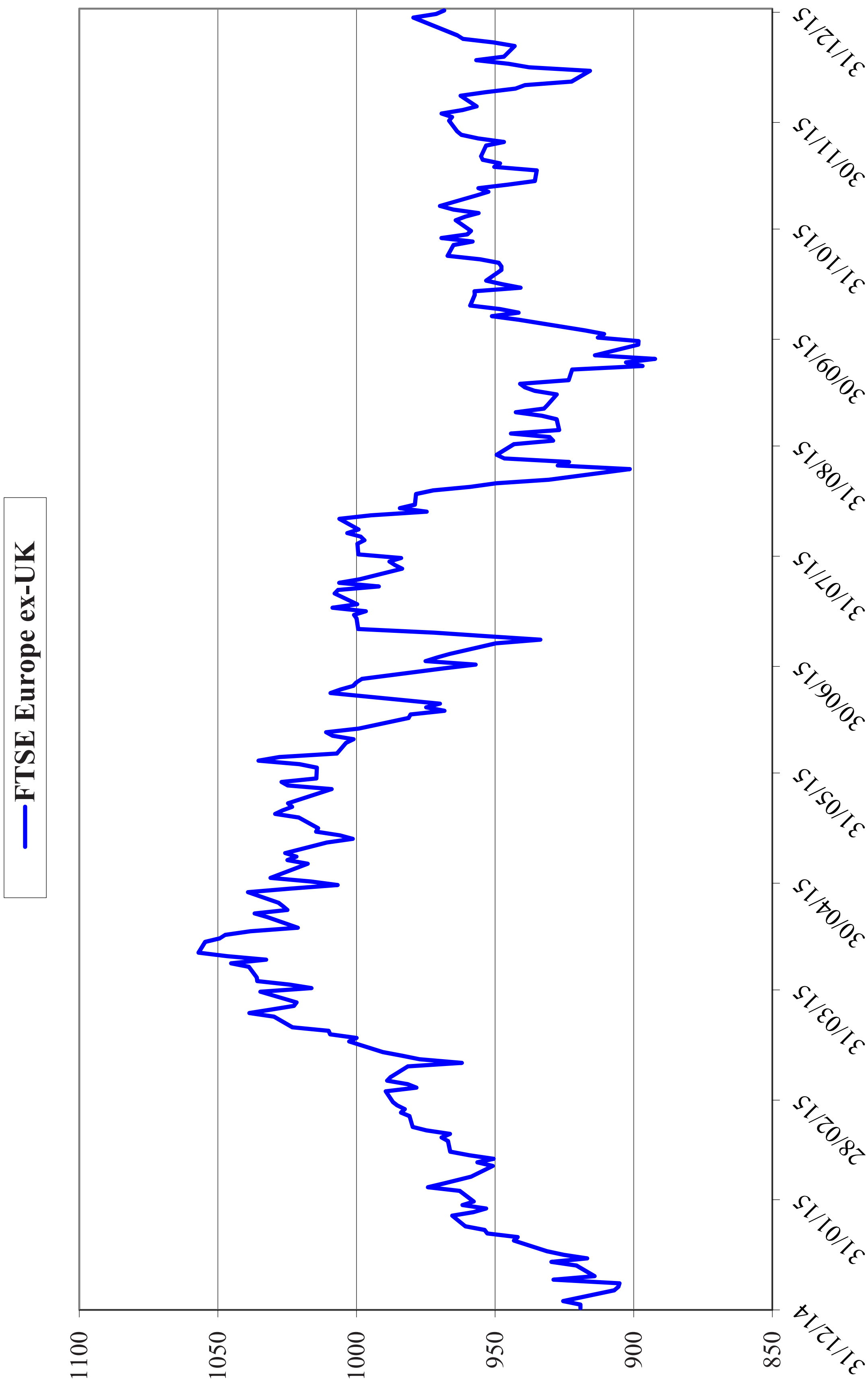
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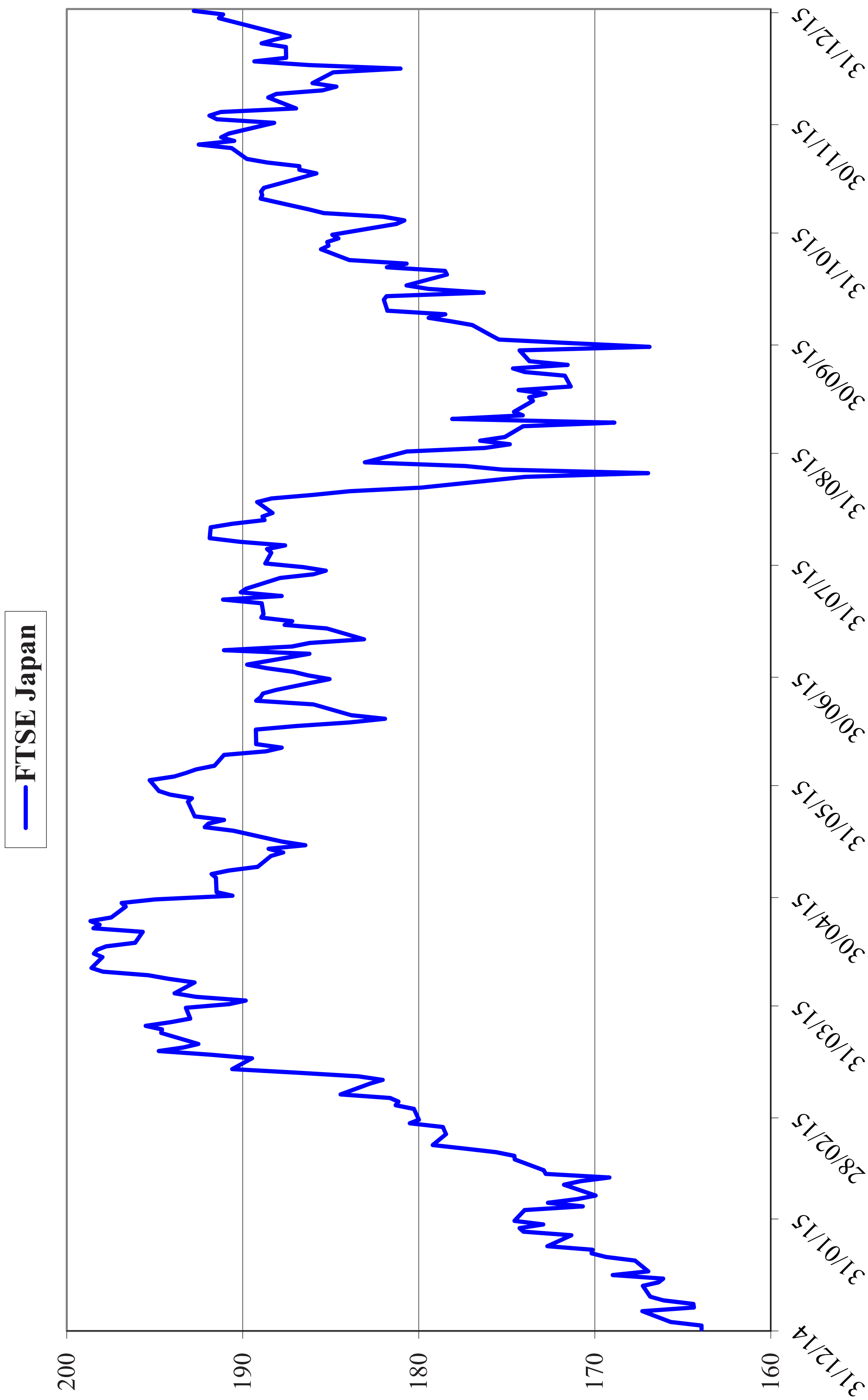
FTSE Japan
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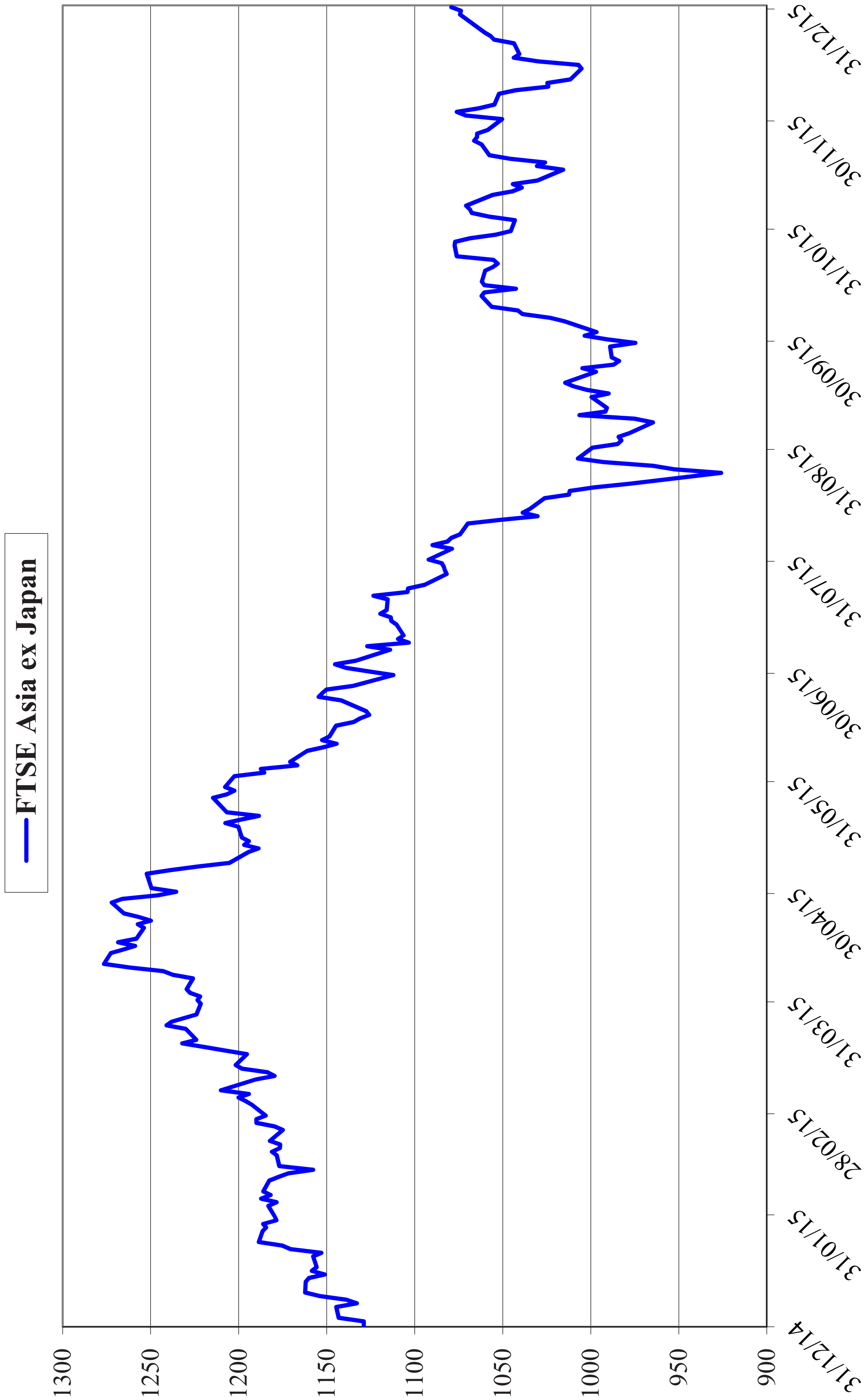
FTSE Asia ex Japan
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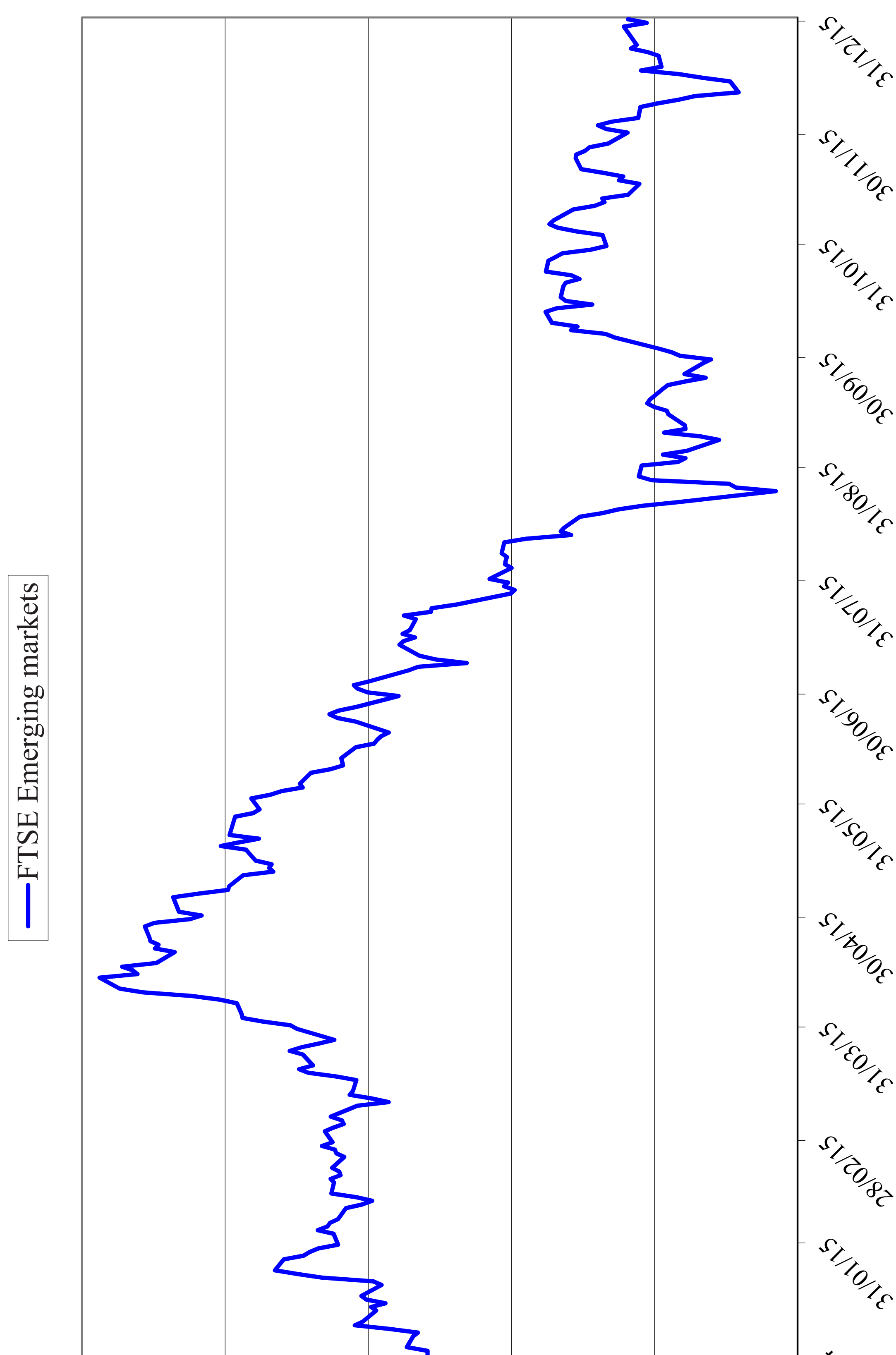
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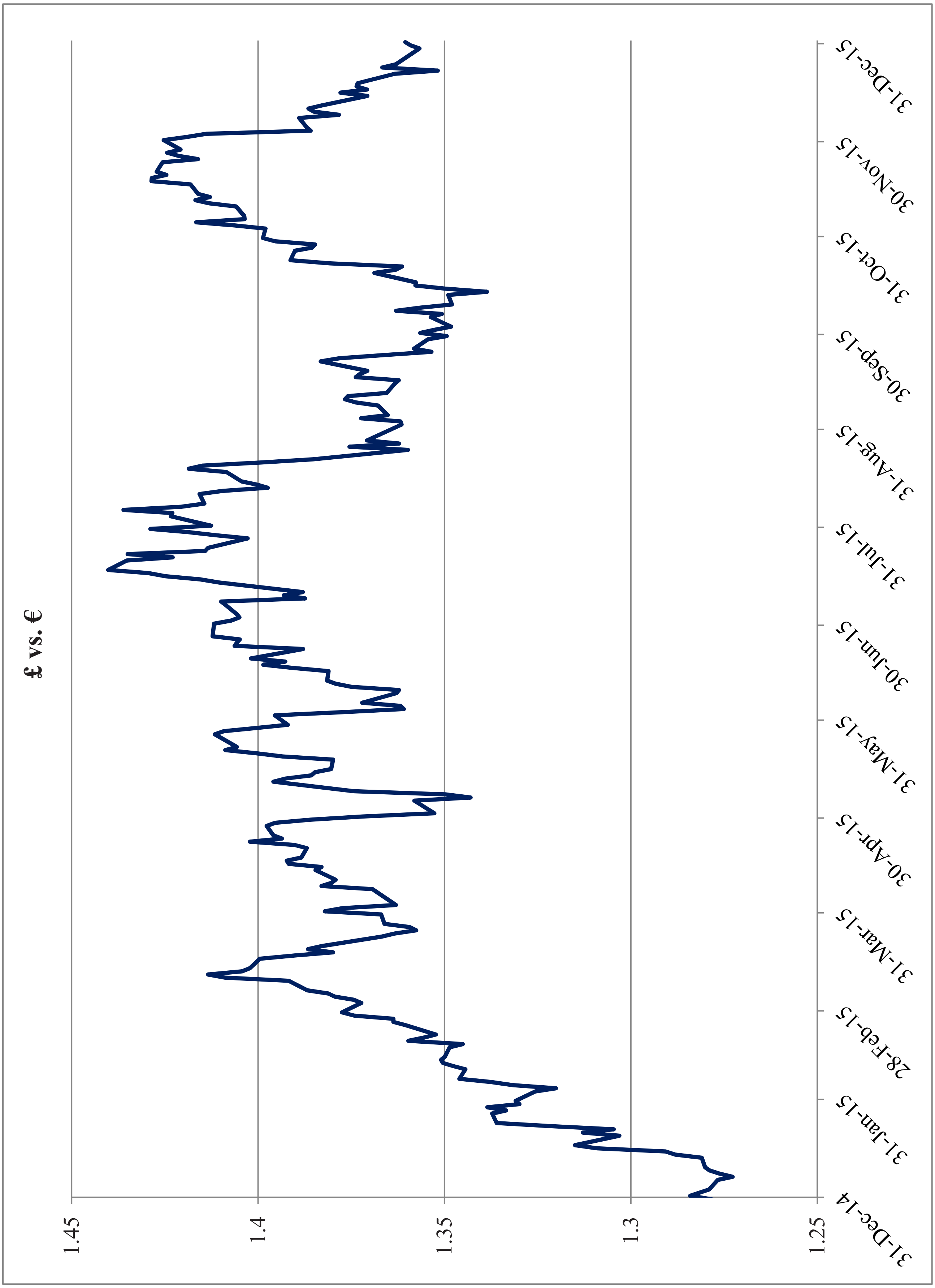
£ vs. €
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31-Dec-14
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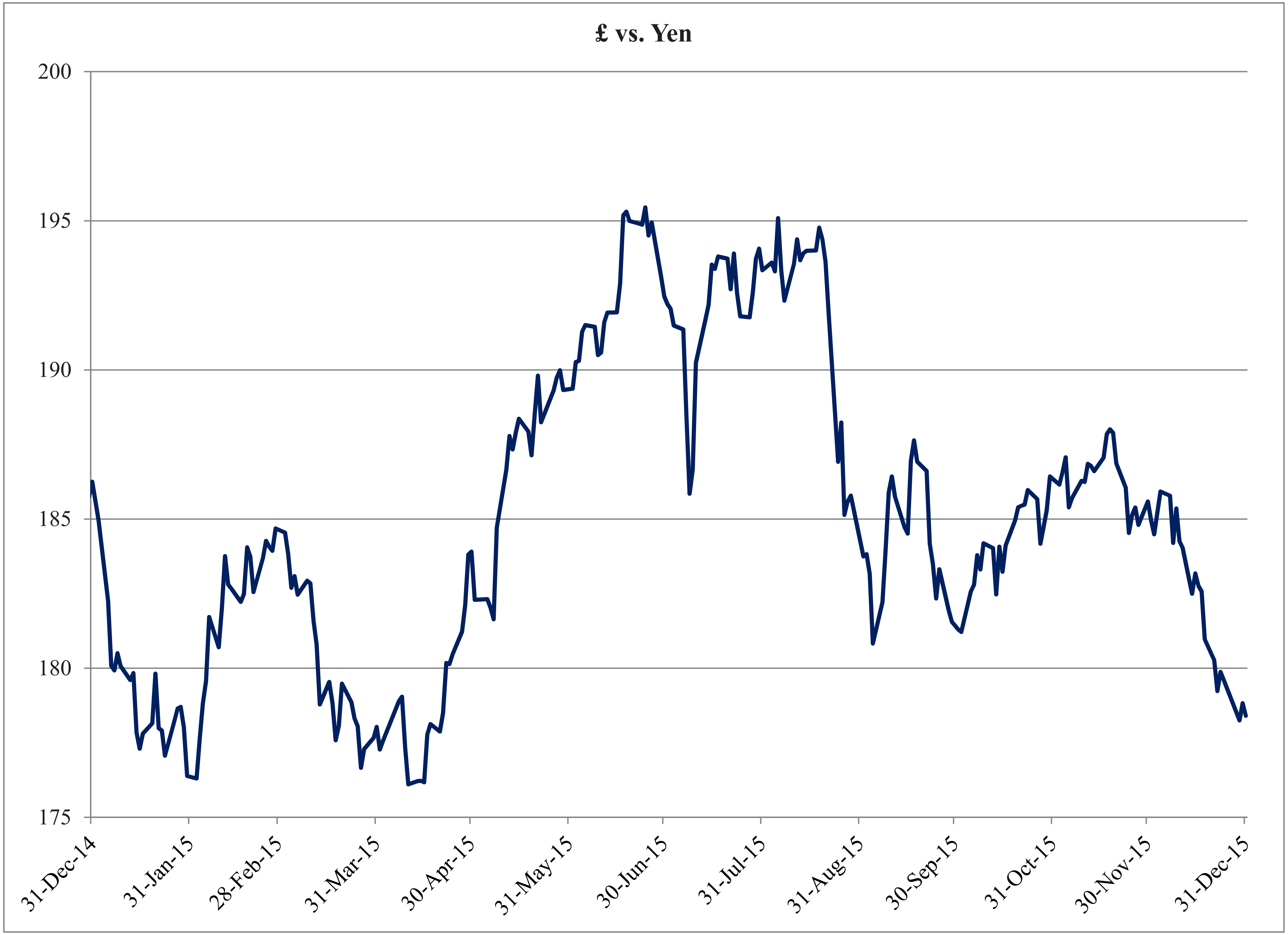

£ vs. Yen
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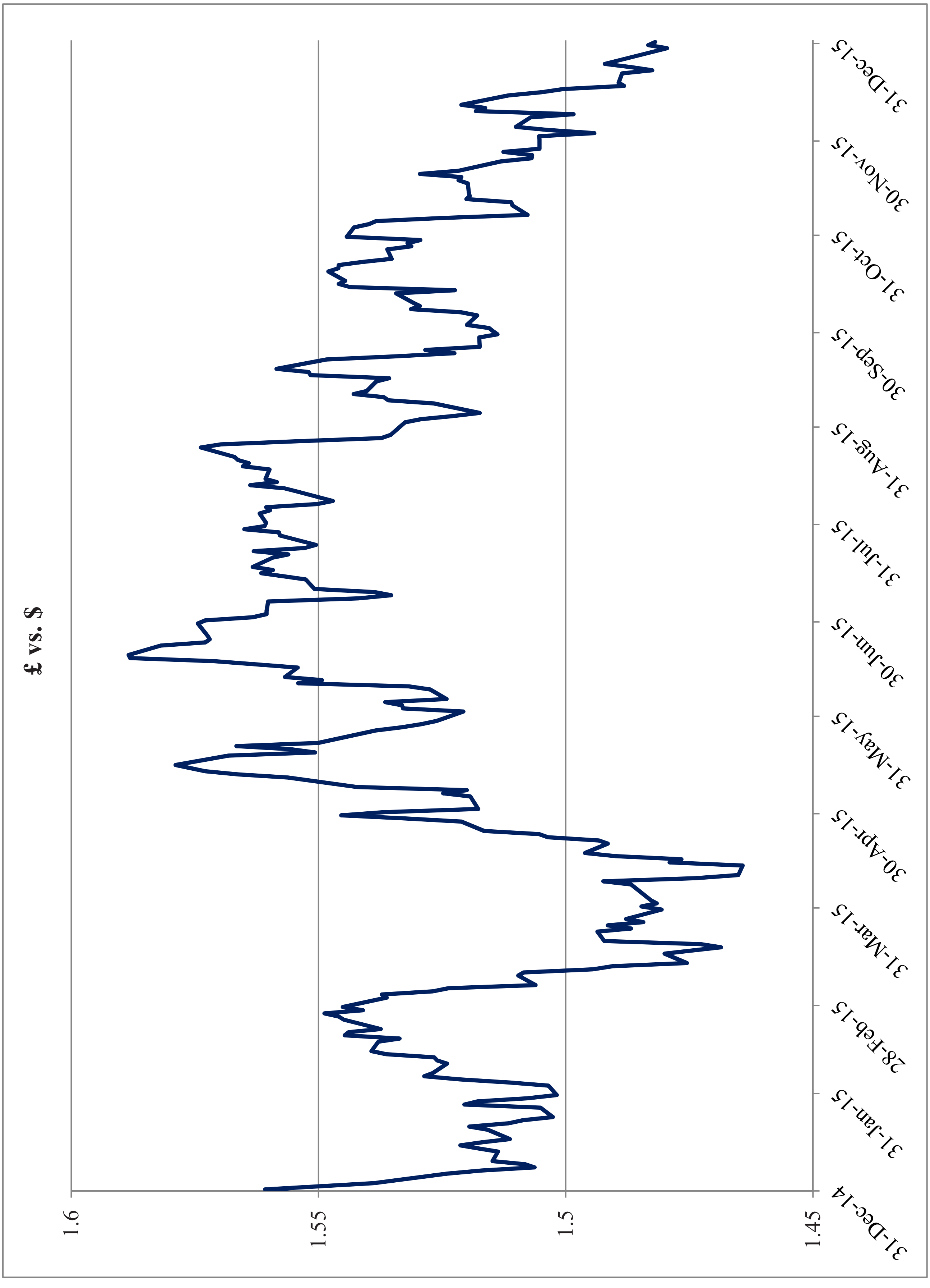
£ vs. $
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31-Dec-15

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Pension Fund Committee

3 March 2016

Overall Value of Pension Fund Investments to 31 December 2015

Don McLure, Corporate Director Resources

Purpose of the Report

1. To inform Members of the overall value of the Pension Fund as at 31 December 2015 and of any additional sums available to the Managers for further investment or amounts to be withdrawn from Managers.

Value of the Pension Fund

2. Reports from the seven appointed Managers:

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

   are included in other papers within this agenda. The value of the Fund at 31 December 2015 was £2 billion,197.47 million.

3. The value of the Fund as at 30 September 2015 was £2 billion, 129.64 million. The value of the fund therefore increased by £67.83 million in the third quarter of 2015/16.

Allocation of New Investment Money and Withdrawal of Investment Money to Deal with Estimated Deficit

4. New investment 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 is withdrawn from Investment Managers.

6. Appendix 1 details the working cash balance position of the Pension Fund and cash flow for the last four quarters, and an estimated cash flow for the quarter ending 31 March 2016. This table includes only cash held by Durham

County Council Pension Fund Bank Account. It does not include cash balances of £66.40m held by the Managers as at 31 December 2015.

7. In determining the amount of cash to be allocated to Managers as at the quarter ended 31 December 2015, 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 enough money in the Durham County Council Pension Fund Bank account to meet the Fund's estimated 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.

Cash Flow Forecast 2015/ 2016

9. Appendix 2 shows the projected cash flow for the Pension Fund for the period March 2016 to March 2017.

10. 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 is forecasted to have a positive cash flow.

11. The quarterly rebalancing exercise is 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.

12. The following assumptions have been used to calculate the cash flow forecast:

- Dividend income receivable in 2015/16 is estimated to be £30.0m, which is based on the actual figures to 31 March 2015. This income is profiled to be received in the same pattern as then, that is:

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

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

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

- Pension increases will be at broadly the same level as 2014/15.

- Payroll Paysheets (payments to pensioners) are forecast to increase by £0.100m per quarter. This figure will alter if there are large numbers of retirements in the employing authorities. It is anticipated, however, that the actual figure will not be materially different to the forecast since the position of the County Council, being the largest employer in the Fund, has been taken into account.

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

13. This is an early indication of the likely impact on the Pension Fund's cash flow forecast over the next 12 months. It will continue to be reviewed each quarter and refined to take into account new information as it becomes available.

Fund Rebalancing

14. 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.

15. There was no rebalancing of the Fund in the previous quarter to allow the impact of the cash placed with the Fund Managers in October to be realised.

16. There will be no rebalancing of the Fund this quarter as the Fund's performance and value figures are not yet available from JP Morgan, the Global Custodian, due to a technical issue at JP Morgan.

Recommendation

17. 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 1 January 2015 to 31 March 2016

Quarter Ended	**31.03.15**		**30.06.15**		**30.09.15**		**31.12.15**		**31.3.16**
	Estimate	**Actual**	**Estimate**	**Actual**	**Estimate**	**Actual**	**Estimate**	**Actual**	**Estimate**
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	£	£	£	£	£	£	£	£	£
Income									
Contributions - DCC	16,400,000	16,780,619	16,800,000	16,774,877	16,800,000	16,584,386	16,800,000	16,560,615	16,800,000
Contributions - Other	7,400,000	7,411,292	7,400,000	14,475,496	7,400,000	8,202,546	7,500,000	8,003,099	7,500,000
Pensions Increase	1,200,000	1,242,761	1,200,000	1,236,045	1,200,000	1,137,723	1,130,000	880,714	1,130,000
Transfer Values	500,000	323,361	300,000	1,135,147	500,000	272,978	500,000	385,463	500,000
Other income	10,000	265,586	250,000	922,512	250,000	1,125,117	250,000	978,590	250,000
Money recovered from Managers						15,443,676	-15,000,000	-18,182,168	-9,555,000
Interest on short term investments	30,000	60,268	40,000	60,448	60,000	68,835	60,000	57,612	45,000
Total Income	25,540,000	26,083,887	25,990,000	34,604,525	26,210,000	42,835,261	11,240,000	8,683,925	16,670,000
Expenditure									
Payroll Paysheets	22,200,000	22,084,713	22,300,000	18,712,769	22,300,000	26,371,670	22,400,000	22,697,764	22,500,000
Payables Paysheets (incl. Managers' fees)	7,000,000	5,972,281	9,000,000	8,776,056	10,000,000	11,571,152	7,000,000	14,000,853	10,000,000
Total Expenditure	29,200,000	28,056,994	31,300,000	27,488,825	32,300,000	37,942,822	29,400,000	36,698,617	32,500,000
Surplus / (-) Deficit	-3,660,000	-1,973,107	-5,310,000	7,115,700	-6,090,000	4,892,439	-18,160,000	-28,014,692	-15,830,000

Balance at Bank (opening)		56,156,417		54,689,000		58,322,978		69,590,581	
Balance at Bank (closing)		54,689,000		58,322,978		69,590,581		41,575,889	

Appendix 2

Projected Cash Flow – including forecasted dividends receivable by Fund Managers for the period 1 January 2016 to 31 March 2017

Quarter Ended	**31.03.16**	**30.06.16**	**30.09.16**	**31.12.16**	**31.03.17**
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£	**£**	**£**	**£**	**£**
Income					
Contributions - DCC	16,800,000	16,800,000	16,800,000	16,800,000	16,800,000
Contributions - Other	7,500,000	7,500,000	7,500,000	7,500,000	7,500,000
Pensions Increase	1,130,000	1,130,000	1,130,000	1,130,000	1,130,000
Transfer Values	500,000	500,000	500,000	500,000	500,000
Other income	250,000	250,000	250,000	250,000	250,000
Gross Dividend and Interest	45,000	45,000	45,000	45,000	45,000
Total Income	26,225,000	26,225,000	26,225,000	26,225,000	26,225,000
Payroll Paysheets	22,500,000	22,600,000	22,700,000	22,800,000	22,900,000
Payables Paysheets (incl. Managers' fees)	8,000,000	8,000,000	8,000,000	8,000,000	8,000,000
Total Expenditure	30,500,000	30,600,000	30,700,000	30,800,000	30,900,000
Surplus / (-) Deficit	-4,275,000	-4,375,000	-4,475,000	-4,575,000	-4,675,000
Dividends Received by Managers	6,300,000	10,200,000	8,100,000	5,400,000	6,300,000
Net Cash Flow Position	2,025,000	5,825,000	3,625,000	825,000	1,625,000

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Pension Fund Committee

3 March 2016

Short Term Investments for the period ended 31 December 2015

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 as at 31 December 2015.

Short Term Investments

2. Durham County Council (DCC) invests the short term cash balances held 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 31December 2015 was £41.576m which was held in the institutions listed in the table below alongside their credit rating at 31 December 2015.

Financial Institution	**Short-term Rating**	**Amount Invested £m**
Bank Deposit Accounts		
Handelsbanken	F1+	0.023
Santander UK Plc	F1	3.853
Barclays	F1	2.251
Fixed Term Deposits		
Barclays	F1	3.001
Bank of Scotland	F1	9.004
Nationwide Building Society	F1	5.252
Goldman Sachs	F1	5.252
Natwest	F2	3.001
Local Authorities	N/A	0.319
National Savings & Investments	N/A	0.150
Money Market Funds	N/A	9.470
Total		**41.576**

4. The following table provides information on the net interest earned during the three month period to 31 December 2015, the average daily investment balance and the average return earned in comparison to the average bank base rate. The interest paid to the Pension Fund is based on the London Interbank Bid (LIBID) three month rate and is net of the fees of £2,500 paid for the Council undertaking the Treasury Management function for the Pension Fund.

	Total
Net Interest Earned	£57,612
Average Return Earned	0.45%
Average Bank of England base rate	0.50%
Average Daily Balance of Investments	£52.509m

Recommendation

5. Members are asked to note the position at 31 December 2015 regarding the Pension Fund's short term investments where £57,612 net interest was earned in the three month period.

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee

3 March 2016

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 2016/17.

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 is reviewed annually and the County Council continues to invest the balances of the Pension Fund on its behalf.

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. It is recommended that the fee for this service continues at the level set with effect from 1 April 2014, which is a flat fee of £2,500 per quarter

Calculation of Interest on Cash Balances

16. 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 2016/17 .

17. 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.

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

Investments

19. 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.

20. 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.

21. 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.

22. It is recommended that this arrangement continues.

Banking Arrangements

23. Following notice from the Co-operative Bank advising the Council it was withdrawing from the Local Authority market on 5 November 2013, the Council went through a full procurement process and appointed Lloyds Bank as the Council's bankers.

24. The Pension Fund bank account is part of the Council's banking contract and is therefore included in the change of banking supplier to Lloyds Bank.

25. The transition from the Co-operative Bank to Lloyds Bank has been successfully completed. To date there have been no changes to the processes in the treasury management function which would have necessitated additional time and cost being allocated to the Pension Fund, however this will continue to be monitored and if necessary, further reports will be prepared to inform Members of changes impacting on the service being delivered.

Recommendation

26. It is recommended that, with effect from 1 April 2016:

    (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 – 4 March 2015 – 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

3 March 2016

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

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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 2016.

Background

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

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

- After consultation with all relevant interested parties involved with the Fund the Administering Authority will prepare and publish their funding strategy;

- In preparing the FSS, the Authority must have regard to:

    i. the guidance issued by the Chartered Institute of Public Finance (CIPFA) for this purpose; and
    ii. their own Statement of Investment Principles (SIP) for the Fund.
    iii. the FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

4 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 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 CIPFA's Pensions Panel Principles for Investment

Decision Making in the Local Government Pension Scheme in the United Kingdom.

Consultation

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

7 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.

8 The FSS was reviewed by the Pension Fund’s Actuary following the last triennial valuation and changes to the FSS reported to Committee in March 2014. Further changes were made in 2015 to reflect Regulation changes.

9 No further changes are required to be made to the FSS, and it remains unchanged from the version reported to Committee in June 2015 and is attached at Appendix 1.

10 The SIP was revised in March 2014 and changes made to reflect the introduction of the three global equity and emerging market managers. Further revisions were made following the appointment of a new Investment Manager for the Dynamic Asset Allocation part of the Fund, to reflect the change of name from AllianceBernstein to AB and a revision to a maximum regional allocation in North America for CBRE in early 2015.

11 No further changes are currently required to be made to the SIP, and it remains unchanged from the version reported to Committee in September 2015 and is attached at Appendix 2.

12 The attached versions of the FSS and SIP are currently published on the Council’s website.

Recommendations

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

Background papers

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

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

(c) Pension Fund Committee – 6 March 2014 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

(d) Pension Fund Committee – 5 June 2014 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

(e) Pension Fund Committee – 11 September 2014 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

(f) Pension Fund Committee – 4 March 2015 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

(g) Pension Fund Committee – 4 June 2015 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

(h) Pension Fund Committee – 10 September 2015 - Pension Fund Policy Documents – Funding Strategy Statement and Statement of Investment Principles

Contact: Hilary Appleton Tel: 03000 266239

Appendix 1

Durham County Council Pension Fund

Funding Strategy Statement

2015

Version Updated May 2015

Index

(A) STATUTORY BACKGROUND AND KEY ISSUES

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

2. Key issues:

   - After consultation with such persons as it considers appropriate, 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.

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

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

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

3. This Statement was as part of the triennial valuation as at 31 March 2013, and has been updated in March 2015.

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

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

  - the regulatory requirement to secure solvency, 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 Regulations

- Determine a schedule of due dates for the payment of contributions -

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

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

- Invest surplus monies in accordance with the Regulations.
-
- Pay from the Fund the relevant entitlements as set out in the Regulations.

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

- 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 of exiting employers and other forms of security for the Administering Authority against the financial effect on the Fund of the employer's default. Such advice will take account of the funding position and Funding Strategy Statement, as well as other relevant matters when instructed to do so.

- Assist the Administering Authority in assessing whether employer contributions need to be revised between actuarial valuations as required 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 exit, the required Probability of Maintaining Solvency will be set at a level higher than 80% dependent on circumstances. For most such bodies, the chance of achieving solvency will be set commensurate with assumed investment in an appropriate portfolio of Government index linked and fixed interest bonds after exit.

Probability of Funding Success

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 exit the Administering Authority will have specific regard to the potential for participation to cease (or to have no contributing members), the potential timing of such exit, and any likely change in notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date of exit (i.e. whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities).

Full Funding and Solvency

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 (most) scheduled bodies in the Fund, the Trajectory Period, at the date of reviewing this FSS, is set to be 25 years.

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.

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25. 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.

26. 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

27. 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

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

29. 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.

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

31. 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

32. 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.

33. 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

34. 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.

35. 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.
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- 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.

36. 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.

37. 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

38. 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.

39. 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.

40. 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

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

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

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

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

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

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

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

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

Guarantors

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

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

46. 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

47. Paragraph 6 of Part 3, Schedule 2 of the Regulations creates a requirement for a new Admission Body to carry out, to the satisfaction of the Administering Authority (and the Scheme Employer in the case of an

Admission Body admitted under paragraph 1(d)(i) of that Part), an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.

48. 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.

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

- In the case of Admission Bodies admitted under Paragraph 1(d) of Part 3, Schedule 2 of the Regulations and other Admission Bodies with a Guarantor, and so long as the Administering Authority judges the relevant Scheme Employer or Guarantor to be of sufficiently sound covenant, any bond exists purely to protect the relevant Scheme Employer on default of the Admission Body. As such, it is entirely the responsibility of the relevant Scheme Employer or Guarantor to arrange any risk assessments and decide the level of required bond. The Administering Authority will be pleased to supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer, but this should not be construed as advice to the relevant Scheme Employer on this matter. The Administering Authority notes that levels of required bond cover can fluctuate and recommends that relevant Scheme Employers review the required cover regularly, at least once a year.

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

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

Subsumed liabilities

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

51. 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

52. Where an employer is exiting the Fund such that it will no longer have any contributing members, unless any residual liabilities are to become subsumed liabilities, the Administering Authority will act on the basis that it will have no further access for funding from that employer once any exit valuation, carried out in accordance with Regulation64 of the Regulations, has been completed and any sums due have been paid. Residual liabilities of employers from whom no further funding can be obtained are known as orphan liabilities.

53. 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.

54. 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

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

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

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

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

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

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

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

General Principles and diversification

59. 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.

60. 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.

61. 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.

62. 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.

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

64. 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

65. 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.

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

67. 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.

68. Employer

These include:

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

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

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

69. 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.

70. 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

71. 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.

72. 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.

73. 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.

74. 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.

75. 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.

76. 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

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

Appendix 2

Durham County Council Pension Fund

Statement of Investment Principles

Version Updated August 2015

Table of Contents

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.

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.

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

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.

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.

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.

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.

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.

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.

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, column 2 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.

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.

By dividing the management of the assets between 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.

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.

Approval has been given to investment as follows:

In-house Management

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

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

ii. **Capital North East**

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

External Investment Management

The Pension Fund Committee has appointed seven 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.

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%	15% 15%
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 +3.0%	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.

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.

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.

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.

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.

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.

Fee Structure

The Investment Managers' fees are based on the value of assets under management. In the case of two 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.

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.

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.

- 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 a Newsletter and Annual Statements which are considered the most appropriate form.

- Investment Managers

The Pension Fund Commitee currently has appointed seven Investment Managers: Aberdeen Asset Management ('Aberdeen'), AB (formerly AllianceBernstein Limited) ('AB'), BNY Mellon Investment Management Ltd ('BNY Mellon'), Mondrian Investment Partners Ltd ('Mondrian'), Royal London Asset Management ('RLAM'), CB Richard Ellis Collective Investors Limited ('CBRE') and BlackRock Investment Management (UK) Limited ('BlackRock') to manage the assets of the Pension Fund.

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

Investment Manager	%	Asset Classes	Investment Style
Aberdeen	15	Global Equities	Active
BNY Mellon	15	Global Equities	Active
Mondrian	7	Emerging Market Equities	Active
AB	15	Global Bonds	Active
RLAM	20	Investment grade sterling and non-sterling bonds	Active
CBRE	8	Global Property	Active
BlackRock	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:

Aberdeen

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

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

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Equity	MSCI All Country World Index (unhedged)

Aberdeen intends to invest in the following to achieve their objective:

Portfolio	%
World Equity Fund	100

The Aberdeen World Equity Fund adopts an unconstrained approach to achieve its objective and as such does not maintain hard restrictions on stock, sector and country exposures. Internal guidelines though are used to assess risk against the benchmark:

	Range
Individual stock exposure	0 - 5% of total portfolio
Deviation in sector exposure	+ / - 15% from the benchmark
Deviation in country exposure	+ / - 35% from the benchmark
Cash holdings	Maximum of 5%

BNY Mellon

The Pension Fund Committee has appointed BNY Mellon to manage a portfolio to be invested in active Global Equities.

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Equity	MSCI World

The Investment Manager's objective is to outperform the Index by 2.5% per annum gross of fees over a full market cycle.

BNY Mellon intends to invest in the following to achieve their objective:

Portfolio	%
Long Term Global equity Fund	100

The BNY Mellon Long Term Global Equity Fund is a UCITS fund and as such is required to adhere to UCITS Investment Guidelines. Additional restrictions imposed by BNY Mellon are:

	Range
Emerging Market equities	Maximum of 20%
Investments in Collective Investment Schemes	Maximum of 10%
Investments in bonds, convertibles, cash and money market instruments	Maximum of 25%
Cash holdings	Maximum of 5%

Mondrian

The Pension Fund Committee has appointed Mondrian to manage a portfolio to be invested in active Emerging Market Equities.

The benchmark allocation is as follows:

Asset Class	Benchmark
Emerging Market Equities	MSCI Emerging Markets Net Index

The Investment Manager's objective is to outperform the Index by 2.5% per annum gross of fees over a full market cycle.

Mondrian intends to invest in the following to achieve their objective:

Portfolio	%
Emerging Market Equities	100

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

	Range
Investments in REITS	Maximum of 20% (client to be informed at any greater than 10%)
Individual Securities	Maximum of 5% in single stock
Sector restrictions	Maximum of 25% of portfolio in single industry
Cash holdings	Maximum of 5%

AB

The Pension Fund Committee has appointed AB 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

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

Portfolio	%
Diversified Yield Plus Fund	100

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

AB 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 AB anticipates VaR exposure of less than or equal to 5%, as calculated by AB 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%
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 45%
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.

BlackRock

The Pension Fund Committee has appointed BlackRock 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 3% per annum net of fees over a rolling three year basis.

The benchmark allocation is as follows:

Asset Class	Benchmark
Multi asset	3-month LIBOR

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

Portfolio	%
Dynamic Diversified Growth Strategy	100

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

The objective of the strategy is to deliver long term consistent growth with low volatility and a strong focus on downside protection. The risk profile is typically one third to one half of equity market risk.

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

Sector	Range / Restrictions
Leverage	The fund may not be leveraged through: • The use of borrowing to purchase additional investment; • Gaining aggregate market exposure (physical long positions plus net economic exposure gained through the use of derivatives) in exess of 100% NAV
High Yield Restriction	15% maximum
Property Restriction	15% maximum
Currency	Minimum GBP exposure of 60% of NAV Exposure of the Portfolio should not exceed + / - 30% of NAV to any single non GBP denominated currency
Maximum allocation to equity	65%

BlackRock are not permitted to hold the following Funds:

Fund
Aberdeen World Equity Fund
AB Diversified Yield Bond Plus Fund,
BNY Mellon Long Term Equity Fund

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Pension Fund Committee

3 March 2016

Agreement of Accounting Policies for Application in the 2015/16 Financial Statements of the Pension Fund

Don McLure, Corporate Director Resources

Purpose of the Report

1. To inform the Pension Fund Committee of the accounting policies to be applied in the preparation of the 2015/16 Final 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 Committee 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 2015/16' (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 2014/15 accounts and there have been no changes to the Code necessitating a change for 2015/16.

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.

Recommendations

9. The Committee is recommended to:

- review the accounting policies and note that there have been no changes to the Code of Practice;

- approve the policies in the preparation of the 2015/16 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: Beverley White Tel: 03000 261900

Appendix 1: Accounting Policies for 2015/16

Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in the 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 deficit funding contributions are accounted for in the year in which they become due in accordance with the Rates and Adjustment Certificate set by the actuary, or on receipt, if earlier than the due date.

Transfers to and from other schemes

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

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

Pension benefits payable

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

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.

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.

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 financial year end;
- changes in the net market value of investments are recognised as income and comprise all realised and unrealised profits/ losses during the year.

Taxation

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

NET ASSETS STATEMENT

Valuation of Investments

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

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. Investment Managers use valuation techniques to establish a price at the year end date based on an arm’s length exchange given normal business considerations;

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

Investment transactions

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

Financial liabilities

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

Actuarial present value of promised retirement benefits

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

Additional Voluntary Contributions (AVCs)

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

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

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Pension Fund Committee

3 March 2016

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 responsibilities of the Pension Fund Committee and ensure that they are clearly defined and understood.

Terms of Reference

4 The Terms of Reference are attached at Appendix 1 and 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

5 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.

6 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.

7 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.

Recommendation

8 It is recommended that Members accept the Terms of Reference as detailed in Appendix 1 and they 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 March 2015 – 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
19	To establish constitutional documents, codes, policies, plans, frameworks and protocols connected with the establishment and operation of the Local Pension Board	As and when required

5. Meetings

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

6. Programme of Work

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

7. Performance and Review

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

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Pension Fund Committee

3 March 2016

Local Government Pension Scheme Investment Regulations

Don McLure, Corporate Director Resources

Purpose of Report

1. To update Members on the Pension Fund's response to the Government's consultation on the revocation and replacement of the Local Government Pension Scheme (Investment and Management of Funds) Regulations 2009.

Background

2. The 2009 Investment Regulations detail the ways that the administering authorities for Local Government Pension Scheme (LGPS) funds must manage and invest those funds. The regulations are detailed and prescriptive, for example setting out how and under what terms investment managers should be appointed and their performance monitored, as well as listing types of permissible investments and limits on what proportions of a fund can be allocated to particular assets or asset classes.

3. The Government's consultation document sets out proposals to revoke and replace the 2009 Investment Regulations with the draft Local Government Pension Scheme (Investment and Management of Funds) Regulations 2016 (the 2016 Investment Regulations).

4. A report was presented to the Pension Fund Committee in December 2015 detailing this consultation.

5. At this meeting, the Pension Fund Committee gave its agreement to the Corporate Director Resources responding to the consultation, after consulting with the Chairman and Vice Chairman and after taking advice from the Fund's investment advisers.

Consultation response

6. The response of Durham County Council Pension Fund was submitted by the Corporate Director Resources, after consulting with the Chairman and Vice Chairman, before the deadline of 19 February 2016. It is attached as Appendix 1 for your information.

Recommendation

7. Members are asked to note the contents of the response to Government on the revocation and replacement of the Local Government Pension Scheme (Investment and Management of Funds) Regulations 2009.

Background Papers

(a) Pension Fund Committee – 15 December 2015 – The Local Government Pension Scheme Investment Regulations.

Contact: Beverley White Tel: 03000 261900

Appendix 1: Consultation Response

Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

Submission by: Durham County Council as Administering Authority for Durham County Council Pension Fund

Contact: Beverley White
Finance Manager
beverley.white@durham.gov.uk
Tel: 03000 261900

Durham County Council (DCC) welcomes the opportunity to respond to the consultation ‘Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009’.

Our response provides answers to the questions raised alongside additional comments where appropriate.

Proposal 1: Deregulating and adopting a local approach to investment

Q1: Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities’ investments are made prudently and having taken advice?

The proposed deregulation appears to achieve the intended policy objectives.

The proposed Investment Strategy Statement appears to have similar contents to those of the existing Statement of Investment Principles. There is an argument that the timescale for reviewing the Investment Strategy Statement should be consistent with the review of the Funding Strategy Statement in order that the two documents can be aligned and take into account the latest actuarial valuation.

Section 3.8 of the consultation document highlights that guidance on how a Fund’s policies on environmental, social, and corporate governance issues are taken into account should reflect UK foreign policy and related issues will be issued prior to the new regulations taking effect. It is difficult to make any comments on this section as the guidance has yet to be issued, however we would like to stress that pension funds make long term investments in order to maximise returns for its investors whereas UK foreign policy can change significantly over the short term.

Q2: Are there any specific issues that should be reinstated? Please explain why.

No, we do not believe there are any specific issues that should be reinstated.

Q3: Is six months the appropriate period for the transitional arrangements to remain in place?

The proposed timeframe, to publish the Investment Strategy Statement within 6 months after the regulations come into force (i.e. by 1 October 2016), would be extremely challenging and will put a strain on limited staff resource. We suggest a period of between 9 to 12 months would be more practicable.

During this 6 month period staff will be busy with the production of their Pension Fund Accounts and Annual Report, developing their submission on pooling to meet the deadline of 15 July 2016, whilst compiling information for the triennial valuation.

Q4: Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?

In addition to being a risk management tool, derivatives could also be used for efficient portfolio management purposes.

Being prescriptive in terms of the ways in which derivatives should be used would not be consistent with the general relaxation of the regulatory framework for Fund investments.

Proposal 2: Introducing a safeguard – Secretary of State power of intervention

Q5: Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?

The proposed power of intervention provides the Secretary of State with wide-ranging powers to intervene in the operation of an individual fund. Therefore, it is imperative that when considering an intervention the Secretary of State considers all available evidence before deciding to intervene and should only do so as a last resort.

The Secretary of State would have to ensure consistency of application across different funds, in order to avoid discrimination.

Q6: Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?

As there are no timescales laid down in the draft regulations it is impossible to comment as to whether authorities have sufficient time to present evidence. However, it should be reiterated that the regulations should ensure that authorities have sufficient time to consider the evidence presented by the Secretary of State as well as to present its own evidence to support a counter argument.

Q7: Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?

As there is very little detail in the regulations and associated consultation document it would appear that the Secretary of State has sufficient flexibility to ensure he is able to introduce a proportionate intervention.

Whilst it is appreciated that it is the intention that the power to intervene is deliberately broad so that it can be applied in a wide range of circumstances there is an argument that the power is too broad. A detailed guidance document should be produced to provide examples of the circumstances under which there is likely to be intervention. This guidance document would need to be far more extensive than the small number of examples given in the consultation document. Interventions should only be considered in extreme circumstances.

Q8: Do the proposals meet the objective of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?

It is appreciated that the Secretary of State requires some form of tool to prevent an adverse impact from the proposed deregulation and to ensure that all funds participate in the requirement to pool assets. However, the circumstances under which this power of intervention would be used need to be further communicated to ensure that it is only being used when an authority materially departs from best practice, guidance or regulation and cannot provide an adequate justification for this action.

Section 4.9 of the consultation document states that all costs relating to an intervention will be met by the pension fund assets however the nature and cause of those costs should determine who ought to bear the costs.

Don McLure
Director Corporate Resources

17 February 2016

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Pension Fund Committee

3 March 2016

Local Government Pension Scheme: Pooling update

Report of Don McLure, Corporate Director Resources

Purpose of the report

1 To update the Committee on progress made towards meeting the Government's requirements on a shared investment approach through pooling Local Government Pension Scheme (LGPS) Fund assets.

Background

2 In the July 2015 Budget, the Chancellor announced the Government's intention to work with LGPS administering authorities to ensure they pool investments to significantly reduce costs whilst maintaining performance.

3 Considerable emphasis was also given to the expectation that LGPS funds would begin to invest substantially more in infrastructure. On 25 November 2015 the Government published the Investment Reform Criteria and Guidance, setting out how LGPS investment pooling would work, and reframing the requirement as that the pools should take the form of up to six "British Wealth Funds" each with assets of at least £25 billion which are "able to invest in infrastructure and drive local growth."

4 A paper presented to the 15 December 2015 Pension Fund Committee set out details of the Government's proposals, explained progress made so far towards pooling of investments, and advised the Committee that an initial response to Government was required by 19 February 2016, giving a commitment to pooling and advising which other LGPS Funds the Pension Fund was likely to pool with.

Progress towards pooling

5 Chairs and Vice Chairs and officers from the three north-east Funds met (along with officers from the Teesside Pension Fund) on 16 December 2015 and agreed that 'relative asset sizes' meant it was not practical to form a separate north-east pool and it would probably not be feasible to act together as a group, but there would be potential political advantages if the Funds were able to consolidate into the same pooled fund. Nevertheless, the primary objective of pooling should be to obtain the best outcome for the Fund from a long-term investment perspective for the benefit of Fund members.

6 Although there was no centrally available record of ongoing pooling activity, through networking with colleagues regionally and more widely it was identified that at the start of 2016 there were potentially eight different groups

considering forming pools – mainly grouped on a regional basis. Of these eight, three met the following criteria:

- Allow the Pension Fund to meet its investment objectives;
- Allow access to internal management – so potentially reducing costs while maintaining returns;
- Allow the Pension Fund an equal say in the setting up and future management of the pool.

These were the 'Border to Coast Pensions Partnership' (Cumbria, East Riding, Surrey and others), the 'Northern Funds' group (Greater Manchester, West Yorkshire and Merseyside) and the 'Midlands Funds' group (West Midlands, Nottinghamshire, Derbyshire plus others).

7 Officers attended meetings and engaged in discussions with representatives of both the 'Border to Coast Pensions Partnership' and the 'Northern Funds' group. The 'Midlands Funds' group was not actively considered as there was no obvious connection with any of the Funds in that group and early feedback showed there would be little prospect of the other north-east funds joining that group.

8 The relative size of the potential other participants in the two possible pools was a factor in the decision-making process. The 'Northern Funds' group comprised three of the four biggest LGPS funds in England and Wales and any smaller fund joining them could therefore struggle in practice to have an equal say in the governance and operation of the pool. Whereas, the 'Border to Coast Pensions Partnership' comprised a range of different sized funds, and it was easier to envisage the Pension Fund having genuine influence in the operation of that pool.

9 Another factor was that 'Border to Coast Pensions Partnership' had declared within its initial principles that it would ensure its internal investment team would operate from a single location. This should ensure better exchange of information within that team and there would be only one location needing to obtain approval from the Financial Conduct Authority. Conversely, the 'Northern Funds' group declared that it would continue to operate internal management from a number of separate locations.

Advice from Pension Fund Advisers

10 The Pension Fund's advisers being; Philip Williams and PSolve were consulted over the relative merits of the Border to Coast Pensions Partnership and the Northern Funds Group.

11 Philip Williams stated that it would be reasonable for the Pension Fund to join the Border to Coast Pensions Partnership, preferring this to the Northern Funds group, which is dominated by three large funds as although the Northern Funds group's proposed governance structure allows for equal representation by each member fund, in practice the Durham Fund might be seen as a "junior" member.

12 PSolve also confirmed that if the Pension Fund joined the Border to Coast Pensions Partnership this should not impact on the Pension Fund's ability to achieve its long-term investment objectives.

Decision

13 The Corporate Director Resources met with the Chair and Vice Chair on 2 February 2016 and agreed that based on the research and advice received, the Pension Fund should advise the Government that it is minded to join the Border to Coast Pensions Partnership by signing up to the Partnership's joint submission.

14 The Pensions Manager then sent a brief note on behalf of the Corporate Director Resources to advise the Government of the Pension Fund's decision on pooling – the note is enclosed as Appendix A. The more detailed Border to Coast Pensions Partnership's joint submission to Government is enclosed as Appendix B.

Next steps

15 Officers will continue to work with colleagues in the Border to Coast Pensions Partnership to further develop pooling proposals. Significant future milestones, taken from the Border to Coast Pensions Partnership submission document, are as follows:

- *19 February 2016 Deadline for initial proposal*
- 15 July 2016 Deadline for detailed proposal
- September 2016 Governance structure agreed
- October 2016 Agreement on audit and risk considerations
- November 2016 Agreement on legal structure
- December 2016 Agreement on specifics of vehicle structure
- June 2017 Formation of internal investment management operation
- December 2017 Full regulatory approval of internal investment management function
- December 2017 Asset transition planning complete
- April 2018 Commencement of asset transition to BCPP pool
- December 2018 Full implementation of listed assets
- Within 15 years Completion of transfer of unlisted assets

Recommendation

16 Members are asked to note the report and that further progress will be reported at subsequent Committee meetings.

Contact: Nick Orton Tel: 03000 269798

Appendix A

Department for Communities and Local Government
By Email to LGPSReform@communities.gsi.gov.uk
15 February 2016

Dear Mr Jones

Local Government Pension Scheme: Investment Reform Criteria and Guidance

I am writing to set out Durham County Council's proposal in its role as administering authority to the Durham County Council Pension Fund in connection with the Government's requirements on investment reform to the Local Government Pension Scheme (LGPS).

I can confirm the following:

Durham County Council is committed to the process of pooled investment with other LGPS Funds, and has been actively involved in discussions with other LGPS Funds and groups of Funds. After considering the options available, Durham County Council proposes to form part of the Border to Coast Pensions Partnership which, subject to Government approval, will comprise the following LGPS Funds:

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

Durham County Council is a signatory to a more detailed joint submission from the Border to Coast Pensions Partnership which sets out in more detail the guiding principles and proposed structure of the pooling arrangement.

Yours sincerely

[redacted]

Nick Orton
Pensions Manager
Durham County Council

APPENDIX B

Border to Coast Pension Partnership (BCPP)

Initial Proposal to Pool LGPS Assets

19th February 2016

INTRODUCTION

1. We, the administering authorities for the following Local Government Pension Scheme (LGPS) Funds, are pleased to have the opportunity to submit to the Department for Communities and Local Government (DCLG) a joint pooling proposal: "*Border to Coast Pensions Partnership*" (BCPP) for your consideration:-

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

2. The BCPP collaboration encompasses 13 Funds with combined assets of £36bn (fund valuations at 31st March 2015).

3. We believe there is an efficiency ceiling for the number of funds within the BCPP pool. The pool needs to be large enough to reach the Government's target for scale, but larger numbers of participant Funds will inevitably lead to more complex governance arrangements. With these two factors in mind we believe the optimum number of funds to be in the range of ten to fourteen.

4. Whilst the purpose of the BCPP pool is for the collective pooling and subsequent management of all partner Funds' investment assets, the assets are held to fund the future benefits of a combined LGPS membership of 905,995, representing 2,166 employers (values as at 31st March 2015). In this regard, it can be stated that the partner Funds have a fiduciary duty to their members.

5. This submission represents BCPP's joint initial response to the request for pooling proposals to address the criteria as set out in DCLG's "*Local Government Pension Scheme: Investment Reform Criteria and Guidance".* The intention of this submission is to set out an initial, high level proposal that demonstrates how the BCPP pool proposes to achieve the overarching aims of maintaining investment performance whilst achieving cost savings. The proposal meets the Government's other specified criteria (scale, governance, and how to build capacity to invest in infrastructure investment).

6. The proposal is for a multi asset pool formed on the basis of "like-minded" ethos and beliefs, which have been outlined in our guiding principles (Appendix 1).

7. We look forward to working more closely with Government in the next phase to expand and enhance our final proposal for submission by 15 July 2016.

HOW BCPP PROPOSE TO MEET THE CRITERIA

A. Scale
B. Strong governance and Decision Making
C. Cost efficiency and value for money
D. Improved capacity to invest in infrastructure

A. SCALE

8. Whilst there are differences in the partner Funds' choice of managers, there is a great deal of similarity with regard to asset choice, investment styles and risk appetite.

9. The 13 partner Funds of BCPP have a combined asset base of £36bn (valuations as at 31st March 2015). The intention is that the vast majority of the assets will be managed and monitored from the initial formation by the BCPP pool and that going forward all new investments will be acquired by suitably regulated, professionally qualified and experienced staff within the BCPP pool on behalf of the partner Funds. Costs will be shared equitably between the partner Funds with both a fixed allocation to cover entity/structure running costs and a variable element representing costs relating to the choices of asset class and the investment process used.

10. It should be stated that certain assets will remain outside of the BCPP pool: some on a run off basis such as directly held property and private equity investments and others, such as cash, held for operational/cash flow reasons.

B. STRONG GOVERNANCE AND DECISION MAKING

11. The proposal is for a multi asset pool formed on the basis of "like-minded" beliefs which have been outlined in our guiding principles (Appendix 1). The intention is to refine and expand these over the next phase of the proposal design process.

12. Core to our "like-minded" belief structures are:-

- One Fund, one vote, regardless of Fund size.

- Asset allocation strategy remains a decision for each Fund. This is necessary to enable Funds to demonstrate that they are exercising their democratic and fiduciary duty.

- The BCPP pool's role is to independently and professionally deliver these asset allocation choices. However, all partner Funds accept that if savings are to be achieved, changes will be required through the rationalisation and standardisation of processes and the selection and appointment of external managers.

- There will be a clear segregation of duties between those undertaken by the partner Funds and those performed by employees of the BCPP pool. This will ensure both that the fiduciary duty and democratic responsibility of the partner Funds can be maintained, whilst achieving the cost benefits and expanded professionalisation of the investment functions through scale.

- The BCPP pool should have a strong corporate governance philosophy, focused on the delivery of long term value through active corporate engagement, the rationale being that this aligns directly with ensuring the partner Funds exercise their fiduciary duty in the best interests of their members and employers. BCPP believes that this is most effectively and efficiently achieved through leveraging the scale of the combined LGPS through collaborations such as the Local Authority Pension Fund Forum (LAPFF). BCPP has both elected member and officer representatives on the LAPFF Executive.

- As a public body representing the financial interests of 905,995 members, BCPP will aim for the highest standards of corporate governance. Amongst other objectives, this includes seeking FCA registration for the internally managed operation within the BCPP pool. To confirm our understanding, BCPP pool legal advice is currently being procured that FCA registration will be required for the BCPP pool to invest on behalf of all Funds within the BCPP pool. Additionally, going forward, this will enable BCPP to meet the Government's requirement that internally managed services can be evaluated alongside externally managed operations.

- Effective management of costs and performance requires timely, consistent and accurate data to enable the operation of effective analysis and benchmarking. All the partner Funds are currently in the process of evaluating their data, including the use of the CEM benchmarking services.

    - Internally: all data on costs and performance will be openly available to all partner Funds, thus encouraging best practice.

    - Externally: Tyne and Wear has been one of the leading Funds in total cost reporting, especially in the alternative asset class space. This experience and expertise will be shared and developed to the benefit of all partner Funds.

- Cost and governance benefits can be most effectively achieved through collaborative working within the BCPP pool, across other LGPS pools, and at a national level. We can demonstrate this through the active engagement of the partner funds in this proposal, through officer engagement in cross fund working to formulate the Project POOL (the Hymans Robertson supported report from the LGPS funds), the jointly procured legal advice currently being undertaken and the representation on the Scheme Advisory Board (SAB) by elected members within the BCPP pool. In addition, several of the partner Funds are actively involved in the LGPS National Frameworks.

13. The broad principles of how the BCPP pool will operate have been agreed by the partners and are outlined below. While the governance structures and associated vehicles have not as yet been finalised, the required tiers of control and governance that will be required have. BCPP intends that it will incorporate the following activities:-

- ***Supervisory Entity:*** the purpose is to provide overall accountability by the partner Funds and act as the conduit back into the partner Funds' democratic and fiduciary processes. There will be equal representation from each Fund at this level. It will define key strategic objectives and operational governance of the BCPP pool, including any scheme of delegation to the Executive Body. Under the BCPP proposal, it could be either a joint committee or shareholder board. Whichever is finally chosen, it will have strong and well defined links back into the partner Funds, so as to ensure they can perform their fiduciary duty to members and employers and demonstrate a clear democratic link.

- ***Executive Body:*** in a formal Collective Investment Vehicle (CIV), this is the equivalent of the Operator. This body makes decisions on manager selection and the number and type of sub funds, legal vehicles and structures. Procurement routes as to the best means of acquiring and housing assets will also be decided. It will have to demonstrate due regard to the views of the supervisory entity. It will need to be a legal entity (e.g. a TECKAL company) in order to create a contractual relationship with suppliers and in the Authorised Contractual Scheme (ACS) sub fund model, it is the legal (but not beneficial) owner of some or all of the assets.

- There are currently three Funds who manage their assets internally (£12.2bn or 34% of the total BCPP assets). It is intended that the BCPP pool will consolidate and expand this capability. This will enable those Funds to take advantage of this well proven, low cost asset management option. As such, it is envisaged that the current teams will transfer into the pooled entity so they can operate independently on behalf of the partner Funds wishing to take advantage of this facility. As they will be undertaking a regulated function, FCA registration will be required. South Yorkshire Pension Fund (SYPF) is already FCA registered and BCPP intends to leverage their experience in this regard to achieve future BCPP pool compliance. BCPP believes that if the pool is to demonstrate the highest levels of governance, risk management and control and thus be able to demonstrate effective controls and independence to all Funds in the BCPP pool, it must achieve regulated status and transfer assets out of the current Fund structures to within the new BCPP pool.

- ***Sub funds*** – a range of asset class and/or risk based 'buckets' which Funds allocate monies to or purchase units from.

- Assets will be held in the most managerially and tax efficient way. To ensure all the asset allocation choices of the partner Funds can be serviced, this will require a range of legal structures (much the same as how most of our partner Funds operate now).

- Some or all of these sub funds may have an ACS wrapper for tax transparency purposes where the operator is the legal owner of the assets.

14. The detailed delivery options to fulfil these aims are currently being evaluated and appropriate legal advice is currently being procured. BCPP wishes to continue the collaborative work that has previously been undertaken across the LGPS and has therefore joined a joint procurement process that is currently underway across three pools. This advice will be used to inform our final detailed proposal to be submitted by 15th July 2016.

C. Cost Efficiency and Value for Money

15. It has not been possible in the time available to determine the total current investment management costs of BCPP on a consistent basis across the partner Funds for this consultation response. However, BCPP is committed to improving the reporting and consistency of cost data and is currently working with CEM Benchmarking to inform its assessment of investment costs and fees to be included in the consultation response of 15th July 2016.

16. Despite this, it has been possible to identify high level potential cost savings as well as additional costs that are expected to be incurred. It is important to note that, whilst BCPP will aim to make material cost savings in investment

management expenses, the overriding objective will be to enhance net investment returns.

17. It should be noted that expected savings in totality from BCPP will be lower than some pools due to the large existing allocation to low cost internal investment management, currently hosted by the East Riding, South Yorkshire and Teesside Funds. ***Cost savings are estimates based on a preliminary analysis of costs and are subject to change.***

18. The initial net cost savings, estimated on a prudent basis, expected to be generated by BCPP within ten years can be summarised as follows:

High Level Summarised Cost Savings	Annual cost saving	Timescale
Fee savings on externally managed assets	£12.3 – £12.9m	Within five years
Fee savings on Alternative investments	£18.0 – £36.0m	Within ten years
Less: Costs of BCPP pool	(£10.8m)	Immediate
Net cost savings	**£19.5 – £38.1m**	

19. The potential costs savings include a reduction in management fees through economies of scale in externally managed assets and fee savings in Alternatives through economies of scale, co-investments, and direct investments. It does not include the potential cost savings from moving externally managed assets (as in the first instance, this is a Fund asset allocation decision) to internal management or the potential savings in performance fees.

20. The costs of the BCPP pool are based on the expected annual cost of operating the pooling arrangements once fully established, and do not include setup costs or transition costs, which are expected to exceed cost savings in the short term.

Potential cost savings

21. The detailed cost analysis of BCPP's partner Funds' existing investment management arrangements shown in Appendices 2 – 3 shows that a wide range of investment management fees are being paid across the partner Funds. As a result, BCPP believes that there is significant scope to identify and implement costs savings where they do not have a detrimental impact on net investment returns.

22. It is important to assess the potential cost savings to BCPP on a consistent basis. Therefore, the savings shown in (18) above have been based on the assumption

that partner Funds' asset allocation and their split between active and passive management, and internal and external management, remain unchanged.

23. The main areas where the partner Funds within BCPP are expected to generate cost savings are:

A. *Achieving cost savings on external management of quoted equities and fixed income through increased scale and manager rationalisation*:-

- Based on a review of existing management fee structures and current market intelligence, this could result in a potential cost saving of circa 10bps p.a. for actively managed investments and circa 2 – 3bps p.a. for passively managed investments.

- As at 30th September 2015, BCPP's Funds had circa £11.2bn in active external investments and circa £5.7bn in passive external investments. This would equate to cost savings of circa £11.2m for actively managed assets and circa £1.1m – £1.7m p.a. for passively managed assets.

B. *Achieving cost savings in Alternative investments through the following:-*

- Reduction in management fees on pooled investments: these can be achieved either through greater economies of scale or earlier participation in fund raises. It is estimated that potential cost savings of circa 20 – 30bps p.a. could be achieved.

- Increased use of co-investments: it is intended that BCPP will increase the level of internal investment resources, enabling it to take advantage of co-investment opportunities, which typically have significantly lower or even zero management fees. It is estimated that potential cost savings of circa 50 – 100bps p.a. could be achieved.

- Increased use of direct investments: as with co-investments, the increased resources within BCPP will enable it to take advantage of direct investments where investment management fees would not be payable. It is estimated that potential cost savings of circa 75 – 100bps p.a. could be achieved.

- Reduction in the use of fund-of-funds: although BCPP will continue to use these vehicles where it is considered to be appropriate, it is likely that investment in fund-of-funds will decrease over time. It is estimated that cost savings of circa 25 – 100bps p.a. could be achieved.

- The total cost savings associated with Alternative investments are difficult to estimate with any degree of certainty as it will depend on each Fund's asset allocation decisions and investment opportunities as and when they arise. However, assuming an average allocation of 20% to Alternatives[1], average investment duration of ten years, and recycling of existing capital into new investments, this would result in new investments of circa £720m p.a. (based on a pool size of £36bn). Assuming a 25 – 50bps p.a. reduction in fees from a combination of the above, this could result in cost savings of circa £1.8m – £3.6m p.a. in the first year, increasing to circa £18.0m - £36.0m within ten years. It has been assumed that there will be no opportunities for cost savings within existing Alternative investments.

C. ***In addition to the above, further cost savings could be made from the transfer of active externally managed assets to active internal management:-***

- BCPP is expected to have a significant internal investment resource from the outset, drawn from existing internally managed funds[2] and will look to build this resource further over time. It is intended that BCPP will look to offer an internal management option for the majority of asset classes. This could result in a potential cost saving of circa 30bps p.a. for Equities and circa 20bps p.a. for Fixed Income, equating to circa £2m – £3m p.a. for each £1bn of assets transferred. It is envisaged that the balance between externally and internally managed assets will initially be determined at the Fund level, but over time will become a decision at the BCPP pool level.

24. The potential savings noted above should be treated with caution at this stage as further detailed analysis is required. However, initial estimates provide a broad indication of the areas where cost savings may be possible and the potential quantum.

25. It is important to note that these proposals for cost savings will only be implemented where it is believed that they can be achieved without having an adverse impact on investment returns.

Additional costs

26. There will be additional costs associated with the creation and operation of BCPP including:

- Initial setup and ongoing operational costs for the BCPP pool are expected to be significant. The Project POOL report[3] noted that the setup costs to date of the London CIV have been circa £2m – £2.5m, with only a limited number of

[1] The WM Local Authority Average allocation to Alternatives (including Property) as at 31 March 2015 was 18.8% – source: State Street Investment Analytics "UK Local Authority Annual Review 2014 – 15".
[2] Currently managing c. £12.2bn of internal assets.
[3] "Findings of Project POOL", January 2016.

sub-funds created, and ongoing costs estimated at circa 3bps p.a. Assuming a BCPP pool size of £36bn, this would result in costs to BCPP of circa £10.8m p.a. However, it should be noted that some of these costs could be offset by more favourable tax treatments in certain jurisdictions.

- Transition costs, including transaction costs and taxes, are also expected to be significant. The Project POOL report noted that Government could assist the pooling process by considering ways of mitigating transition costs, a view that BCPP would support but which cannot be assumed. In addition, there is a significant level of execution risk in the transition of assets on this scale which could erode a significant amount of the expected savings if it were done incorrectly.

- There will be additional costs at the outset of this project, including legal, tax, and professional fees in the commissioning of suitable advice. It should be noted that BCPP intends to collaborate with other pools on the commissioning of this advice in order to minimise any costs incurred.

- It is recognised that certain elements of costs currently within partner funds will reduce or disappear (e.g. global custodian fees), but other specific costs will not reduce (e.g. fund actuary fees). With regard to staffing costs incurred with funds predominantly externally managed, there may not be a reduction in staffing at fund level, given the other aspects of fund governance and managing the Pension Fund at individual fund level.

27. The costs noted above should be treated with caution as it has not been possible to accurately quantify them for the first consultation response. It is intended that a more detailed analysis will be presented in the second consultation response by 15th July 2016.

D. Improved Capacity To Invest in Infrastructure

28. The partner Funds currently hold allocations to infrastructure equating to 3.8%, which is already much higher than the LGPS average figure of 0.3%, as quoted in the Scheme Advisory Board 2013 Annual Report. Therefore, any opportunity to deliver enhanced capability and capacity to generate savings in this area, whilst retaining asset allocation choice at Fund level and investment discretion at the pool level, would be well received by BCPP. Within the partner Funds, the BCPP pool already invests in a wide range of infrastructure assets, both in the UK and Overseas.

29. BCPP also wants to reiterate its broad support for the findings from the Hymans coordinated Project POOL report, in that Infrastructure assets considered most

attractive to LGPS pension funds are the established infrastructure projects delivering steady inflation proof income streams (since pension fund payments increase with CPI inflation). Additionally, any assistance that central Government can give in helping to increase access to such asset pipelines would be welcomed.

30. Due to the scale and complexity involved in infrastructure investing, BCPP believes that collaborative work across pools is probably the most efficient means of achieving the Government's goals in this area. However, we believe that this would form only part of our infrastructure capability.

31. As such, we are currently engaged in discussions with other pools (both individually and as part of a national officer group) to investigate how this might be best delivered.

32. Whilst we recognise and support collaborative work in this area to help build capability and capacity to enable the LGPS to invest directly in infrastructure, this has to be achieved within a strong governance framework, which recognises that asset allocation to infrastructure is an individual Fund decision, while how each investment is delivered is a BCPP pool decision. To demonstrate due diligence and appropriate risk management, BCPP would need to retain investment discretion at all levels throughout the asset selection process.

POTENTIAL TIMETABLE FOR IMPLEMENTATION

33. This timetable represents an early indication of potential key dates. This is likely to be subject to significant change as the pooling proposal is developed

19th February 2016	Deadline for initial proposal
15th July 2016	Deadline for detailed proposal
September 2016	Governance structure agreed
October 2016	Agreement on audit and risk considerations
November 2016	Agreement on legal structure
December 2016	Agreement on specifics of vehicle structure
June 2017	Formation of internal investment management operation
December 2017	Full regulatory approval of internal investment management function
December 2017	Asset transition planning complete
April 2018	Commencement of asset transition to BCPP pool
December 2018	Full implementation of listed assets
Within 15 years	Completion of transfer of unlisted assets

SUMMARY

34. The 13 Funds comprising the BCPP (AUM £36bn) are pleased to have this opportunity to submit to Government our initial proposal for asset pooling. BCPP's proposal is for a multi asset, collaborative pooling proposition, based around a set of guiding principles which outline an ethos of "like-minded" investment, governance and risk beliefs where partner Funds retain strategic asset allocation but the BCPP pool manages and acquires all assets on their behalf.

35. We are proactively engaged within the BCPP pool, and engaged with external industry experts and with other pools in gathering the evidence required to enable us to finalise our detailed proposition. To help assist us in this, we look forward to having the opportunity to work more closely with central Government over the next five months to ensure that the final detailed proposal submitted from BCPP in July meets all participants requirements.

LIST OF APPENDICES

Appendix 1: BCPP Guiding Principles
Appendix 2: Investment Management Costs on a Weighted Average Basis
Appendix 3: Range of Investment Management Costs Across Existing Mandates

Bedfordshire Pension Fund	[redacted] Cllr. Doug McMurdo	Bedfordshire Pension Fund
Cumbria Pension Fund	[redacted] Cllr. Melvyn Worth	Cumbria County Council
Durham Pension Fund	[redacted] Cllr Andy Turner	Durham County Council
East Riding Pension Fund	[redacted] Cllr. John Holtby	ERPF East Riding Pension Fund
Lincolnshire Pension Fund	[redacted] Cllr. Mark Allan	Lincolnshire County Council Working for a better future
North Yorkshire Pension Fund	[redacted] Cllr. John Weighell	North Yorkshire County Council
Northumberland Pension Fund	[redacted] Cllr. Tony Reid	Northumberland Northumberland County Council
South Yorkshire Pension Fund	[redacted] Cllr. Sue Ellis	South Yorkshire Pensions Authority
South Yorkshire Passenger Transport Pension Fund	[redacted] Cllr. David Leech	Sheffield City Region Combined Authority
Surrey Pension Fund	[redacted] Cllr. Denise Le Gal	Surrey Pension Fund
Teesside Pension Fund	[redacted] Cllr. Steve Bloundele	
Tyne and Wear Pension Fund	[redacted] Cllr. Eileen Leask	Tyne and Wear Pension Fund Administered by South Tyneside Council
Warwickshire Pension Fund	[redacted] Cllr. Izzi Seccombe	Warwickshire pension fund

BCPP - GUIDING PRINCIPLES

The key factors that Funds have looked to address in any options presented to Members for their consideration are that:

Asset Strategy

1) Asset allocation strategy must be retained at an individual Fund level;

2) Partner Funds must have a complementary investment ethos and strategy; and

3) Any new structure should be capable of complementing a bespoke investment strategy for scheme employers with common characteristics.

Governance / Vehicle Structure

4) Any new structure must be compatible with the Government's aims of ability to achieve scale, improved governance, infrastructure and fee savings;

5) The partner Funds should retain a pivotal role in the governance of any pooled structure chosen;

6) Any new structures should offer opportunities for savings, while retaining or improving on the Fund's performance net of fees;

7) The possibility to expand internal investment management capability and increase resilience for all partner Funds;

8) The structure chosen must be sufficiently flexible to ensure assets are only transferred into any vehicle when/if it is cost effective, tax efficient and managerially effective to do so;

9) Any new structure must be scalable to ensure it is capable of achieving the Government's stated aims;

10) There must be a specific solution to infrastructure investing; and

11) The initial assumption should be that any vehicle used would be an ACS due to Government's current preference for this type of vehicle.

Sharing Resource Improving Resilience

12) Any solution provides additional resilience and capacity over and above current investment structures;

13) The solution will seek to provide internal shared resource to progress more proactive management of liability and cash flows;

14) Activities will be distributed across the partner organisations to improve performance through creating centres of excellence and improving resilience through larger teams; and

15) The shared investment team will be situated in a location with a consideration to access.

INVESTMENT MANAGEMENT COSTS ON A WEIGHTED AVERAGE BASIS (IN BPS)[4]

ASSET CLASS	INTERNAL		EXTERNAL	
	ACTIVE	PASSIVE	ACTIVE	PASSIVE
EQUITIES	2	2	37	7
UK	3	2	34	3
EUROPE	2	-	22	5
NORTH AMERICA	2	-	21	4
JAPAN	2	-	34	2
PACIFIC EX JAPAN	2	-	28	2
EMERGING MARKETS	2	-	55	18
GLOBAL	-	-	38	10
GLOBAL EX-UK	-	-	-	-
DEVELOPED EX-UK	-	-	-	-
FIXED INCOME	2	-	22	5
UK GOVERNMENT	4	-	19	7
UK INDEX-LINKED	1	-	18	4
UK CORPORATE	3	-	13	7
OVERSEAS GOVERNMENT	2	-	24	12
OVERSEAS CORPORATE	2	-	25	7
HIGH YIELD	1	-	45	-
EMERGING MARKETS	-	-	64	-
ABSOLUTE RETURN	-	-	36	-
ALTERNATIVES				
PROPERTY	22	-	28	-
OTHER ALTERNATIVES	-	-	69	-

4 The data analysis is based on the direct costs of investment management for either internal management or where there is an external investment mandate. It does not include the costs of pooled investments.

RANGE OF INVESTMENT MANAGEMENT COSTS ACROSS EXISTING MANDATES (IN BPS)[5]

ASSET CLASS	INTERNAL		EXTERNAL	
	ACTIVE	PASSIVE	ACTIVE	PASSIVE
EQUITIES				
UK	2 – 4	2	19 – 52	2 – 5
EUROPE	2 – 4	-	21 – 22	2 – 9
NORTH AMERICA	2	-	21	2 – 9
JAPAN	2	-	21 – 49	2 – 9
PACIFIC EX-JAPAN	2	-	21 – 45	2 – 9
EMERGING MARKETS	2	-	21 – 30	13 – 25
GLOBAL	-	-	20 – 75	6 – 20
FIXED INCOME				
UK GOVERNMENT	2 – 4	-	18 – 29	7
UK INDEX-LINKED	1 – 2	-	18	3 – 7
UK CORPORATE	2 – 4	-	10 – 30	8
OVERSEAS GOVERNMENT	1 – 4	-	15 – 30	12
OVERSEAS CORPORATE	2	-	19 – 30	7
HIGH YIELD	1	-	45	-
EMERGING MARKETS	-	-	64	13
ABSOLUTE RETURN	-	-	23 – 80	-
ALTERNATIVES				
PROPERTY	22	-	18 – 98	-
OTHER ALTERNATIVES	-	-	45 – 170	-

5 The data analysis is based on the direct costs of each fund's investment management arrangements.

Pension Fund Committee

03 March 2016

Procurement of Professional Services

Don McLure, Corporate Director Resources

Purpose of the Report

1 To provide Members with an update on the progress made to date regarding the procurement of professional services required for the Pension Fund.

Background

2 A report detailing a plan for the procurement of professional services was presented to Members at the Pension Fund Committee meeting on 10 September 2015. At that meeting Members:

i. agreed the use of a LGPS framework for the appointment of the:
    - Fund Actuary
    - Pension Fund Adviser
    - Global Custodian

ii. agreed to retain the services of Philip Williams until 31 March 2016 to advise and assist in the procurement and appointment of the actuary and new advisers;

iii. agreed to retain the services of P-Solve until 31 March 2016, at which time it was anticipated the new advisers would have been appointed;

iv. agreed to appoint one investment adviser initially then review the need for an additional independent adviser at a later stage;

v. noted the review of the viability to use a LGPS framework or establish a bespoke framework for a Transition Manager;

vi. agreed the extension of the contract with Europlan, to 30 November 2019, for the Investment Monitoring Service;

vii. agreed the direct award of a contract to KPMG as tax consultant to the Pension Fund through the Council's neutral vendor framework;

viii. noted the management of the Dynamic Asset Allocation mandate of the Fund will continue to be managed by BlackRock until new advisers have been appointed and the strategic asset allocation is reviewed; and

ix. agreed any procurement of specialist legal services be directly awarded via the LGPS Legal Services Framework.

Actuarial Services

3 This contract was awarded on 1 February 2016 to Aon Hewitt, the Fund's former actuary.

4 Four tenders (out of a possible five) were submitted via the LGPS Framework to provide actuarial services and have been evaluated internally by the administering authority's officers.

5 The contract end date is 31 December 2020; contracts awarded under the framework for actuarial services are not allowed to extend beyond this date.

Pension Fund Advisers

6 The LGPS framework has been used as a basis for the procurement of the prospective investment adviser.

7 Out of a possible six suppliers, five tenders were submitted and recently evaluated. A decision has been made, but the name of the successful bidder cannot be announced until the standstill period has ended on 7 March 2016.

8 The contract is expected to commence on 1 April 2016, as planned, for a period of 4 years.

Global Custodian

9 The process for the procurement of a global custodian is underway, facilitated by the use of the LGPS framework. The invitation to tender was issued on 26 February 2016 and it is anticipated that the contract will commence on 1 May 2016.

10 JPMorgan is the existing custodian and as they are included in the list of suppliers on the LGPS framework they will have the option to tender for this service provision.

11 In view of the requirement for all Pension Fund's to pool their assets and the Government's expectation that the Fund's investments will start transferring into the agreed Pool as early as April 2018, a shorter contract term of 2 years is expected to be awarded to the custodian (with a further option to extend the contract period if required). Once all of the Fund's investments are under the management of the Pool, it is anticipated that there will no longer be a need for the Fund to appoint its own custodian.

Transition Manager

12 The Pension Fund will look to appoint a transition manager in advance of any change to the Fund's investments. As previously agreed, the viability of using a LGPS framework or establishing a bespoke framework for the Pension Fund will be considered.

Tax Consultants

13 The current tax consultant is KPMG and as they are involved in on-going work on behalf of the Fund, it was agreed to directly award the new contract to KPMG through the Council's neutral vendor framework, NEPRO.

14 Although there was an original target date for completion of this procurement of September 2015, it is now expected to be completed in June 2016. KPMG are continuously providing tax advice and guidance to the Fund.

Dynamic Asset Allocation Mandate

15 BlackRock have been managing this mandate since January 2015. The terms of the agreement were that BlackRock would manage this part of the Fund's portfolio for a minimum of one year. The Fund's investment strategy and asset allocations are likely to be reviewed and revised on the advice of the soon to be appointed Fund adviser. It is therefore proposed that BlackRock retain the management of this part of the Fund's assets until the review of the Pension Fund's investment strategy is undertaken.

Specialist Legal Services

16 As previously agreed, future procurement of specialist legal services will be by direct award via the LGPS Legal Services Framework. There are currently no plans to procure legal services, however the Fund will be able to make same day appointments by using the framework, should the need arise.

Recommendations

17 Members are asked to note the progress made to date regarding the procurement of professional services required for the Pension Fund.

Background Papers

(a) Pension Fund Committee - 10 September 2015 - Procurement of Professional Services

Contact: Beverley White Tel: 03000 261900

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Pension Fund Committee

03 March 2016

Internal Audit Plan 2016/2017

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

Purpose of the report

1 To present the proposed Annual Audit Plan for 2016/17 for approval.

Background

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

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

2016/17 Audit Plan

4 The Audit Plan for 2016/17 has been developed following discussions between officers from Internal Audit and officers who have responsibility for the Pension Fund, using the strategic audit plan as the basis of the discussion. The proposed plan is shown in the table below.

Audit Title	Audit Type
Transfer payments into and out of the Pension Fund	Assurance
Accuracy, completeness and timeliness of benefit calculations	Assurance
Bank reconciliation	Assurance
Debt recovery arrangements	Assurance
National Fraud Initiative – Identification of potential error/fraud	Counter Fraud
Management time and ad hoc advice	Advice and Consultancy

Recommendation

5 Members are asked to approve the proposed audit plan for 2016/17.

Contact: Paul Monaghan Tel: 03000 269662

Appendix 1: Implications

Finance

The audit fee for the 2016/17 internal audit plan, to be delivered by the DCC Internal Audit Service, which is chargeable direct to the Pension Fund, remains the same as 2015/16 at £19,500.

Staffing

None

Risk

None

Equality and Diversity/Public Sector Equality Duty

None

Accommodation

None

Crime and disorder

None

Human rights

None

Consultation

None

Procurement

None

Disability Issues

None

Legal Implications

None

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