Pension Fund Committee

Date Thursday 8 December 2016

Time 10.00 am

Venue Committee Room 1A/1B, County Hall, Durham

Business

Part A

Items during which the Press and Public are welcome to attend. Members of the Public can ask questions with the Chairman's agreement.

1. Apologies for Absence
2. Declarations of interest (if any)
3. The Minutes of the Meeting held on 8 September 2016 (Pages 5 - 10)
4. Performance Measurement of Pension Fund Investments to 30 September 2016 (Pages 11 - 24)
5. Overall Value of Pension Fund Investments to 30 September 2016 (Pages 25 - 30)
6. Short Term Investments for the Period Ended 30 September 2016 (Pages 31 - 32)
7. Review of Pension Fund Risks November 2016 (Pages 33 - 36)
8. Investment Regulations (Pages 37 - 60)
9. Investment Pooling Update (Pages 61 - 62)
10. Local Pension Board Work Plan (Pages 63 - 68)
11. Feedback from Local Pension Board
12. Such other business as, in the opinion of the Chairman of the Meeting is of sufficient urgency to warrant consideration
13. 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)

14. The Minutes of the Meeting held on 8 September 2016 (Pages 69 - 76)
15. Report of the Pension Fund Adviser (Pages 77 - 108)
16. Actuarial Valuation Draft Results (Pages 109 - 114)
17. Durham Pension Fund Investment Strategy Review (Pages 115 - 118)
18. Report of Walter Scott (BNY Mellon) (Pages 119 - 126)
19. Report of Aberdeen Asset Management (Pages 127 - 150)
20. Report of Mondrian Investment Partners (Pages 151 - 156)
21. Report of AB (Pages 157 - 174)
22. Report of CBRE Global Investment Partners (Pages 175 - 188)
23. Report of Royal London (Pages 189 - 192)
24. Report of BlackRock (Pages 193 - 198)
25. Such other business as, in the opinion of the Chairman of the meeting, is of sufficient urgency to warrant consideration

Colette Longbottom
Head of Legal and Democratic Services

County Hall
Durham
30 November 2016

To: The Members of the Pension Fund Committee

County Council Members:
Councillors A Turner, W Stelling, J Alvey, C Carr, M Davinson, B Kellett, J Lethbridge, J Lindsay, J Maitland, N Martin and J Shuttleworth

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

Chief Executive	T Collins
Corporate Director Resources	J Hewitt
Head of Legal and Democratic Services	C Longbottom
Pensions Manager	N Orton

Independent Adviser
J Holden – Mercer

Investment Managers
Walter Scott (BNY Mellon)
Aberdeen Asset Management
Mondrian Investment Partners
AB
CBRE Global Investment Partners
Royal London
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 2, County Hall, Durham on **Thursday 8 September 2016 at 10.00 am**

Present:

Councillor A Turner (Chairman)

Members of the Committee:
Councillors M Davinson, B Kellett, J Lindsay and J Maitland

Admitted Bodies Representative
J Norton

Pensioner Representative
D Ford

Also Present:
County Council Advisers
P Darby – Interim Corporate Director Resources
N Orton – Pensions Manager
B White - Finance Manager – Pensions and Technical

Independent Advisers
J Holden – Mercer

Observers
Local Pension Board
Councillor F Tinsley

1 Apologies for Absence

Apologies for absence were received from Councillors J Alvey, C Carr, N Martin, J Lethbridge and W Stelling, and Darlington Borough Councillor S Harker.

2 Declarations of interest

Councillor Lindsay advised of members of his family who were beneficiary/contributing members of the Local Government Pension Scheme.

Councillor Davinson advised that he was a Member of Audit Committee.

3 Minutes

The Minutes of the meeting held on 6 June 2016 and the Special meeting held on 6 July 2016 were agreed as a correct record and were signed by the Chairman.

4 Overall Value of Pension Fund Investments to 30 June 2016

Consideration was given to the report of the Interim Corporate Director Resources which informed Members of the overall value of the Pension Fund as at 30 June 2016, and of any sums available to the Managers for further investment or amounts to be withdrawn from Managers (for copy see file of Minutes).

Following questions from Councillor Davinson about negative cash flow, Nick Orton advised that cash flow was affected by factors such as the changing ratio of pensioners to active members and a fall in employee levels, but should not be of great concern as long as it was carefully managed. The Actuarial Valuation had identified a need for an increase in employer contributions from April 2017 and this would have a positive impact on the Fund's cash flow position.

Councillor Davinson also asked about the potential impact of a larger than forecasted number of retirements in the employing authorities. Nick Orton advised that this should not materially affect the forecasted position because the cash flow forecast was for the whole Fund.

Councillor Davinson referred to re-balancing and expressed concern that funds were withdrawn from Managers who were performing well and given to poorer performing Managers to support the working cash balance of the Fund. The Member was informed that the fixed percentage approach to asset allocation would be examined as part of the review of the Investment Strategy.

Resolved:

That the information contained in the report be noted.

5 Performance Measurement of Pension Fund Investments to 30 June 2016

Consideration was given to the report of the Interim Corporate Director Resources which provided an overview of the performance of the Fund to 30 June 2016 (for copy see file of Minutes).

The report of JP Morgan, the Fund's custodian informed Members of the performance of the Fund Managers for the quarter, the year to date and since inception.

Resolved:

That the information contained in the report be noted.

6 Short Term Investments for the Period Ended 30 June 2016

Consideration was given to the report of the Interim Corporate Director Resources which provided the Committee with information on the performance of the Pension Fund's short term investments as at 30 June 2016 (for copy see file of Minutes).

Following a question from Councillor Davinson, Beverley White advised that Handelsbanken had been included in the report as the Fund had previously held surplus cash in the institution.

Resolved:

That the position at 30 June 2016 regarding the Pension Fund's short term investments where £19,395 net interest was earned in the three month period, be noted.

7 Statement of Accounts for the Year Ended 31 March 2016

Consideration was given to the report of the Interim Corporate Director Resources which presented the Pension Fund Statement of Accounts for the year ended 31 March 2016 and raised any significant issues (for copy see file of Minutes).

For information Beverley White advised of changes to the approval process with effect from 2018 which would require the Statement of Accounts to be signed off by Audit Committee before 31 July, instead of 30 September. In readiness for the changes Officers would aim to complete the process for the 2016/2017 Statement of Accounts in line with the revised deadlines.

Resolved:

That the contents of the report be noted.

8 Internal Audit Progress Report to 30 June 2016

Consideration was given to the report of the Chief Internal Auditor and Corporate Fraud Manager which outlined progress made in delivering the 2016/2017 internal audit plan relevant to the Pension Fund Committee (for copy see file of Minutes).

A summary of the approved audit plan, together with the status of each audit was set out in the report. The report also provided a summary of the final report issued in the first quarter for Payroll and Pensions, for which a substantial assurance opinion had been given.

Resolved:

That the work undertaken by Internal Audit during the period ending 30 June 2016 and the updated assurance on the control environment provided within the Pensions Service, be noted.

9 Feedback from Local Pension Board

Nick Orton advised that there was no written feedback or recommendations from Local Pension Board to report to the Committee. By way of information Members were advised that Councillor Hopgood had been elected chair of the Board for the ensuing year, the position being alternated annually between a scheme member and scheme employer representative.

Members were also informed of steps taken to fill the vacant position of scheme employer representative on the Board. All employers in the Fund had been invited to make application and it was hoped that the position would be filled within the next few weeks.

Resolved:

That the information given be noted.

10 Any Other Business

The Chairman agreed that in order to keep Members informed, consideration be given to the following items of business:-

a) **Actuarial Valuation**

Nick Orton advised that the draft results from the Actuarial Valuation were expected in the first week in October 2016. Employer contribution rates were expected to increase as returns on investments had not been as high as anticipated and the economic outlook at present was volatile. Employers would be notified of the amended contribution rates as soon as possible which would assist with their budget-setting processes.

Resolved:

That the information given be noted.

b) **Pooling of LGPS Investments**

Nick Orton reported that the Border to Coast Pensions Partnership had submitted its final submission to the Government by 15 July 2016 deadline, but until formal confirmation had been received from the Government, and Investment Regulations had been published, the Partnership was reluctant to formalise pooling arrangements. However, regular meetings of the Partnership were continuing in preparation, and the Member Steering Group was due to meet on 30 September 2016. Councillor Turner thanked Councillor Davinson for attending the Steering Group meetings on his and the Vice-Chair's behalf.

David Ford made reference to the timescales for implementation and was informed that unless the Government confirmed its commitment to pooling in the very near future it was unlikely that the deadlines set by the Government to have a fully regulated entity operational and ready to start the transition of assets by April 2018 could be achieved.

Following a question from Councillor Tinsley about investment in infrastructure, Councillor Davinson advised that in the submission to the Government the Partnership had included a statement that sufficient resources would be allocated on the basis of serving a combined ambition of up to 10% of the Partner Funds' asset holdings.

Resolved:

That the information given be noted and further developments be awaited.

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Pension Fund Committee
8 December 2016

Performance Measurement of Pension Fund Investments to 30 September 2016

John Hewitt, Corporate Director, Resources

Purpose of the Report

1 To provide an overview for Members of the performance of the Fund to 30 September 2016.

Background

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

(a) The Managers benchmarks.

(b) The total Fund performance, for the quarter to 30 September 2016, year to date and since inception.

(c) The Managers' performance in absolute and relative terms against the relevant benchmarks, for the quarter to 30 September 2016, year to date and since inception.

(d) A portfolio comparison for the quarter ended 30 September 2016 and for the period since inception.

Recommendation

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

Contact: Beverley White Tel: 03000 261900

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J.P.Morgan

Durham Quarterly Report

Report Package

Published 31-Oct-2016 11:11:35

Table of Contents

J.P.Morgan

Index and Benchmark Report - Monthly
Durham CC (UK005)
As at September 2016

Name	Month Return
Business Unit Indices	
Equities	
FT-All Share +3%	1.94
FTSE-Ftse All-Share (Gross)	1.70
FTSE-Ftse Aw Developed (Gross)	1.43
MSCI AC World Index (Gross) + 2.5%	1.69
MSCI AC World Index (Gross) + 3%	1.73
MSCI EM (Emerging Markets) (Net)	2.12
MSCI EM (Emerging Markets) (Net) + 2.5%	2.33
MSCI-Acwi (Gross)	1.49
MSCI-Em (Emerging Markets) (Gross) + 2.5%	2.36
MSCI-World (Gross)	1.40
Fixed Income	
British Gov Index Linked over 5 Yr + 0.5%	(0.80)
Cash And Cash Equivalent	
3 MONTH GBP LIBOR	0.03
3Month GBP Libor +4%	0.36
3Month libor in GBP plus 3%	0.28
GBP Zero Return Index	0.00
RPI + 5%	0.60
Retail Price Index (UK)	0.19

Executive Summary

Durham CC (UK005)
As of September 2016
Gross of Fee
Total Fund Composite (0UK00501)

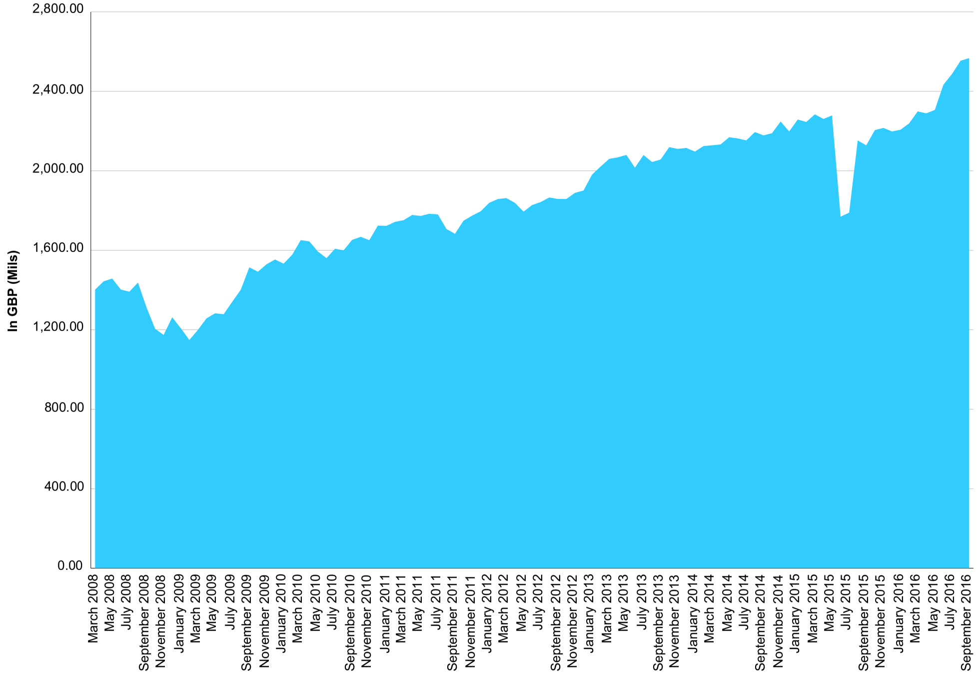
Market Value Overview

	In GBP (Mils)				
	September 2016	June 2016	March 2016	December 2015	September 2015
Market Value	2,567.52	2,433.49	2,299.09	2,198.32	2,128.44
Net Cash Flow	3.70	(16.48)	19.06	18.18	(15.44)
Net Income / Appreciation	130.33	150.88	81.72	51.69	374.58

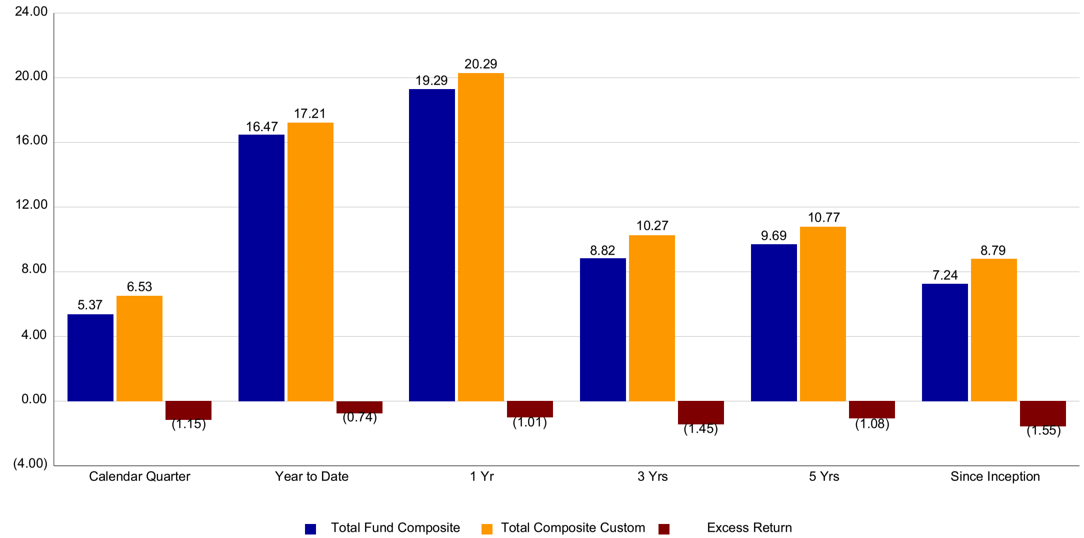
Performance Overview

	Performance (Annualised > 1 Year)					
	Calendar Quarter	Year to Date	1 Yr	3 Yrs	5 Yrs	Since Inception
Total Fund Composite	5.37	16.47	19.29	8.82	9.69	7.24
Total Composite Custom	6.53	17.21	20.29	10.27	10.77	8.79
Excess Return	(1.15)	(0.74)	(1.01)	(1.45)	(1.08)	(1.55)

Development of Market Value - Since Inception



Performance Returns



J.P.Morgan

Portfolio Comparison

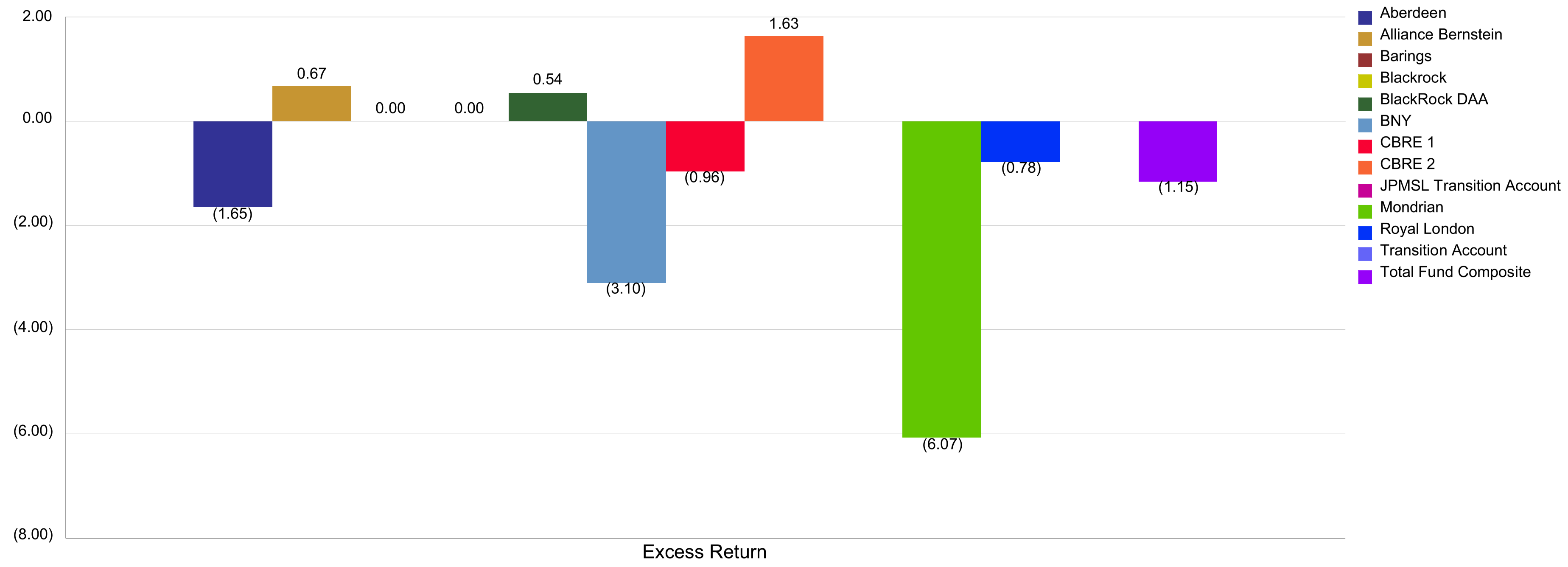
Durham CC (UK005)
As of September 2016
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Manager	Benchmark	Market Value (mils)	Weight	Trailing 3 Months Return	Benchmark Trailing 3 Months Return	Excess Returns	Current Contribution to Return
Aberdeen	MSCI-Acwi (Gross) + 3%	399.46	15.56	7.66	9.31	(1.65)	1.19
Alliance Bernstein	3 Month Libor in GBP +3% pa	354.99	13.83	1.52	0.85	0.67	0.21
Barings	Zero return - Historically 3 Month Libor in GBP +4% pa	0.11	0.00	0.00	0.00	0.00	0.00
Blackrock	Zero Return - Historically FTSE All Share (Gross) +3% pa	0.01	0.00	0.00	0.00	0.00	0.00
BlackRock DAA	3 Month Libor in GBP +3% pa	448.88	17.48	1.39	0.85	0.54	0.24
BNY	MSCI AC World Index (Gross) + 2.5%	404.28	15.75	6.07	9.17	(3.10)	0.96
CBRE 1	Headline RPI +5% pa (CBRE1)	175.45	6.83	0.95	1.92	(0.96)	0.07
CBRE 2	Headline RPI +5% pa (CBRE2)	36.75	1.43	3.55	1.92	1.63	0.05
JPMSL Transition Account	Not Applicable	0.00	0.00	0.00	-	-	0.00
Mondrian	MSCI EM (Emerging Markets) (Gross) + 2.5%	180.67	7.04	6.93	13.00	(6.07)	0.49
Royal London	FTSE index Linked more than 5 years +0.5% pa	566.91	22.08	10.27	11.05	(0.78)	2.27
Transition Account	Not Applicable	0.01	0.00	0.00	-	-	0.00
Total Fund Composite	**Total Composite Custom**	**2,567.52**	**100.00**	**5.37**	**6.53**	**(1.15)**	**5.37**

Portfolio Comparison

Durham CC (UK005)
As of September 2016
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Excess Returns - Trailing 3 Months



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Relative Performance
Durham CC (UK005)
For Period Ending September 2016
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Total Fund Composite (0UK00501)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
00047879	JPMSL Transition Account	218.76	0.00	0.00	0.00	0.00	0.00	-	(0.20)
	Not Applicable		-	-	-	-	-	-	-
	Excess Return		-	-	-	-	-	-	-
00047880	Blackrock	10,317.74	0.00	0.00	0.00	0.00	2.14	7.85	5.21
	Zero Return - Historically FTSE All Share (Gross) +3% pa		0.00	0.00	0.00	0.00	2.09	9.55	6.93
	Excess Return		0.00	0.00	0.00	0.00	0.05	(1.70)	(1.72)
00047881	Royal London	566,910,467.65	(0.63)	10.27	30.43	26.42	15.88	11.94	10.57
	FTSE index Linked more than 5 years +0.5% pa		(0.80)	11.05	31.73	27.53	16.53	12.35	10.73
	Excess Return		0.18	(0.78)	(1.30)	(1.11)	(0.65)	(0.41)	(0.15)
00047882	Alliance Bernstein	354,985,134.42	(0.23)	1.52	5.32	5.94	3.65	4.31	4.16
	3 Month Libor in GBP +3% pa		0.28	0.85	2.65	3.56	3.56	3.64	4.21
	Excess Return		(0.51)	0.67	2.67	2.38	0.09	0.67	(0.05)
00047884	Barings	106,941.85	0.00	0.00	0.00	0.00	4.54	5.72	6.36
	Zero return - Historically 3 Month Libor in GBP +4% pa		0.00	0.00	0.00	0.00	2.30	3.28	4.42
	Excess Return		0.00	0.00	0.00	0.00	2.24	2.44	1.94
00047885	CBRE 1	175,448,722.52	0.08	0.95	4.97	8.15	10.07	9.27	3.41
	Headline RPI +5% pa (CBRE1)		0.60	1.92	5.43	7.15	6.78	7.28	7.79
	Excess Return		(0.51)	(0.96)	(0.46)	1.01	3.30	1.99	(4.38)

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Relative Performance
Durham CC (UK005)
For Period Ending September 2016
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Total Fund Composite (0UK00501)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
00051183	CBRE 2	36,753,153.83	(0.54)	3.55	19.92	26.79	14.49	14.38	7.23
	Headline RPI +5% pa (CBRE2)		0.60	1.92	5.43	7.15	6.78	7.28	7.79
	Excess Return		(1.14)	1.63	14.49	19.65	7.72	7.10	(0.56)
00082265	Transition Account	11,302.07	0.00	0.00	0.00	0.00	0.00	-	3.34
	Not Applicable		-	-	-	-	-	-	-
	Excess Return		-	-	-	-	-	-	-
00301582	BlackRock DAA	448,875,168.85	(0.50)	1.39	0.72	2.87	-	-	0.77
	3 Month Libor in GBP +3% pa		0.28	0.85	2.90	4.06	-	-	4.21
	Excess Return		(0.78)	0.54	(2.18)	(1.20)	-	-	(3.44)
00301629	Mondrian	180,672,959.88	1.12	6.93	29.48	33.12	-	-	3.63
	MSCI EM (Emerging Markets) (Gross) + 2.5%		2.36	13.00	34.42	40.01	-	-	10.53
	Excess Return		(1.23)	(6.07)	(4.94)	(6.89)	-	-	(6.90)
00301630	Aberdeen	399,461,961.49	0.88	7.66	25.16	32.94	-	-	8.44
	MSCI-Acwi (Gross) + 3%		1.73	9.31	24.23	35.25	-	-	17.73
	Excess Return		(0.85)	(1.65)	0.92	(2.31)	-	-	(9.29)
00301691	BNY	404,283,676.24	1.10	6.07	21.45	31.56	-	-	16.11
	MSCI AC World Index (Gross) + 2.5%		1.69	9.17	23.78	34.59	-	-	17.39
	Excess Return		(0.59)	(3.10)	(2.33)	(3.03)	-	-	(1.29)

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Relative Performance
Durham CC (UK005)
For Period Ending September 2016
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Total Fund Composite (0UK00501)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
0UK00501	Total Fund Composite	2,567,520,025.30	0.12	5.37	16.47	19.29	8.82	9.69	7.24
	Total Composite Custom		0.65	6.53	17.21	20.29	10.27	10.77	8.79
	Excess Return		(0.53)	(1.15)	(0.74)	(1.01)	(1.45)	(1.08)	(1.55)

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Disclaimer

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

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Pension Fund Committee

8 December 2016

Overall Value of Pension Fund Investments to 30 September 2016

John Hewitt, Corporate Director Resources

Purpose of the Report

1. To inform Members of the overall value of the Pension Fund as at 30 September 2016 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 30 September 2016 was £2 billion, 567.52 million.

3. The value of the Fund as at 30 June 2016 was £2 billion, 433.49 million. The value of the fund therefore increased by £134.03 million in the second quarter of 2016/17.

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. This table includes only cash held by Durham County Council Pension Fund Bank Account. It does not include

cash balances of £33.14 million held by the Managers as at 30 September 2016.

7. In determining the amount of cash to be allocated to Managers as at the quarter ended 30 September 2016, 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 2016/17

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

10. This table shows that the Pension Fund is estimated to be in deficit in each quarter of the forecast period. 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 retained by Managers. When this is taken into account, the Pension Fund is forecasted to have positive cash flow, over the period to 31 December 2017.

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 2016/17 is estimated to be £28.0m, which is based on the actual figures to 31 March 2016. This income is profiled to be received in the same pattern as then, that is:

  - Quarter ended 30 June 2016 17%
  - Quarter ended 30 September 2016 33%
  - Quarter ended 31 December 2016 24%
  - Quarter ended 31 March 2017 26%

- Estimated increases in contributions in line with the ongoing actuarial valuation are included. In light of the current valuation, future contributions will continue to be reviewed. Comprehensive information is still required from the actuary, in order to produce a complete picture.

- ‘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.

- Payroll Paysheets (payments to pensioners) are forecast to increase by £0.200m 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 15 months. It should be noted that the cash balance is forecast to continue to decline over this period, with the cash balance forecast to reach a low level (below £10 million balance at bank) by April 2017. It is not recommended that any cash is returned from Fund Managers at this point. Daily cash balances will continue to be reviewed over the period. Longer term forecasts will continue to be refined, to take into account new information as it becomes available, including detail of the exact additional contributions due from employers as a consequence of the current actuarial valuation, and the timing of those contributions.

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. Following advice from Mercer, there was a rebalancing of the Fund for the period to 30 September 2016. This took place on 21 November.

16. There will be no rebalancing of the Fund this quarter.

Recommendation

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

Contact:	**Beverley White**	**Tel:**	**03000 261900**

Appendix 1

Actual Cash Flow – for the period 1 October 2015 to 30 September 2016

Quarter Ended	**31.12.15**		**31.03.16**		**30.06.16**		**30.09.16**	
	Estimate	**Actual**	**Estimate**	**Actual**	**Estimate**	**Actual**	**Estimate**	**Actual**
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	£	£	£	£	£	£	£	£
Income								
Contributions - DCC	16,800,000	16,560,615	16,800,000	16,612,581	16,650,000	16,929,884	16,650,000	16,749,648
Contributions - Other	7,500,000	8,003,099	7,500,000	7,784,726	7,800,000	8,801,635	8,200,000	8,408,381
Unfunded pensions recharges	1,130,000	880,714	1,130,000	1,228,584	1,120,000	824,479	1,120,000	1,533,757
Transfer Values	500,000	385,463	500,000	1,705,991	500,000	147,693	500,000	286,031
Other income	250,000	978,590	250,000	4,627,867	1,000,000	2,781,473	2,000,000	2,624,429
Funds recovered from Managers	0	0	0	0	0	17,000,000	10,000,000	10,198,377
Interest on short term investments	60,000	57,612	45,000	34,466	20,000	19,395	30,000	24,827
Total Income	26,240,000	26,866,093	26,225,000	31,994,215	27,090,000	46,504,559	38,500,000	39,825,450
Expenditure								
Payroll Paysheets	22,400,000	22,697,764	22,500,000	22,796,589	22,700,000	22,981,433	22,800,000	23,211,460
Payables Paysheets (incl. Managers' fees)	7,000,000	14,000,853	10,000,000	9,428,192	10,000,000	12,117,843	11,000,000	11,170,473
Funds transferred to Managers	15,000,000	18,182,168	9,555,000	19,055,000	2,760,000	520,000	4,920,000	13,895,000
Other Expenditure	0	0	0	3,960,143	0	12,394	0	1,115
Total Expenditure	44,400,000	54,880,785	42,055,000	55,239,924	35,460,000	35,631,670	38,720,000	48,278,048
Surplus / (-) Deficit	-18,160,000	-28,014,692	-15,830,000	-23,245,709	-8,370,000	10,872,889	-220,000	-8,452,598
Balance at Bank (opening)		69,590,581		41,575,889		17,904,838		27,554,055
Balance at Bank (closing)		41,575,889		17,904,838		27,554,055		18,648,105

Appendix 2

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

Quarter Ended	**31.12.16**	**31.03.17**	**30.06.17**	**30.09.17**	**31.12.17**
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£	**£**	**£**	**£**	**£**
Income					
Contributions - DCC	16,650,000	16,650,000	19,100,000	19,100,000	19,100,000
Contributions - Other	8,200,000	8,200,000	9,410,000	9,410,000	9,410,000
Unfunded pensions recharges	1,120,000	1,120,000	1,131,200	1,131,200	1,131,200
Transfer Values	500,000	500,000	500,000	500,000	500,000
Other income	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Funds recovered from Managers	30,000,000	0	0	0	0
Interest on short term investments	15,000	10,000	5,000	5,000	0
Total Income	58,485,000	28,480,000	32,146,200	32,146,200	32,141,200
Expenditure					
Payroll Paysheets	23,400,000	23,600,000	23,800,000	24,000,000	24,200,000
Payables Paysheets (incl. Managers' fees)	11,000,000	11,000,000	11,000,000	11,000,000	11,000,000
Funds transferred to Managers	30,000,000	0	0	0	0
Other Expenditure	0	0	0	0	0
Total Expenditure	64,400,000	34,600,000	34,800,000	35,000,000	35,200,000
Surplus / (-) Deficit	-5,915,000	-6,120,000	-2,653,800	-2,853,800	-3,058,800
Balance at Bank (opening)	18,648,105	12,733,105	6,613,105	3,959,305	1,105,505
Balance at Bank (closing)	12,733,105	6,613,105	3,959,305	1,105,505	-1,953,295
Dividends Received by Managers	6,720,000	7,280,000	4,760,000	9,240,000	6,720,000
Net Cash Flow Position	805,000	1,160,000	2,106,200	6,386,200	3,661,200

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Pension Fund Committee

8 December 2016

Short Term Investments for the period ended 30 September 2016

John Hewitt, 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 30 September 2016.

Short Term Investments

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

3. The Pension Fund's surplus cash holding as at 30 September 2016 was £18.648 million which was held in the institutions listed in the table below alongside their credit rating at 30 September 2016.

Financial Institution	**Short-term Rating**	**Amount Invested £m**
Bank Deposit Accounts		
Handelsbanken	F1+	0.000
Santander UK Plc	F1	4.449
Barclays	F1	0.000
Fixed Term Deposits		
Barclays	F1	0.000
Bank of Scotland	F1	5.392
Nationwide Building Society	F1	2.247
Goldman Sachs	F1	3.146
Royal Bank of Scotland	F2	1.798
Local Authorities	N/A	0.000
National Savings & Investments	N/A	0.090
Money Market Funds	N/A	1.526
Total		**18.648**

4. The following table provides information on the net interest earned during the three month period to 30 September 2016, 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	£24,827
Average Return Earned	0.31%
Average Bank of England base rate	0.34%
Average Daily Balance of Investments	£34.731m

Recommendation

5. Members are asked to note the position at 30 September 2016 regarding the Pension Fund's short term investments where £24,827 net interest was earned in the three month period.

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee

8th December 2016

Review of Pension Fund Risks November 2016

John Hewitt, Corporate Director Resources

1. Purpose of the Report

The purpose of this report is to update Members on the revisions to the Pension Fund Risk Register following a review by the Risk Officer in November 2016. The updated Risk Register is attached.

2. Background

The strategic risks of the Service are reviewed every six months, in line with the Council's risk management strategy. New risks are identified, and some of the existing risks may be amended, or where they are no longer a risk, removed from the register.

4. Emerging Risks/ Risk update

5. Recommendation

Members are requested to approve the risk register attached in appendix 1.

Contact: Teresa Morgan Tel: 03000 269666

Appendix 1

Factor and Description		Financial impact	Likelihood
5	Critical	Over £15m	Highly Probable – more than once a year
4	Major	£5m - £15m	Probable – once a year
3	Moderate	£1m - £5m	Possible – every 1-3 years
2	Minor	£0.5m - £1m	Unlikely – every 3-5 years
1	Insignificant	£0.5m	Remote – over 5 years

Ref	Investment Risk	Potential Impact	Financial impact score	Like-lihood	Gross Score	Mitigating controls	Financial impact score	Like-lihood	Net score
1	Investment strategy is not reviewed and updated and implemented in a timely manner, leading to movements out of line with the market.	1. Investments made are not in line with Fund strategy leading to exposure to risk / damage. 2. Portfolios may not yield the required / expected returns of the Fund. 3. Increased requirement for non-investment income to support fund (i.e. via contributions)	5	3	15	1. Investment advisor reviews strategy 2. Investment strategy is approved by the Pension Fund Committee. 3. Local pension board reviews activity of pension committee.	3	2	6
2	Investments are not held in accordance with the Fund's Statement of Investment Principles.	1. Exposure to investment risks is not mitigated leading to financial loss 2. Reputation loss 3. Non-compliance with legislation 4. Increased requirement for non-investment income to support fund (i.e. via contributions)	5	3	15	1. Investment advisors monitor Fund compliance with SIP. 2. SIP is updated on an annual basis. 3. Rebalancing strategy in place on a quarterly basis to move back in line with SIP.	3	2	6
3	The investment managers' activities are not properly managed and monitored.	1. Portfolios may be managed ineffectively by the managers leading to reduction in assets of the Fund. 2. Inappropriate investments are made by the managers resulting in damage to the Fund's reputation 3. Increased requirement for non-investment income to support fund (i.e. via contributions)	5	3	15	1. Investment Advisor reports to Pension Fund Committee on a quarterly basis. 2. Quarterly performance figures of the IMs are reported and challenged at the Pension Fund Committee. 3. Investment advisor reviews the portfolios of the investment managers on a regular basis. 4. Local pension board reviews activity of pension committee.	5	1	5

Ref	Investment Risk	Potential Impact	Financial impact score	Like-lihood	Gross Score	Mitigating controls	Financial impact score	Like-lihood	Net score
4	In-house short term loans made through the Council's Treasury Management functions, are not properly managed and monitored	1. Short term loans do not yield required returns. 2. Non-compliance with Treasury Management Strategy, leading to losses	5	2	10	1. Use of external Treasury Management advisors 2. Treasury management strategy in place. 3. Spreading of investments across different counter parties reduces risk of defaults being material.	3	1	3
5	Appropriate reports are not taken to the Pension Fund Committee where adverse performance is noted.	1. Investment manager continue s making poor investments leading to reduction in market value of assets of the Fund 2. Pension Fund Committee is not provided with sufficient detail to challenge poor performance 3. Lack of monitoring could lead to adverse performance not being identified 4. Increased requirement for non-investment income to support fund (i.e. via contributions)	4	3	12	1. Investment advisor reviews the portfolios of the investment managers on a regular basis 2. Quarterly performance figures of the IMs are reported and challenged at the Pension Fund Committee 3. Investment Advisor reports to Pension Fund Committee on a quarterly basis 4. Follow-up with IMs of poor performance, leading to action taken where appropriate.	3	1	6
6	Exceptions and outstanding contributions may not be identified and raised with the participating employer in a timely manner, and the council may be exposed to the risk of irrecoverable debtors	1. Fund runs into deficit 2. Irrecoverable debts for the Fund	3	3	9	1. Reconciliation performed between bank account, cashbook and GL but only as part of annual accounts prep. 2. Annual returns reconciled to monthly payments.	3	2	6
7	Cash transfer values out are not calculated correctly	1. Transfer values are incorrect leading to incorrect payment to another fund 2. Reputational damage 3. Misstated financial records	2	3	6	1. Calculation of transfers out must be checked by an authoriser 2. Vouchers passed for payment must be authorised by a senior member of the Pensions Team 3. Reliance on UPM software and 3rd party provider updates to standing data	2	2	4
8	That financial instability in an admissions body or any other employer may lead to them failing and leaving an unfunded deficit in the scheme	1. Where guarantees are in place, that funding requirements fall on the guarantor (including DCC) 2. Where guarantees are not in place, shortfall is payable by the fund as a whole	4	3	12	1. Use of bonds and guarantees 2. Pension Fund Committee discuss admittance of admitted bodies where there is a choice (e.g. non-TUPE ones covered by LGPS Regulations) 3. Actuary calculation of the bond options (with DCC making final choice)	3	2	6

Ref	Investment Risk	Potential Impact	Financial impact score	Like-lihood	Gross Score	Mitigating controls	Financial impact score	Like-lihood	Net score
9	Information sent to the actuary may be incomplete or inaccurate	1. Actuary statement may be incorrect leading to incorrect contributions from admitted bodies.2. Incorrect contributions could result in funding levels decreasing for the Fund. 3. Shortfalls due to inaccurate information will have to be recouped in future years.	3	3	9	1. Actuary gets annual reports and checks the figures against these.	3	2	6
10	That financial problems in an admissions body may result in shorter-term failures to comply with contribution requirements.	1. Failure to comply with contribution requirements extending to a more significant failure to pay	2	3	6	1. As part of the process for the actuary's triennial valuation, bodies have opportunity to discuss funding.	2	2	4
11	That longer-term funding strategies (e.g. contribution rates / recovery periods) may not be appropriate to the individual situations of specific different member bodies.	1. Enhanced likelihood of bodies being in financial difficulty whilst carrying a large pensions deficit. 2. Increased likelihood of the fund, or guarantor bodies, having to cover a funding shortfall.	4	3	12	1. Ongoing liaison with the actuary.	4	2	8
12	Inability to effectively contribute to the establishment of the Border to Coast Pensions Partnership (BCPP)due to lack of resources.	1. Lack of input and direct control. Unable to invest in the way DCC wants to. 2. Reputational damage. Adverse financial impact.	5	3	15	1. Regular liaison with senior officers and pension fund committee. 2. Established communication with other pool contributors at Officer and Member level. 3. Investment advisors also involved.	5	2	10
13	Data may not be held in a secure environment, leading to risks of data loss or corruption.	1. Data breach leading to national press exposure 2. Compensation / fines payable because of data breach 3. Reputational damage 4. Investigation by Information Commission	2	3	6	1. Access levels in system set up for individual users. 2. Wider DCC policies over data security.	2	2	4

	Emerging risks								
	Introduction of BCPP								

Pension Fund Committee

8 December 2016

Investment Regulations

John Hewitt, Corporate Director Resources

Purpose of the Report

1. To inform Members of the publication of the Local Government Pension Scheme (LGPS) (Management and Investment of Funds) Regulations 2016, associated guidance relating to setting an investment strategy unde these regulations and their impact on the management of the Pension Fund.

Background

2. In November 2015 the Government issued a consultation on proposed new regulations to replace the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("the 2009 Regulations").

3. The consultation ended on 19 February 2016 and the Local Government Pension Scheme (LGPS) (Management and Investment of Funds) Regulations 2016 ("the 2016 Regulations") were published on 23 September 2016, following the issue on 15 September 2016 of Guidance from the Department for Communities and Local Government (DCLG) on Preparing and Maintaining an Investment Strategy Statement required by the 2016 Regulations ("the Guidance").

4. The 2016 Regulations came into force from 1 November 2016. Copies of the 2016 Regualtions and the Guidance are included as Appendices to this report.

The 2016 Regulations

5. The 2016 Regulations are significantly different in approach to the 2009 Regulations. They contain fewer restrictions or limitations on what an LGPS Fund can invest in and, for example, expressly confirm that 'derivatives' count as 'investments'. However there is a requirement for Funds to comply with the Guidance published by the Secretary of State, and there is now a power for the Secretary of State to intervene in the investment functions of an administering authority.

6. The regulations remove the restrictions in the 2009 Regulations that set limits on the percentage of an LGPS Fund that could be invested in a particular investment or type of investment. This removal is needed to allow LGPS pooling to take place, and also reflects a move to investing within a 'prudent

framework' approach. The Guidance explains this approach, and consequent need for a Secretary of State power of intervention as follows:

> "In relaxing the regulatory framework for scheme investments, administering authorities will be expected to make their investment decisions within a prudential framework with less central prescription. It is important therefore that the regulations include a safeguard to ensure that this less prescriptive approach is used appropriately and in the best long term interests of scheme beneficiaries and taxpayers."

7. The regulations require the Council (as an administering authority), after taking 'proper advice', to formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State. The Council is required to consult with "such persons as it considers appropriate" on the content of the proposed investment strategy, which must be published no later than 1 April 2017. The investment strategy must be reviewed and revised (if necessary) from time to time but at least every 3 years. The investment strategy must include:

   - a requirement to invest fund money in a wide variety of investments;
   - the Council's assessment of the suitability of particular investments and types of investments
   - the Council's approach to risk, including the ways in which risks are to be assessed and managed;
   - the Council's approach to pooling investments, including the use of collective investment vehicles and shared services;
   - the Council's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
   - the Council's policy on the exercise of the rights (including voting rights) attaching to investments.

8. The 2016 Regulations give the Secretary of State the power to issue directions to administering authorities if they fail to act in accordance with the Guidance issued on formulating an investment strategy, and allow the Secretary of State to direct the authority to:
   - make specified changes to its investment strategy statement;
   - invest some or all of the fund's assets in a specified manner;
   - permit the Secretary of State (or a nominee) to exercise the authority's investment functions for a specific period or as long as is considered appropriate; and/or
   - comply with instructions issued by the Secretary of State / nominee in relation to the exercise of its investment functions.

9. These directions may only be issued after consultation with the administering authority and after consideration of all reasonably available evidence regarding the authority's actual or proposed exercise of its investment functions.

Investment Strategy Statement Guidance

10. The Guidance issued on preparing and maintaining an Investment Strategy Statement incudes summaries of how administering authorities should comply with each of the following requirements set out in the 2016 Regulations:

11. *Investment of money in a wide variety of investments.*
In formulating and maintaining their policy on diversification, administering authorities:-
- Must take proper advice
- Must set out clearly the balance between different types of investments
- Must identify the risks associated with their overall investment strategy
- Must periodically review their policy to mitigate against any such risks

12. *The suitability of particular investments and types of investments.*
In formulating their policy on the suitability of particular investments and types of investments, administering authorities:-
- Must take proper advice
- Should ensure that their policy on asset allocation is compatible with achieving their locally determined solvency target
- Must periodically review the suitability of their investment portfolio to ensure that returns, risk and volatility are all appropriately managed and are consistent with their overall investment strategy

13. *The approach to risk, including the ways in which risks are to be measured and managed.*
In formulating their policy on their approach to risk, administering authorities:-
- Must take proper advice
- Should clearly state their appetite for risk
- Should be aware of the risks that may impact on their overall funding and investment strategies
- Should take measures to counter those risks
- Should periodically review the assumptions on which their investment strategy is based
- Should formulate contingency plans to limit the impact of risks that might materialise

14. *The approach to pooling investments, including the use of collective investment vehicles and shared services*
In formulating and maintaining their approach to pooling investment, including the use of collective investment vehicles and shared services, an administering authority must
- Confirm the pooling arrangements meet the criteria set out in the November 2015 investment reform and criteria guidance, or have been otherwise agreed by the Government
- Notify the Scheme Advisory Board and the Secretary of State of any changes which result in failure to meet the criteria
- Set out the proportion of assets that will be invested through pooling

- Set out the structure and governance arrangements of the pool and the mechanisms by which the authority can hold the pool to account
- Set out the services that will be shared or jointly procured
- Provide a summary of assets that the authority has determined are not suitable for investing through the pool along with its rationale for doing so, and how this demonstrates value for money;
- Regularly review any assets, and no less than every 3 years, that the authority has previously determined should be held outside of the pool, ensuring this continues to demonstrate value for money
- Submit an annual report on the progress of asset transfers to the Scheme Advisory Board

15. *How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments*

    In formulating and maintaining their policy on social, environmental and coporate governance factors, an administering authority:-
    - Must take proper advice
    - Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors
    - Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments
    - Should not pursue policies that are contrary to UK foreign policy or UK defence policy
    - Should explain their approach to social investments

16. *The exercise of rights (including voting rights) attaching to investments*

    In formulating their policy on the exercise of rights, administering authorities:-
    - Must give reasons in their Investment Strategy Statement for not adopting a policy of exercising rights, including voting rights, attaching to investments
    - Should, where appropriate, explain their policy on stewardship with reference to the Stewardship Code
    - Should strongly encourage their fund managers, if any, to vote their company shares in line with their policy under Regulation 7(2)(f)
    - May wish to appoint an independent proxy voting agent to exercise their proxy voting and monitor the voting activity of the managers, if any, and for reports on voting activity to be submitted annually to the administering authority
    - Should publish a report of voting activity as part of their pension fund annual report under Regulation 57 of the 2013 Regulations

17. Much of the information set out in paragraph 11 to 13 is already included within the Statement of Investment Principles – the document required under the 2009 Regulations which is being replaced by the Investment Strategy Statement. The information set out in paragragh 14 will be covered by an

explanation of the Council's decision to pool investments through the Border to Coast Pensions Partnership. The 2016 Regulations are the mechanism by which the Government is facilitating LGPS investment pooling and is also enforcing pooling, by requiring each LGPS Fund to demonstrate how it will meet the Government's pooling objectives.

18. The information set out in paragraph 15 relates to how social, environmental and corporate governance issues are taken into account in the investment process. This section generated a significant response to the Government's consultation – 98% of the 23,516 responses the Government received were from members of the public and these were primarily in response to the proposal that in formulating their policy on the extent to which non-financial factors should be taken into account when making investment decisions, administering authorities should not pursue policies that run contrary to UK foreign policy. In practice, this restriction is unlikely to have any impact on the Pension Fund's investment approach.

19. The information set out in paragraph 16 relates to how the Pension Fund exercises its voting rights as an investor. This section will require the Council to have a more explicit approach to responsible investment issues, including a likelihood that the Council as administering authority to the Pension Fund should sign up to the UK Stewardship Code.

Next steps

20. The Council as administering authority to the Pension Fund needs to prepare consult on and publish an Investment Strategy Statement by 1 April 2017. For practical reasons it is reasonable for the consultation (with Pension Fund employers) to take place as the same time as the consultation on changes to the Funding Strategy Statement that is likely to be needed as part of the implementation of the current actuarial valuation.

21. The Council is required to take 'proper advice' in formulating the Investment Strategy Statement. The Investment Advisor and, if appropriate, the Pension Fund Actuary will be consulted during the preparation of the Investment Strategy Statement. Also, the section on investment pooling (as set out in pargraph 14) will be drawn up in consultation with other partner LGPS Funds in the Border to Coast Pensions Partnership.

Recommendation

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

Contact:	**Nick Orton**	**Tel:**	**03000 269798**

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STATUTORY INSTRUMENTS

2016 No. 946

PUBLIC SERVICE PENSIONS, ENGLAND AND WALES

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

Made - - - -	*21st September 2016*
Laid before Parliament	*23rd September 2016*
Coming into force - -	*1st November 2016*

The Secretary of State makes these Regulations in exercise of the powers conferred by sections 1(1) and 3(1) to (4) of, and Schedule 3 to, the Public Service Pensions Act 2013(**a**).

In accordance with section 21(1) of that Act, the Secretary of State has consulted such persons and the representatives of such persons as appeared to the Secretary of State to be likely to be affected by these Regulations.

In accordance with section 3(5) of that Act, these Regulations are made with the consent of the Treasury.

Citation, commencement and extent

1.—(1) These Regulations may be cited as the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

(2) These Regulations come into force on 1st November 2016.

(3) These Regulations extend to England and Wales.

Interpretation

2.—(1) In these Regulations—

"the 2000 Act" means the Financial Services and Markets Act 2000(**b**);

"the 2013 Regulations" means the Local Government Pension Scheme Regulations 2013(**c**);

"the Transitional Regulations" means the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014(**d**);

"authority" means an administering authority listed in Part 1 of Schedule 3 to the 2013 Regulations;

"fund money" means money that is or should be in a pension fund maintained by an authority;

(**a**) 2013 c. 25; see section 2 of and Schedule 2 to that Act as to how the power is exercisable by the Secretary of State.
(**b**) 2000 c. 8.
(**c**) S.I. 2013/2356.
(**d**) S.I. 2014/525.

"proper advice" means the advice of a person whom the authority reasonably considers to be qualified by their ability in and practical experience of financial matters;

"the Scheme" means the scheme established by the 2013 Regulations.

(2) Any restrictions imposed by these Regulations apply to authorities which have the power within section 1 of the Localism Act 2011(**a**) (local authority's general power of competence) or section 5A(1) of the Fire and Rescue Services Act 2004(**b**) in the exercise of those powers.

(3) Any authority which does not have the powers mentioned in paragraph (2) has, by virtue of these Regulations the power to do anything authorised or required by these Regulations.

Investment

3.—(1) In these Regulations "investment" includes—

(a) a contract entered into in the course of dealing in financial futures, traded options or derivatives;

(b) a contribution to a limited partnership in an unquoted securities investment;

(c) a contract of insurance if it is a contract of a relevant class, and is entered into with a person within paragraph (2) for whom entering into the contract constitutes the carrying on of a regulated activity within the meaning of section 22 of the 2000 Act(**c**).

(2) The persons within this paragraph are—

(a) a person who has permission under Part 4A of the 2000 Act (permission to carry on regulated activities)(**d**) to effect or carry out contracts of insurance of a relevant class;

(b) an EEA firm of the kind mentioned in paragraph 5(d) of Schedule 3 to the 2000 Act (EEA passport rights), which has permission under paragraph 15 of that Schedule(**e**) to effect or carry out contracts of insurance of a relevant class; and

(c) a person who does not fall within sub-paragraph (a) or (b) whose head office is in an EEA state other than the United Kingdom, and who is permitted by the law of that state to effect or carry out contracts of insurance of a relevant class.

(3) A contract of insurance is of a relevant class for the purposes of paragraphs (1)(c) and (2) if it is—

(a) a contract of insurance on human life or a contract to pay an annuity on human life where the benefits are wholly or partly to be determined by reference to the value of, or income from, property of any description (whether or not specified in the contract) or by reference to fluctuations in, or an index of, the value of property of any description (whether or not so specified); or

(b) a contract to manage the investments of pension funds, whether or not combined with a contract of insurance covering either conservation of capital or payment of minimum interest.

(4) For the purposes of this regulation—

"limited partnership" has the meaning given in the Limited Partnerships Act 1907(**f**);

"recognised stock exchange" has the same meaning as in section 1005 of the Income Tax Act 2007(**g**);

"traded option" means an option quoted on a recognised stock exchange; and

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(**a**) 2011 c. 20.
(**b**) 2004 c. 21; section 5A was inserted by section 9(1) of the Localism Act 2011.
(**c**) Section 22 was amended by section 7(1) of the Financial Services Act 2012 (c. 21).
(**d**) Part 4A of the 2000 Act was inserted by section 11(2) of the Financial Services Act 2012.
(**e**) Paragraph 15 was amended by S.I. 2003/2066, 2007/3253, 2012/1906,2013/1881 and 2015/575.
(**f**) 1907 c. 24.
(**g**) 2007 c. 3; section 1005 was substituted by the Finance Act 2007 (c. 11) and amended by the Taxation (International and Other Provisions) Act 2010 (c. 8).

"unquoted securities investment partnership" means a partnership for investing in securities which are not quoted on a recognised stock exchange when the partnership buys them.

Management of a pension fund

4.—(1) An authority must credit to its pension fund(**a**), in addition to any sum otherwise required to be credited by virtue of the 2013 Regulations or the Transitional Regulations—

(a) the amounts payable by it or payable to it under regulations 15(3)(b), 67 and 68 of the 2013 Regulations (employer's contributions and further payments);

(b) all amounts received under regulation 69(1)(a) of the 2013 Regulations (member contributions);

(c) all income arising from investment of the fund; and

(d) all capital money deriving from such investment.

(2) In the case of an authority which maintains more than one pension fund, as respects sums which relate to specific members, the references in this regulation to the authority's pension fund is to the fund which is the appropriate fund(**b**) for the member in question in accordance with the 2013 Regulations.

(3) Interest under regulation 71 of the 2013 Regulations (interest on late payments by Scheme employers) must be credited to the pension fund to which the overdue payment is due.

(4) An authority must pay any benefits to which any person is entitled by virtue of the 2013 Regulations or the Transitional Regulations from its pension fund.

(5) Any costs, charges and expenses incurred administering a pension fund may be paid from it except for charges prescribed by regulations made under sections 23, 24 or 41 of the Welfare Reform and Pensions Act 1999(**c**) (charges in relation to pension sharing costs).

Restriction on power to borrow

5.—(1) Except as provided in this regulation, an authority must not borrow money where the borrowing is liable to be repaid out of its pension fund.

(2) Subject to paragraph (3), an authority may borrow by way of temporary loan or overdraft which is liable to be repaid out of its pension fund, any sums which it may require for the purpose of—

(a) paying benefits due under the Scheme; or

(b) to meet investment commitments arising from the implementation of a decision by it to change the balance between different types of investment.

(3) An authority may only borrow money under paragraph (2) if, at the time of the borrowing, the authority reasonably believes that the sum borrowed and interest charged in respect of that sum can be repaid out of its pension fund within 90 days of the borrowing.

Separate bank account

6.—(1) An authority must hold in a separate account kept by it with a deposit-taker all fund money.

(2) "Deposit-taker" for the purposes of paragraph (1) means—

(a) a person who has permission under Part 4A of the 2000 Act (permission to carry on regulated activities) to carry on the activities specified by article 5 of the Financial

(**a**) An administering authority is required to maintain a pension fund by regulation 53(1) of, and paragraph 1 of Schedule 3 to the 2013 Regulations.

(**b**) See regulation 53(2) of and Part 2 of Schedule 3 to the 2013 Regulations for provisions relating to an administering authority becoming the "appropriate administering authority" in relation to a person.

(**c**) 1999 c. 30; see S.I. 2000/1047 and S.I. 2000/1049.

Services and Markets Act 2000 (Regulated Activities) Order 2001 (accepting deposits)(**a**);

(b) an EEA firm of the kind mentioned in paragraph 5(b)(**b**) of Schedule 3 to the 2000 Act (EEA passport rights) which has permission under paragraph 15 of that Schedule(**c**) to accept deposits;

(c) the Bank of England or the central bank of an EEA state other than the United Kingdom; or

(d) the National Savings Bank.

(3) An authority must secure that the deposit-taker may not exercise a right of set-off in relation to the account referred to in paragraph (1) in respect of any other account held by the authority or any party connected to the authority.

Investment strategy statement

7.—(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State.

(2) The authority's investment strategy must include—

(a) a requirement to invest fund money in a wide variety of investments;

(b) the authority's assessment of the suitability of particular investments and types of investments;

(c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;

(d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;

(e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and

(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

(3) The authority's investment strategy must set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment.

(4) The authority's investment strategy may not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007(**d**).

(5) The authority must consult such persons as it considers appropriate as to the proposed contents of its investment strategy.

(6) The authority must publish a statement of its investment strategy formulated under paragraph (1) and the first such statement must be published no later than 1st April 2017.

(7) The authority must review and if necessary revise its investment strategy from time to time, and at least every 3 years, and publish a statement of any revisions.

(8) The authority must invest, in accordance with its investment strategy, any fund money that is not needed immediately to make payments from the fund.

(**a**) S.I. 2001/544; article 5 was amended by S.I. 2002/682.
(**b**) Sub-paragraph (b) of paragraph (5) was substituted by S.I. 2006/3211 and then further substituted by S.I. 2013/3115.
(**c**) Paragraph 15 has been amended by S.I. 2003/2066, S.I. 2007/3253, 2012/1906, 2013/1881 and 2015/575.
(**d**) 2007 c. 28; section 212 was amended by the Police Reform and Social Responsibility Act 2011 (c. 13) and there are prospective amendments made by the Local Audit and Accountability Act 2014 (c. 2).

Directions by the Secretary of State

8.—(1) This regulation applies in relation to an authority's investment functions under these Regulations and the 2013 Regulations if the Secretary of State is satisfied that the authority is failing to act in accordance with guidance issued under regulation 7(1).

(2) Where this regulation applies in relation to an authority the Secretary of State may make a direction requiring all or any of the following—

(a) that the authority make such changes to its investment strategy under regulation 7 as the Secretary of State considers appropriate, within such period of time as is specified in the direction;

(b) that the authority invest such assets or descriptions of assets as are specified in the direction in such manner as is specified in the direction;

(c) that the investment functions of the authority under these Regulations and under the 2013 Regulations be exercised by the Secretary of State or a person nominated by the Secretary of State for a period specified in the direction or for so long as the Secretary of State considers appropriate;

(d) that the authority comply with any instructions of the Secretary of State or the Secretary of State's nominee in relation to the exercise of its investment functions under these Regulations and the 2013 Regulations and provide such assistance as the Secretary of State or the Secretary of State's nominee may require for the purpose of exercising those functions.

(3) Before making a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must consult the authority concerned.

(4) In reaching a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must have regard to such evidence of the manner in which the authority is discharging or proposes to discharge its investment functions as is reasonably available including—

(a) any report from an actuary appointed under section 13(4) of the Public Service Pensions Act 2013 (employer contributions in funded schemes) or by the authority under regulation 62 of the 2013 Regulations (actuarial valuations of pension funds);

(b) any report from the local pension board appointed by the authority or from the Local Government Pension Scheme Advisory Board(**a**);

(c) any representations made by the authority in response to the consultation under paragraph (3);

(d) any other evidence that the Secretary of State regards as relevant to whether the authority has been complying with these Regulations or acting in accordance with guidance issued under regulation 7(1).

(5) If the Secretary of State is of the opinion that additional information is required to enable a decision to be taken whether to issue a direction under this regulation, or as to what any direction should contain, the Secretary of State may carry out such inquiries as the Secretary of State considers appropriate to obtain that information.

(6) An authority must comply with any request from the Secretary of State intended to facilitate the obtaining of information under paragraph (5).

Investment managers

9.—(1) Instead of managing and investing fund money itself, an authority may appoint one or more investment managers to manage and invest fund money, or any part of such money, on its behalf.

(**a**) The Local Government Pension Scheme Advisory Board is established by regulation 110 of the 2013 Regulations (which was inserted by S.I. 2015/57).

(2) But the authority may only appoint an investment manager if the authority complies with paragraphs (3) and (4).

(3) The authority must reasonably believe that the investment manager's ability in and practical experience of financial matters make that investment manager suitably qualified to make investment decisions for it.

(4) The authority must take proper advice in relation to the appointment and the terms on which the appointment is made.

Investments under section 11(1) of the Trustee Investments Act 1961

10. An authority to which section 11 of the Trustee Investments Act 1961(**a**) applies may invest, without any restriction as to quantity, in any investment made in accordance with a scheme under section 11(1) of that Act (which enables the Treasury to approve schemes for local authorities to invest in collectively).

Consequential amendments

11.—(1) The 2013 Regulations are amended as follows.

(2) For regulation 57(1)(i) (pension fund annual report) substitute—

"(i) the current version of the investment strategy under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016;".

(3) For regulation 58(4)(b) (funding strategy statement) substitute—

"(b) the current version of the investment strategy under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.".

(4) For regulation 69(2)(b) (payment by Scheme employers to administering authorities) substitute—

"(b) paragraph (1)(c) does not apply where the cost of the administration of the fund is paid out of the fund under regulation 4(5) (management of a pension fund) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.".

Revocations and transitional provision

12.—(1) The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009(**b**) and the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013(**c**) are revoked.

(2) Regulations 11 (investment policy and investment of pension fund money), 12 (statement of investment principles), 14 (restrictions on investments), 15 (requirements for increased limits) of and Schedule 1 (table of limits on investments) to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 continue to have effect in relation to an authority until the date when that authority first publishes its investment strategy statement under regulation 7.

(3) For the period starting on 1st November 2016 and ending on whichever is the earlier of the date the authority publishes its investment strategy statement under regulation 7, or 31st March 2017, regulation 7 applies to an authority only to the extent necessary to enable that authority to formulate and publish its investment strategy statement.

(**a**) 1961 c. 62; section 11(1) was amended by the London Government Act 1963 (c. 4) and the Local Government Act 1985 (c. 51).
(**b**) S.I. 2009/3093.
(**c**) S.I. 2013/410.

We consent to the making of these Regulations

David Evennett
Guto Bebb
Two of the Lords Commissioners of Her Majesty's Treasury

Signed by authority of the Secretary of State for Communities and Local Government

Marcus Jones
Parliamentary Under Secretary of State
21st September 2016 Department for Communities and Local Government

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations make provision in relation to the management and investment of pension funds held by administering authorities required to maintain such funds by the Local Government Pension Scheme Regulations 2013.

Regulations 2 and 3 respectively contain definitions and make provision that the restrictions imposed by the regulations bind authorities which have the "power of general competence" in the exercise of that power.

Regulations 4, 5 and 6 respectively set out which payments must be made into and out of the pension fund, restrict powers of borrowing and require fund money to be in a separate account.

Regulations 7 and 8 respectively require authorities to publish an investment strategy in accordance with guidance issued by the Secretary of State and enable the Secretary of State to issue a direction to any authority which fails to comply with its statutory obligations as regards its pension fund or which fails to act in accordance with the guidance.

Regulations 9 and 10 respectively allow for the appointment of investment managers and investment in Treasury approved schemes.

Regulations 11 and 12 respectively make consequential amendments relating to the investment strategy published under regulation 7 and transitional provisions.

No impact assessment has been produced because it has no impact on business, charities or voluntary bodies and minimal impact on the public sector.

Printed and published in the UK by The Stationery Office Limited under the authority and superintendence of Carol Tullo, Controller of Her Majesty's Stationery Office and Queen's Printer of Acts of Parliament.

£6.00

UK2016092116 09/2016 19585

http://www.legislation.gov.uk/id/uksi/2016/946

ISBN 978-0-11-114997-3

Department for Communities and Local Government

Local Government Pension Scheme

Guidance on Preparing and Maintaining an Investment Strategy Statement

September 2016
Department for Communities and Local Government

This document/publication is also available on our website at www.gov.uk/dclg

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September 2016

ISBN: 978-1-4098-4897-4

Foreword

This guidance has been prepared to assist administering authorities in the local government pension scheme in England and Wales with the formulation, publication and maintenance of their Investment Strategy Statement.

New investment regulationsto be introduced later this year will include a requirement for administering authorities to publish new Investment Strategy Statements by 1st April 2017 in accordance with the guidance set out below.

Administering authorities will be required to act in accordance with the provisions in this guidance when Regulation 7 of the Local Govenrment Pension Scheme (Management and Investment of Funds) Regulations 2016 comes into force.

Part 1

Introduction and background

This guidance has been prepared to assist administering authorities in the formulation, publication and maintenance of their Investment Strategy Statement required by Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. Unless otherwise stated, references to regulations are to the 2016 Regulations.

An administering authority's duty to prepare, maintain and review their Funding Strategy Statement under Regulation 58 of the Local Government Pension Scheme Regulations 2013 ("the 2013 Regulations") is unaffected.

Statutory background

Regulation 7(1) requires an administering authority to formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State.

The Investment Strategy Statement required by Regulation 7 must include:-

a) A requirement to invest money in a wide variety of investments;
b) The authority's assessment of the suitability of particular investments and types of investments;
c) The authority's approach to risk, including the ways in which risks are to be measured and managed;
d) The authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
e) The authority's policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and

f) The authority's policy on the exercise of rights (including voting rights) attaching to investments.

The Investment Strategy Statement must also set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment. This, in effect, replaces Schedule 1 to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("the 2009 Regulations").

Under Regulation 7(6) and (7), the statements must be published by 1st April 2017 and then kept under review and revised from time to time and at least every three years. Under transitional arrangements, key elements of the 2009 Regulations relating to investment policies will continue in force until such time that the Investment Strategy Statement under Regulation 7 is published.

Directions by the Secretary of State

Regulation 8 enables the Secretary of State to issue a Direction if he is satisfied that an administering authority is failing to act in accordance with this guidance.

One of the main aims of the new investment regulations is to transfer investment decisions and their consideration more fully to administering authorities within a new prudential framework. Administering authorities will therefore be responsible for setting their policy on asset allocation, risk and diversity, amongst other things. In relaxing the regulatory framework for scheme investments, administering authorities will be expected to make their investment decisions within a prudential framework with less central prescription. It is important therefore that the regulations include a safeguard to ensure that this less prescriptive approach is used appropriately and in the best long term interests of scheme beneficiaries and taxpayers.

Where there is evidence to suggest that an authority is acting unreasonably, it may be appropriate for the Secretary of State to consider intervention, but only where this is justified and where the relevant parties have been consulted. Regulation 8 includes a number of safeguards, including full consultation with the relevant authority, to ensure that the proposed power is used appropriately, proportionately and only where justified by the evidence.

The Secretary of State's power of intervention does not interfere with the duty of elected members under general public law principles to make investment decisions in the best long-term interest of scheme beneficiaries and taxpayers.

The power of Direction can be used in all or any of the following ways:-

a) To require an administering authority to make changes to its investment strategy in a given timescale;
b) To require an administering authority to invest assets as specified in the Direction;
c) To transfer the investment functions of an administering authority to the Secretary of State or a person nominated by the Secretary of State; and

d) To require an administering authority to comply with any instructions from either the Secretary of State or the appointed person in circumstances when the investment function has been transferred.

Before issuing any Direction, the Secretary of State must consult the administering authority concerned and before reaching a decision, must have regard to all relevant evidence including reports under section 13(4) of the Public Service Pensions Act 2013; reports from the scheme advisory board or from the relevant local pension board and any representations made in response to the consultation with the relevant administering authority. The Secretary of State also has the power to commission any other evidence or additional information that is considered necessary.

General

Part 2 below sets out the guidance for authorities under each of the component parts of Regulation 7. The specific requirements under each heading are shown at the end of each sub section in a text box and in bold type. It is important to note, however, that these lists are not exclusive and that administering authorities are also required to comply with general public law principles and act within a prudential framework.

Part 2

Regulation 7(2) (a) - Investment of money in a wide variety of investments

A properly diversified portfolio of assets should include a range of asset classes to help reduce overall portfolio risk. If a single investment class is not performing well, performance should be balanced by other investments which are doing better at that time. A diversified portfolio also helps to reduce volatility.

For example, the range of asset classes could include UK and overseas equities of different sectors; bonds with varying maturity; alternative investment assets such as private equity, infrastructure and cash instruments.

However, this guidance does not purport to prescribe the specific asset classes over which fund monies must be diversified. This remains a decision for individual administering authorities to make. Administering authorities are expected to be able to demonstrate that those responsible for making investment decisions have taken and acted on proper advice and that diversification decisions have been taken in the best long term interest of scheme beneficiaries.

An administering authority must also be able to demonstrate that they review their diversification policy from time to time to ensure that their overall target return is not put at risk.

Summary of requirements

In formulating and maintaining their policy on diversification, administering authorities:-

- **Must take proper advice**

- **Must set out clearly the balance between different types of investments**
- **Must identify the risks associated with their overall investment strategy**
- **Must periodically review their policy to mitigate against any such risks**

Regulation 7(2)(b) - The suitability of particular investments and types of investments

The concept of suitability is a critical test for whether or not a particular investment should be made. Although individual investment classes will have varying degrees of suitability in the context of an authority's funding and investment strategies, the overall aim of the fund must be to consider suitability against the need to meet pension obligations as they fall due.

Assessing the suitability of different investment classes involves a number of factors including, for example, performance benchmarks, appetite for risk, policy on non-financial factors and perhaps most importantly, funding strategy.

What constitutes suitability is clearly a matter for individual administering authorities to consider and decide in the light of their own funding and investment strategies, but there is a clear expectation that the assessment should be broadly consistent across all administering authorities. Administering authorities must therefore take and act on proper advice in assessing the suitability of their investment portfolio and give full details of that assessment in their Investment Strategy Statement.

Summary of requirements

In formulating their policy on the suitability of particular investments and types of investments, administering authorities:-

- **Must take proper advice**
- **Should ensure that their policy on asset allocation is compatible with achieving their locally determined solvency target**
- **Must periodically review the suitability of their investment portfolio to ensure that returns, risk and volatility are all appropriately managed and are consistent with their overall investment strategy**

Regulation 7(2)(c) - The approach to risk, including the ways in which risks are to be measured and managed

The appetite of individual administering authorities for taking risk when making investment decisions can only be a matter for local consideration and determination, subject to the aim and purpose of a pension fund to maximise the returns from investment returns within reasonable risk parameters.

Some of the key risks that an administering authority needs to be aware include financial, demographic or regulatory risks. A detailed summary of the identification of all risks and counter-measures to mitigate against them is beyond the scope of this guidance, but administering authorities will continue to have regard to the requirement under Regulation

58 of the 2013 Regulations to have regard to the "Guidance on Preparing and Maintaining a Funding Strategy Statement" published by CIPFA, which includes a section on risk and the ways in which it can be measured and managed.

Summary of requirements

In formulating their policy on their approach to risk, administering authorities:-

- **Must take proper advice**
- **Should clearly state their appetite for risk**
- **Should be aware of the risks that may impact on their overall funding and investment strategies**
- **Should take measures to counter those risks**
- **Should periodically review the assumptions on which their investment strategy is based**
- **Should formulate contingency plans to limit the impact of risks that might materialise**

Regulation 7(2)(d) - The approach to pooling investments, including the use of collective investment vehicles and shared services

All authorities must commit to a suitable pool to achieve benefits of scale. Administering authorities must confirm their chosen investment pool meets the investment reform and criteria published in November 2015, or to the extent that it does not, that Government is content for it to continue.

Any change which results in failure to meet the criteria must be reported by the administering authority, and/or pool, to the Secretary of State and the Scheme Advisory Board.

Administering authorities should set out their approach to pooling and the proportion of assets that will be invested through the pool. This must include the structure and governance arrangements and the mechanisms by which the authority can hold the pool to account.

Where services are shared or jointly procured, the administering authority must set out the rationale underpinning this and the cost benefit of this, as opposed to pooling.

Administering authorities must provide a summary of assets to be held outside of the pool, and how this demonstrates value for money. The progress of asset transfers to the pool must be reported annually against implementation plans and submitted to the Scheme Advisory Board. Where it is possible that an asset could be pooled in the future, authorities must set a date for review and criteria that need to be met before the asset will be pooled.

Summary of requirements

In formulating and maintaining their approach to pooling investment, including the use of collective investment vehicles and shared services, an administering authority must:-

- **Confirm the pooling arrangements meet the criteria set out in the November 2015 investment reform and criteria guidance at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479925/criteria_and_guidance_for_investment_reform.pdf, or have been otherwise agreed by the Government**
- **Notify the Scheme Advisory Board and the Secretary of State of any changes which result in failure to meet the criteria**
- **Set out the proportion of assets that will be invested through pooling**
- **Set out the structure and governance arrangements of the pool and the mechanisms by which the authority can hold the pool to account**
- **Set out the services that will be shared or jointly procured**
- **Provide a summary of assets that the authority has determined are not suitable for investing through the pool along with its rationale for doing so, and how this demonstrates value for money;**
- **Regularly review any assets, and no less than every 3 years, that the authority has previously determined should be held outside of the pool, ensuring this continues to demonstrate value for money**
- **Submit an annual report on the progress of asset transfers to the Scheme Advisory Board**

Regulation 7(2)(e) - How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

When making investment decisions, administering authorities must take proper advice and act prudently. In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence. This approach is the standard that those responsible for making investment decisions must operate.

Although administering authorities are not subject to trust law, those responsible for making investment decisions must comply with general legal principles governing the administration of scheme investments. They must also act in accordance with ordinary public law principles, in particular, the ordinary public law of reasonableness. They risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it.
The law is generally clear that schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and

corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise.

However, the Government has made clear that using pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.

Investments that deliver social impact as well as a financial return are often described as "social investments". In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with the prudent approach. In other cases, some part of the financial return may be forgone in order to generate the social impact. These investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund.

Summary of requirements

In formulating and maintaining their policy on social, environmental and corporate governance factors, an administering authority:-

- **Must take proper advice**
- **Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors**
- **Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments**
- **Should not pursue policies that are contrary to UK foreign policy or UK defence policy**
- **Should explain their approach to social investments**

Regulation 7(2)(f) - The exercise of rights (including voting rights) attaching to investments

The long-term investment interests of administering authorities are enhanced by the highest standards of corporate governance and corporate responsibility amongst the companies in which they invest. Poor governance can negatively impact shareholder value.

Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure and corporate governance, including culture and remuneration. Engagement by administering authorities is purposeful and can identify problems through continuing dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.

Engagement enables administering authorities as long term shareholders to exert a positive influence on companies to promote strong governance, manage risk, increase accountability and drive improvements in the management of environmental, social and corporate governance issues.

Administering authorities are encouraged to consider the best way to engage with companies to promote their long-term success, either directly, in partnership with other investors or through their investment managers, and explain their policy on stewardship with reference to the Stewardship Code. Administering authorities should become Signatories to the Code and state how they implement the seven principles and guidance of the Code, which apply on a "comply or explain" basis.

Concern has been expressed in the past about the scope of Regulation 12(2)(g) of the 2009 Regulations which, in effect, allowed each administering authority to decide whether or not to adopt a policy on the exercise of the rights attaching to investments, including voting rights. To increase awareness and promote engagement, Regulation 7(2)(f) now requires every administering authority to formulate a policy that reflects their stewardship responsibilities.

Summary of requirements

In formulating their policy on the exercise of rights, administering authorities:-

- **Must give reasons in their Investment Strategy Statement for not adopting a policy of exercising rights, including voting rights, attaching to investments**
- **Should, where appropriate, explain their policy on stewardship with reference to the Stewardship Code**
- **Should strongly encourage their fund managers, if any, to vote their company shares in line with their policy under Regulation 7(2)(f)**
- **May wish to appoint an independent proxy voting agent to exercise their proxy voting and monitor the voting activity of the managers, if any, and for reports on voting activity to be submitted annually to the administering authority**
- **Should publish a report of voting activity as part of their pension fund annual report under Regulation 57 of the 2013 Regulations**

Pension Fund Committee

8 December 2016

Investment Pooling Update

Report of Don McLure, Corporate Director, Resources

Purpose of the Report

1 To update the Committee on progress towards investment pooling and to ask the Committee to agree on a recommendation on the ownership of the investment management company that will be created through pooling and on the membership of the Joint Committee that will supervise that company.

Background

2 At its 6 July 2016 meeting the Committee approved a detailed submission to Government on the proposed pooling of the investment of the Pension Fund's assets and confirmed the Pension Fund's previous commitment to be part of the Border to Coast Pensions Partnership (BCPP).

3 At the time of writing this report, the Government has not provided a formal written response to the BCPP pooling submission. However, the Department for Communities and Local Government (DCLG) has arranged to meet separately with representatives from each prospective asset pool, with BCPP's meeting scheduled for 24 November 2016. Formal written approval is expected to follow soon after this meeting.

4 The Government has indicated that despite the four month wait for approval the deadline for LGPS investment pools to be created and holding assets remains April 2018. Given the short time frame it is imperative that work progresses in a planned, focused way once Government approval has been given.

Creation of asset management company supervised by Joint Committee

5 BCPP will need to set up a separate Financial Conduct Authority (FCA) regulated asset management company, appoint staff (including through transfer from the three internally-managed Funds where appropriate) and develop the corporate and governance structures needed to enable the pooling of assets to take place from April 2018.

6 A Joint Committee overseeing the FCA- authorised investment management company is central to the BCPP proposal. The Joint Committee will comprise twelve individuals, one from each of the twelve BCPP partner funds. In

addition, the investment management company itself will be wholly owned by the administering authorities of all twelve partner funds.

7 As shareholders owning the investment management company, the administering authorities of the partner funds in the BCPP will exercise control over its operation including
- the appointment and removal of directors, including non-executive directors
- the approval of the annual business plan, budgets, the remuneration policy
- the approval of capital requirements, any significant transactions (mergers and acquisitions)
- review of risk register

8 As a member of the Joint Committee the Council, as Pension Fund administering authority, will ensure its interests as an investor are appropriately considered. The Joint Committee will exercise scrutiny over the investment performance of the BCPP investment management company and its sub-funds. It will also retain an advisory role over the functioning of the company. Its meetings will be governed by local government law and privacy determined accordingly. Voting will be by simple majority.

9 As administering authority, the Council will have to approve the acquisition of one share in the BCPP investment management company, and will have to authorise the BCPP Joint Committee to act as the supervisory body of the BCPP investment management company on behalf of the Durham County Council Pension Fund as a partner fund.

10 The Council will also have to agree which individual(s) should have membership of the BCPP Joint Committee and how the Council's shareholding of the BCPP investment management company will be exercised.

Recommendations

11 That a paper should be drafted for the County Council's January or February meeting asking the Council to approve its acquisition of a share in the BCPP investment management company and its membership of the Joint Committee supervising the BCPP investment management company.

12 The paper should recommend that the Chair of the Pension Fund Committee (or nominated representative) represents the Council on the BCPP Joint Committee, and exercises the Council's vote as joint owner of the BCPP investment management company.

Contact: Nick Orton Tel: 03000 269798

Pension Fund Committee

8 December 2016

Local Pension Board Work Plan

John Hewitt, Corporate Director Resources

Purpose of Report

1. To inform Members of the work plan the Local Pension Board agreed to follow at its last meeting.

Background

2. The Council, in its role as Administering Authority to the Pension Fund was required to establish a Local Pension Board from 1 April 2015. The Local Pension Board first met on 9 July 2015 and has met a further five times since then, with most meetings taking place on the same day as a meeting of the Pension Fund Committee.

3. At meeting on 13 July 2016 the Local Pension Board asked for a more formal work plan to be devised, encompassing the broad range of areas the Local Pension Board is expected to cover in its role of assisting the Administering Authority to secure compliance with regulations, and ensuring the effective and efficient governance and administration of the Local Government Pension Scheme (LGPS).

4. The national LGPS Scheme Advisory Board has produced best practice guidance on the creation and operation of Local Pension Boards which includes information on their suggested remit. This guidance categorises the two main functions of Local Pension Board as follows:

   i) To assist the Administering Authority in securing compliance with the Regulations, any other legislation relating to the governance and administration of the Scheme, and requirements imposed by the Pensions Regulator in relation to the Scheme; and

   ii) To ensure the effective and efficient governance and administration of the Scheme

5. The guidance goes on to provide more detail of suggested areas and activities that Local Pension Boards can focus on. An annotated extract from the guidance is enclosed as Appendix A, the full guidance can be found at the following link:

http://www.lgpsboard.org/images/Guidance/LGPS_Board_Guidance_FINAL_PUBLISHEDv1%201clean.pdf

Work plan

6. A work plan for the Local Pension Board covering the next two years has been agreed by the Local Pension Board at its meeting on 12 September 2016. The plan takes into account the planned and expected activities of the Pension Fund Committee over that period. The plan is based on holding four Local Pension Board meetings a year, which reflects the frequency of meetings held since the Local Pension Board was established.

7. Officers will provide the necessary support to allow the Local Pension Board to carry out its core functions and to develop and implement its work plan. Appendix A gives further detail of how this proposed work plan should help the Local Pension Board ensure it is able to fulfil its core functions.

Meeting	Topics to be considered	Comments
December 2016	Pensions Regulator Code of Practice	Consider Gap analysis against Code of Practice
March 2017	Member and employer communications Internal disputes cases, Pensions Ombudsman cases	Review standard communications and communication strategy Review and consider any lessons learned
June 2017	Review performance statistics – review Key Performance Indicators Review training approach Review final valuation report outcome	Consider Board members, Committee members and officers involved in scheme administration
September 2017	Review (draft) accounts and annual report Assist in development and review of asset voting and engagement processes	Consider compliance with UK Stewardship Code
December 2017	Pensions Regulator Code of Practice	Review and update gap analysis
March 2018	Member and employer communications Internal disputes cases, Pensions Ombudsman cases	Review standard communications and communication strategy Review and consider any lessons learned
June 2018	Review performance statistics – review Key Performance Indicators	
September 2018	Employer and Administering Authority discretions	Review approach and application

8. The Local Pension Board will report any relevant findings to the Committee as and when they arise.

Recommendation

9. Members are asked to note the information set out in this report.

Contact:	**Nick Orton**	**Tel:**	**03000 269798**

Appendix A – Functions of the Local Pensions Board

(taken from "Schedule A – Example remit of a Local Pension Board" from the Scheme Advisory Board's document "Guidance on the creation and operation of Local Pension Boards in England and Wales)

Function	When	How
Review regular compliance monitoring reports which shall include reports to and decisions made under the Regulations by the Committee.	Ongoing	Review of Committee papers and minutes, attendance at Committee
Review management, administrative and governance processes and procedures in order to ensure they remain compliant with the Regulations, relevant legislation and in particular the Code of Practice.	December 2016	Code of Practice gap analysis
Review the compliance of scheme employers with their duties under the Regulations and relevant legislation.	December 2016	Code of Practice gap analysis
Assist with the development of and continually review such documentation as is required by the Regulations including Governance Compliance Statement, Funding Strategy Statement and Statement of Investment Principles.	Ongoing	Consider and review, as and when statements are updated by the Committee
Assist with the development of and continually review scheme member and employer communications as required by the Regulations and relevant legislation.	March 2017 March 2018	Review standard employer and scheme member communications
Monitor complaints and performance on the administration and governance of the scheme.	June 2017 June 2018	Review performance statistics over previous year
Assist with the application of the Internal Dispute Resolution Process.	March 2017 March 2018	Review application of dispute procedure

Function	When	How
Review the complete and proper exercise of Pensions Ombudsman cases.	March 2017 March 2018	Review handling of any cases referred to Pensions Ombudsman
Review the implementation of revised policies and procedures following changes to the Scheme.	As required	Following legislative changes to Scheme
Review the arrangements for the training of Board members and those elected members and officers with delegated responsibilities for the management and administration of the Scheme.	June 2018	
Review the complete and proper exercise of employer and administering authority discretions.	September 2018	
Review the outcome of internal and external audit reports.	Ongoing	Audit reports and outcomes are supplied to Committee
Review draft accounts and scheme annual report.	September 2016, 2017, 2018	
Review the compliance of particular cases, projects or process on request of the Committee.	As required	
Any other area within the core function (i.e. assisting the Administering Authority) the Board deems appropriate.	As required	
Review regular compliance monitoring reports which shall include reports to and decisions made under the Regulations by the Committee.	Ongoing	
Assist with the development of improved customer services.	Ongoing	
Monitor performance of administration, governance and investments against key performance targets and indicators.	March 2017	Waiting for Scheme Advisory Board to issue Key Performance Indicators (expected by December 2016)

Function	When	How
Review the effectiveness of processes for the appointment of advisors and suppliers to the Administering Authority.	June 2017	Review procurements carried out for Pension Fund
Monitor investment costs including custodian and transaction costs.	March 2017	As part of review of Key Performance Indicators
Monitor internal and external audit reports.	Ongoing	Through Committee reports
Review the risk register as it relates to the scheme manager function of the authority.	Ongoing	As risk register is presented to Committee
Assist with the development of improved management, administration and governance structures and policies.	Ongoing	
Review the outcome of actuarial reporting and valuations.	June 2017	Final valuation report as at 31 March 2016 will be available at the end of March 2017
Assist in the development and monitoring of process improvements on request of Committee.	As required	
Assist in the development of asset voting and engagement processes and compliance with the UK Stewardship Code.	March 2017	
Any other area within the core function (i.e. ensuring effective and efficient governance of the Scheme) the Board deems appropriate.	As required	

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Agenda Item 20

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