



## **Pension Fund**

# Annual Report and Accounts

For the year ended 31 March 2014

The Durham County Council Pension Fund is registered with the Pension Schemes Registry  
No. 10079166

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## INTRODUCTION

Welcome to the Annual Report and Accounts of the Durham County Council Pension Fund (the Fund) for the financial year ended 31 March 2014.

These are the key issues:

- Contributing members increased by 3.66% to 17,454;
- Market value of the Fund's assets increased from £2.085m to £2.131 (2.2%).

The report provides further information on these issues and on the activities and management of the Fund during the year.

I hope this report provides useful information about your Pension Fund. However, it is important that we try to improve the quality and suitability of information provided within the report and feedback is welcomed. For further information on the Fund or providing me with your views on this report, contact details are provided at the end of the report.

**Don McLure, C.P.F.A.**  
**Corporate Director Resources**

30 September 2014

## **THE LOCAL GOVERNMENT PENSION SCHEME**

Durham County Council Pension Fund (the Fund) is part of the Local Government Pension Scheme (LGPS) administered by Durham County Council. It is a statutory scheme governed by regulations made under the Superannuation Act 1972.

With effect from 1 April 2014 the Fund is administered in accordance with the following secondary legislation:

- LGPS Regulations 2013 (as amended)
- LGPS (Transitional Provisions, Savings and Amendment) Regulations 2014
- LGPS (Management and Investment of Funds) Regulations 2009

During the reporting period (1 April 2013 to 31 March 2014) the following legislation governed the Fund:

- LGPS (Benefits, Membership and Contributions) Regulations 2007 (as amended)
- LGPS (Administration) Regulations 2008 (as amended)
- LGPS (Transitional Provisions) Regulations 2008 (as amended)
- LGPS (Management and Investment of Funds) Regulations 2009

## **HOW THE SCHEME PRESENTLY WORKS**

The LGPS is required to be funded. Scheme funds, currently surplus to immediate pension benefit requirements, are invested in approved securities. The Fund must be sufficient to sustain future pension entitlements of past and present members. The Fund is financed by contributions from members, employers and earnings from investments.

Until 31 March 2014 the LGPS was classified as a Final Salary Scheme whereby the annual pension and any retirement grant were paid based on the period of membership and (usually) the final twelve months pay. Benefits built up in the LGPS up to and including 31 March 2014 will continue to be calculated on a final salary basis.

With effect from 1 April 2014 the LGPS changed from a Final Salary Scheme to a Career Average Scheme. All benefits built up in the LGPS after 31 March 2014 will be calculated under the rules of the new career average scheme.

An independent actuarial valuation of the Fund is carried out every three years to review the assets and liabilities of the Fund and to determine the rate of contributions which the employers must make to the Fund. The most recent valuation applicable to the period

covered by the report was undertaken as at 31 March 2013 and a report of the actuary is provided on page 28. The next review is due to take place during 2016/17 for the valuation as at 31 March 2016.

From 1 April 2014 contributors to the scheme are required to pay between 5.5% and 12.5% of their pensionable salary to the Fund. The rate they pay depends on which of nine different salary bands their pay falls into. Employee contributions qualify for income tax relief. Members may have additional voluntary contributions (AVCs) deducted from pay and paid into a personal fund. AVCs can be invested with any of the following companies: Standard Life, Prudential and Equitable Life (closed to new investors).

Contributors to the scheme can also choose to pay Additional Pension Contributions (APCs) over a number of years or by a one-off payment to buy additional pension on retirement. Prior to 1 April 2014, contributors to the scheme could choose to pay Additional Regular Contributions (ARCs) over a number of years to buy additional pension on retirement.

Members who leave the scheme may transfer their accrued benefits to other approved schemes. Members who leave with less than two years membership receive a refund of their contributions (less income tax and a payment to the State Second Pension) provided they have no other LGPS benefits in the Fund or any other LGPS Funds in England or Wales. (In comparison, anyone who left the scheme with less than three months service before 1 April 2014 could only get a refund). New members may transfer benefits accrued with other schemes into the Fund.

From 1 April 2014 the scheme includes a 50/50 option which allows a member to contribute half of their normal contribution rate into the scheme in return for half of their normal pension. Under this option full life assurance and ill health cover is retained.

## **PENSION BENEFITS**

Membership from 1 April 2014 will build up an annual pension at a rate of  $1/49^{\text{th}}$  of the amount of pensionable pay received for each year of membership (or half that rate under the 50/50 option). This annual pension amount is added to an individual's pension account and revalued at the end of each year in line with inflation.

Pension is earned at a rate of  $1/60^{\text{th}}$  of final pay for each year of membership between 1 April 2008 and 31 March 2014 and  $1/80^{\text{th}}$  of final pay for each year of membership before 1 April 2008.

Retirement grants are based on  $3/80^{\text{th}}$  of final pay for each year of membership before 1 April 2008. Retirees have the option to take more lump sum from the scheme up to certain limits, getting £12 of tax free lump sum for every £1 of annual (taxable) pension given up.

Where a member dies in service a lump sum in the form of a death grant would be paid to the member's estate. This death grant is equal to three years' pay. Survivor's pensions are payable on the death of a scheme member to that scheme member's husband, wife, civil partner or eligible co-habiting partner. Children's pensions are also payable to eligible children of deceased scheme members. A survivor's pension is at a rate of half of the member's pension calculated on membership before 1 April 2008, 37.5% of the member's pension calculated on membership between 1 April 2008 and 31 March 2014 (inclusive) and 30.625% of the member's pension earned on or after 1 April 2014. The survivor's pension for an eligible co-habiting partner only takes into account the member's pensionable service after 5 April 1988. Eligible children receive a pension of one half of the survivor's pension, subject to a maximum of half for two or more children. (Giving up pension for lump sum will not affect the amount of any survivor pension payable after the member's death).

In the main, benefits are payable immediately upon leaving in the following circumstances:

- on reaching State Pension Age;
- between the age of 55 and State Pension Age, however early retirement reductions will normally apply where someone draws their pension benefits before State Pension Age. The amount of reduction that applies depends on the individual's age, length of pensionable service and the date they joined the scheme;
- at any age, with at least 2 years membership, if the member retires on the grounds of permanent ill-health. Three different levels of ill-health benefit are payable, depending on how soon it is judged that an individual will be able to obtain gainful employment again in future. In the case of death in service, dependants' benefits are paid even if the membership is less than 3 months. For death in service where membership is at least 2 years, an additional period of membership is awarded in calculating the survivor pension;
- at the age of 55 and over with at least 2 years membership, if the member is made redundant or retires under an employer's early retirement scheme.

If a member leaves with at least 2 years membership and is not entitled to immediate payment of benefits, nor elects for a transfer of accrued benefits, deferred benefits are awarded. Deferred benefits are benefits which remain in the Fund and are paid when the member reaches retirement age. Such benefits are subject to inflationary increases between the date of leaving and the date of payment.

## PENSION INCREASES

Mandatory increases in pensions and deferred benefits are made in accordance with annual statutory Pension Increase (Review) Orders to help protect pensions against inflation. The pension increase is currently linked to the Consumer Price Index (CPI).

The following table shows the pension increases over the last 5 years:

<i><b>Effective Date</b></i>	<i><b>% Increase</b></i>
12 April 2010	0.0
11 April 2011	3.1
9 April 2012	5.2
8 April 2013	2.2
7 April 2014	2.7

Pensioners must be over the age of fifty five or have retired on ill-health grounds to receive the increase. Those in receipt of a widow's, widower's or dependant's benefit receive the increase regardless of age.

## CHANGES TO THE LGPS FROM 1 APRIL 2014

The Independent Public Service Pensions Commission, chaired by Lord Hutton, was established to review all aspects of Public Sector pension provision. The Commission's final report proposed a number of changes for all public sector pensions, including an increase in normal pension age and a move from final salary to career average revalued earnings benefits.

The key features of the revised LGPS which came into force on 1 April 2014 are as follows:

- career Average Revalued Earnings scheme structure;
- pension earned at 1/49<sup>th</sup> of pensionable earnings for each year of service;
- revaluation rate of CPI for benefits of all types of member;
- normal Retirement Age linked to the State Pension Age ;
- member contribution rates increased for those earning above £43,000, with potential reductions for part-time members (as contribution rates will be based on actual rather than full time equivalent pay);
- a two year vesting period, where anyone who joins the pension scheme from 1 April 2014 and leaves with less than two years membership, will get a refund of their

- contributions, instead of a deferred pension benefit;
- introduction of a 50/50 option where a member can choose to pay half of the member contribution rate to earn benefits at half of the normal rate;
- pre April 2014 benefits protected and calculated by reference to final salary and current retirement ages;
- an underpin for members within 10 years of the age of 65 in April 2012.



## MANAGEMENT AND FINANCIAL PERFORMANCE REPORT

### PENSION FUND COMMITTEE MEMBERS, MANAGERS AND ADVISERS

The Constitution of Durham County Council, as administering authority to the Fund, has delegated to the Pension Fund Committee powers and duties arising from Section 7 of the Superannuation Act 1972 and Regulations made thereunder, regarding the administration and investment of funds.

In order to effectively carry out their role, the Committee obtains professional advice, as and when required, from suitably qualified persons, including external advisers, investment managers and officers of the Council.

The contact details of managers and advisers as at 31 March 2014 were as follows:

<b>PENSION FUND</b>	Durham County Council	Councillor Andrew Turner (Chairman)
<b>COMMITTEE:</b>	Members:	Councillor Watts Stelling (Vice Chairman)
		Councillor Colin Carr
		Councillor Patrick Conway
		Councillor Mark Davinson
		Councillor Sonia Forster
		Councillor Ian Geldard
		Councillor John Lethbridge
		Councillor Nigel Martin
		Councillor George Richardson
		Councillor Robin Todd
	Darlington Borough Council	Councillor I G Haszeldine
	Members:	Councillor S Harker
	Scheduled Body Representative	( Vacancy )
	Admitted Body Representative	Mr J Norton
	Pensioner Representative	Mr D Ford
	Active Members Representative	( Vacancy )
	Further Education Colleges Representative	( Vacancy )

<b>ADMINISTERING AUTHORITY OFFICERS:</b>	G Garlick C Longbottom, LLB  D McLure	Chief Executive Head of Legal and Democratic Services Corporate Director – Resources
<b>STAFF OBSERVERS:</b>	N Hancock (Vacant)	UNISON
<b>GLOBAL CUSTODIAN</b>	J P Morgan Europe Ltd	1 Chaseside, Bournemouth, BH7 7DA
<b>ACTUARY:</b>	AonHewitt	40 Queen Square, Bristol. BS1 4QP
<b>INVESTMENT MANAGERS:</b>	AllianceBernstein Ltd	50 Berkeley Street, London. W1J 8HA
	Baring Asset Management	155 Bishopsgate, London. EC2M 3XY
	BlackRock Investment Management (UK) Ltd	12 Throgmorton Avenue, London. EC2N 2DL
	CB Richard Ellis Collective Investors Ltd	3 <sup>rd</sup> Floor, One New Change, London. EC4M 9AF
	Royal London Asset Management Ltd	55 Gracechurch Street, London. EC3V 0UF
<b>INDEPENDENT ADVISERS:</b>	P. J. Williams PSolve Asset Solutions	11 Strand, London, WC2N 5HR
<b>AVC PROVIDERS:</b>	Equitable Life Assurance Society	PO Box 177, Walton Street, Aylesbury, Bucks. HP21 7YH
	Prudential	Local Government AVC Department, Stirling. FK9 4UE
	Standard Life	Occupational Pensions, Standard Life House, 30 Lothian Road, Edinburgh. EH1 2DH
<b>AUDITOR:</b>	Mazars LLP	Tower Bridge House, St Katharine's Way, London. E1W 1DD

## RISK MANAGEMENT

The Statement of Investment Principles (SIP), provided as Appendix 2, sets out the roles of the Fund's investment managers and custodian, who have a responsibility for the management and safekeeping of the Pension Fund's assets. The Funding Strategy Statement (FSS), at Appendix 1, identifies the Fund's key risks and counter measures taken by the administering authority to mitigate those risks. The administering authority takes professional advice from the actuary, custodian and advisers before taking appropriate action.

The Fund's primary long-term risk is that the Fund's assets fall short of its liabilities (i.e. promised benefits payable to members). The Fund's assets are diversified to reduce exposure to market (price, currency and interest rate) risk and credit risk. The assets are divided between five investment managers to further control risk. Asset allocation benchmarks have been set and performance is monitored relative to these benchmarks to ensure compliance with the Fund's investment strategy.

Liquidity risk is the risk that the Fund will not be able to meet its financial obligations as they fall due. The administering authority manages the Fund's liquidity position through a comprehensive cashflow management system to ensure cash is available when needed.

Note 18 of the Pension Fund's Accounts provides more detail on the nature and extent of risks arising from financial instruments and how the administering authority manages those risks.

The Pensions Administration team manages the risk of late payment of contributions by monitoring contribution payments, identifying cases of late payment and contacting employing bodies as appropriate.

Responsibility for the Fund's risk management rests with the Pension Fund Committee. The objective of the risk management strategy is to identify, manage and control the risks faced by the Fund whilst achieving a good return on investment. Risk is measured, in part, by the administering authority's risk management team as part of its assessment of the County Council's risks, and is reviewed as part of the independent Governance review undertaken by the Pension Fund.

Performance of investment managers is reported monthly; reviews are carried out by officers monthly and on a quarterly basis by the Pension Fund Committee. All internal and external audit reports are reviewed by the Pension Fund Committee.

The investment managers and custodian are audited by companies outside of the administering authority's control. However their auditors produce an annual Reporting Accountants Report, which is used to provide some level of assurance to the Pension

Fund that the managers and custodian have effective internal controls in operation within their organisations.

## KEY FINANCIAL INFORMATION

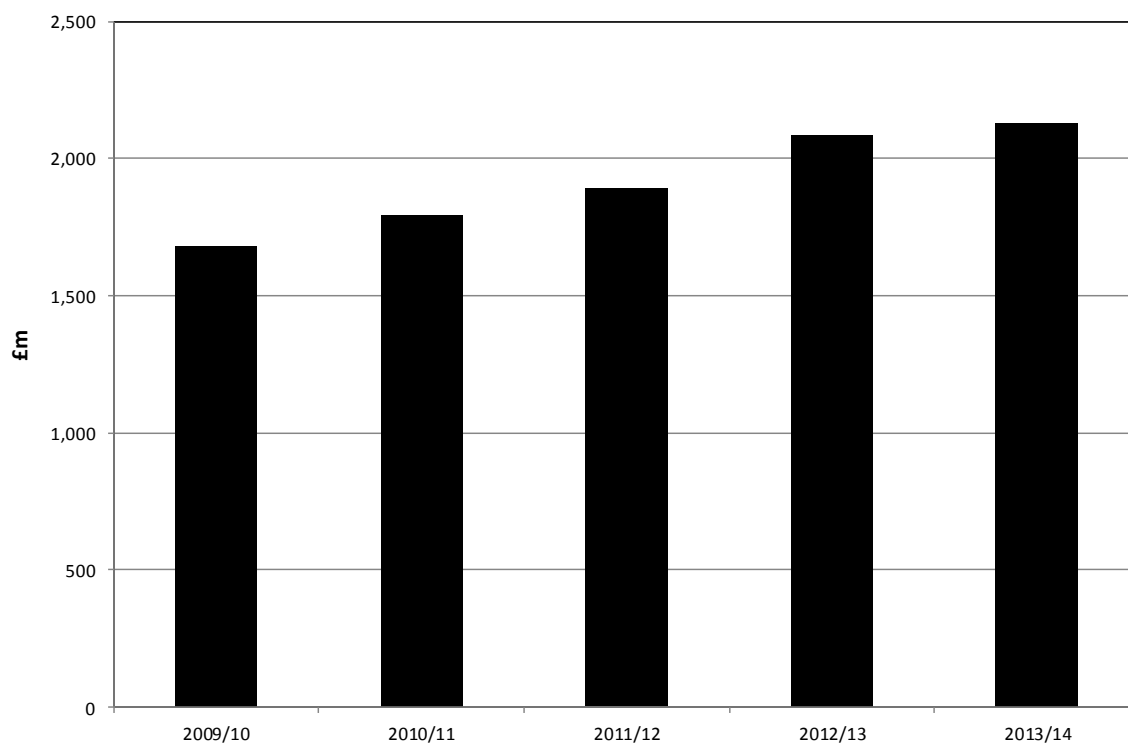
The following table and bar chart provide an overview of the Fund's financial position over the last five years. The key financial information is summarised below:

- over the last 4 years the market value of the net assets has steadily increased to £2,130.855m as at 31 March 2014;
- during the 2 years 2011/12 to 2012/13, the benefits paid to scheme members outweighed contributions received by employers and employees, however in 2013/14 contributions receivable were slightly higher than benefits payable;
- the Fund's income has been gradually reducing since 2009/10 due to lower contributions and other income receivable;
- other expenses in 2013/14 are significantly higher than in previous years which is due to a one-off payment relating to the bulk transfer of Durham Probation staff transferring out of the Fund. Further details can be found in Note 11 to the Fund Accounts on page 53.

	2009/10 £000	2010/11 £000	2011/12 £000	2012/13 £000	2013/14 £000
<b>Income</b>					
Contributions	118,041	101,633	96,448	93,884	96,800
Investment and other income	42,564	47,282	48,082	38,939	32,957
<b>Total Income</b>	<b>160,605</b>	<b>148,915</b>	<b>144,530</b>	<b>132,823</b>	<b>129,757</b>
<b>Expenditure</b>					
Benefits	85,473	86,533	99,973	95,978	96,669
Other expenses	18,212	20,466	14,814	15,849	38,683
<b>Net income</b>	<b>56,920</b>	<b>41,916</b>	<b>29,743</b>	<b>20,996</b>	<b>-5,595</b>
Increase/ decrease(-) in market value of investments	375,300	69,702	65,556	175,578	50,990
<b>Increase/ decrease(-) in Fund during year</b>	<b>432,220</b>	<b>111,618</b>	<b>95,299</b>	<b>196,574</b>	<b>45,395</b>
<b>Net assets at 31 March</b>	<b>1,681,969</b>	<b>1,793,587</b>	<b>1,888,886</b>	<b>2,085,460</b>	<b>2,130,855</b>

## NET ASSETS OF THE FUND

The following graph shows how the net assets of the Fund have changed over the last five years:



## ADMINISTRATIVE MANAGEMENT PERFORMANCE

The Council participates in the annual CIPFA benchmarking exercise, which analyses the pension administration function of the various authorities that participate. One aspect of this benchmarking involves a comparison of the Council's pension's administration activity against a set of industry standard performance indicators. The following table shows how the Fund compared against these industry standard performance indicators and the average of the 62 participating authorities in 2013:

Industry Standard Performance Indicators	Target (in days)	Achieved by the Fund %	Average of authorities %
Letter detailing transfer in quote	10	98.3	95.7
Letter detailing transfer out quote	10	99.1	96.6
Process refund and issue payment voucher	5	91.3	93.0
Letter notifying estimate of retirement benefit	10	95.4	93.2
Letter notifying actual retirement benefit	5	99.6	93.7
Letter acknowledging death of member	5	74.5	93.2
Letter notifying amount of dependant's benefits	5	69.2	91.4
Calculate and notify deferred benefits	10	75.5	87.0

## MEMBERSHIP

The Durham County Council Pension Fund was established in 1974 to cover the future pension entitlement of all eligible employees of the County Council and former District Councils. The Fund excludes provision for teachers, police officers and fire-fighters, for whom separate arrangements exist. A number of other bodies also participate in the Scheme. These include Parish and Town Councils, Further Education Colleges, Academy Schools, Police and Fire Authorities (non-uniformed staff only) and Admitted Bodies. Admitted Bodies are those which are able to apply for membership of the Scheme under the Regulations. If the Pension Fund Committee agrees to the application, an Admission Agreement is drawn up admitting the body into the Scheme.

Appendix 4 provides a list of all organisations currently contributing to the Fund. It includes their contribution rates, expressed as a percentage of employees' pensionable pay, and additional annual payments for those participating bodies which would otherwise have a shortfall in contributions by the end of the recovery period.

During 2013/14 the number of contributing members within the Pension Fund increased by 3.66% from 16,837 to 17,454. In summary, the number of members contributing to the Scheme is:

<b>As at 31 March 2013</b>	<b>Contributing Members</b>	<b>As at 31 March 2014</b>
907	Colleges	978
1,897	Darlington Borough Council	1,722
10,751	Durham County Council	11,108
866	Durham Police & Crime Commissioner & Chief Constable	895
102	Fire and Rescue Authority	91
194	Town/ Parish Councils	198
2,120	Others	2,462
<b>16,837</b>	<b>Total</b>	<b>17,454</b>

The number of pensioners in receipt of payments from the Fund increased from 16,386 to 16,700 (or 1.92%).

The following table and bar chart provide a summary of contributing members, pensioners in payment and deferred pensioners over the last five years:

	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>
Contributing Members	19,405	18,526	17,235	16,837	17,454
Pensioners in Payment	14,922	15,341	16,049	16,386	16,700
Pensioners Deferred	9,715	10,595	11,573	12,211	13,040



Appendix 5 provides a detailed analysis of the movement in the numbers of pensionable employees and pensioners of the scheme between 31 March 2013 and 31 March 2014.



## **INVESTMENT POLICY AND PERFORMANCE REPORT**

### **INVESTMENT POWERS AND DUTIES**

Durham County Council, as administering authority, has delegated responsibility for the investment arrangements of the Pension Fund to the Pension Fund Committee who decide on the investment policy most suited to meet the liabilities of the Pension Fund. The principal powers to invest are contained within the Local Government Pension Scheme Regulations 1997 which permit a wide range of investments in the UK and overseas markets.

Income to the Fund is primarily from the contributions of the Fund members and their employers and from the interest and dividends received from investments. Income to the Fund, which is not required to pay pension and other benefits, must be invested having regard to the need for a suitably diversified portfolio of investments and the advice of appropriately qualified advisers.

### **FUNDING STRATEGY STATEMENT**

The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 provide the statutory framework from which administering authorities are required to prepare a Funding Strategy Statement. A copy of the Funding Strategy Statement, which was revised during 2013/14, and is in line with the fund's Statement of Investment Principles, is included at Appendix 1. The purpose of the Funding Strategy Statement is to establish a clear and transparent fund specific strategy which will identify how employers' pension liabilities are best met going forward and to provide a means of supporting the requirement to maintain employer contribution rates at a level which is as constant as possible. The Statement raises the level of transparency and accountability, and provides a helpful context for adopting higher levels of communication with scheme employers.

### **STATEMENT OF INVESTMENT PRINCIPLES**

It is a statutory requirement for administering authorities to prepare and maintain a Statement of Investment Principles. On 16 March 2009, the Pension Fund Committee authorised the Corporate Director Resources to make suitable amendments to the Investment Managers' Agreements and to make consequential changes to the Statement of Investment Principles. The Statement of Investment Principles was revised during 2013/14 and is attached in Appendix 2. This document provides details of the principles governing the pension fund's decisions about investment.

## ASSET ALLOCATION

The long-term strategic target asset allocations have been determined in line with the Fund's Statement of Investment Principles and following the advice of the independent advisers. The target asset allocation and actual asset allocations during the first and last days of 2013/14, split between investment managers, are detailed in the table below:

Investment Manager	Asset Class	Investment Style	% Asset Allocation			
			at 31 March 2013		at 31 March 2014	
			Target	Actual	Target	Actual
Aberdeen	Global Equities	Active	N/A	N/A	15.00	0.00
AllianceBernstein	Global Bonds	Active	15.00	14.67	15.00	14.32
BNYM	Global Equities	Active	N/A	N/A	15.00	0.00
Barings	Dynamic Asset Allocation - all major asset classes	Active	20.00	19.35	20.00	19.60
BlackRock	UK Equities	Active	15.00	15.82	0.00	16.56
BlackRock (pooled)	Global Equities	Passive	22.00	23.49	0.00	23.99
CBRE	Global Property	Active	8.00	6.59	8.00	6.82
Mondrian	Emerging Market Equities	Active	N/A	N/A	7.00	0.00
RLAM	Investment grade sterling bonds	Active	20.00	20.08	20.00	18.71
Totals			100.00	100.00	100.00	100.00

The small variances between the actual asset allocation and the target asset allocation are due to market movements. The larger variances between the target and actual allocations as at 31 March 2014 are due to the Fund's investment strategy review and the timing of the reallocation of assets. Following a review of the Pension Fund's investment strategy, a decision was made to reduce and reshape the strategic allocation to equity holdings. Consequently on 1 May 2013, the Pension Fund Committee approved the appointment of three new investment managers:

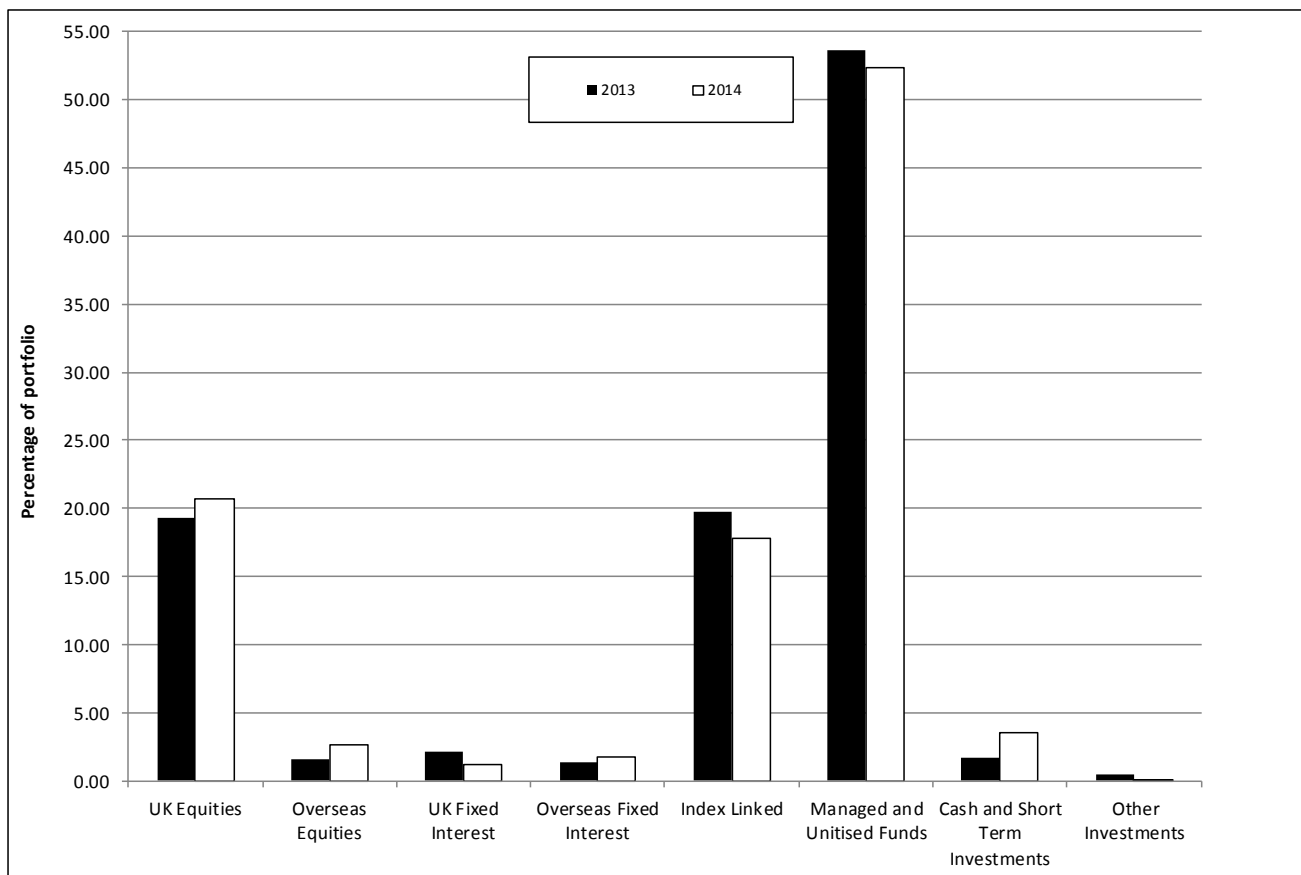
- Bank of New York Mellon Investment Management Ltd (BNYM) and Aberdeen Asset Management (Aberdeen) to manage global equity with an emerging market bias; and
- Mondrian Investment Partners Ltd (Mondrian) to manage an emerging market equity mandate.

It is anticipated that the re-allocation of the Fund's equity assets will take place in the third quarter of 2014/15.

An asset allocation rebalancing exercise is normally undertaken by the administering authority on a quarterly basis, however whilst the Fund is going through this strategic asset allocation review, rebalancing has been suspended until the re-allocation of the Fund's equity assets has been completed.

## DISTRIBUTION OF INVESTMENTS

The following graph shows the distribution of Fund investments (by market value) at the beginning and end of the year. Further details of the distribution are shown in Note 16 to the Pension Fund Accounts and Appendix 6.



## INVESTMENT MONITORING AND PERFORMANCE STATISTICS

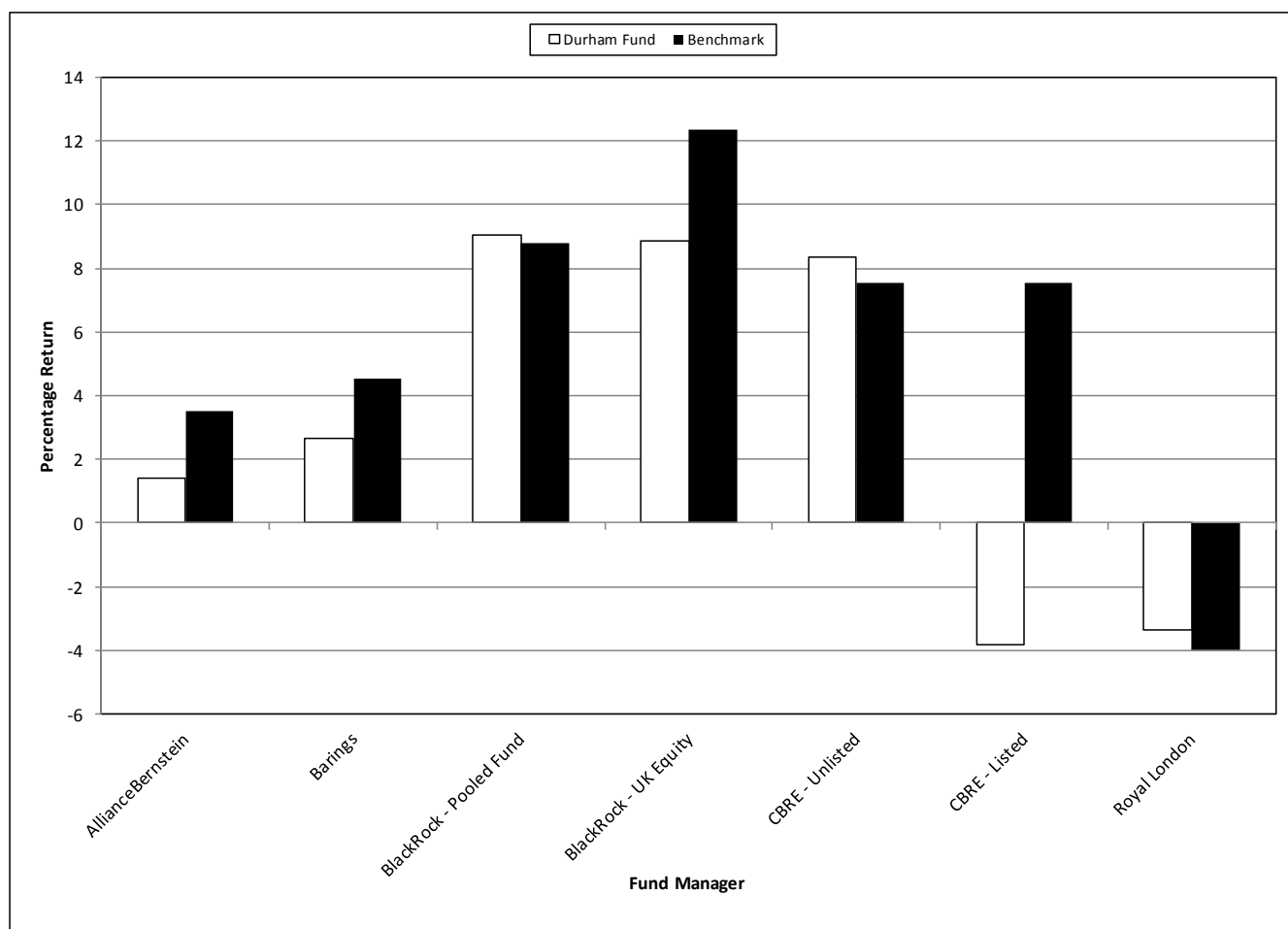
The performance of the investment managers is monitored and reported to the Pension Fund Committee on a quarterly basis, with an Annual Meeting to consider the full year's performance. At the quarterly meetings of the Committee, the investments are reviewed and advice is given by independent advisers. The Managers submit reports to the

meetings giving detailed information on transactions, views on the economy and investment strategy, including any proposed changes in asset allocation and a valuation of the investments and cash under management as at the end of the quarter.

Performance measurement is undertaken by J P Morgan, the Pension Fund's Global Custodian. Performance reports are produced on a quarterly basis, and the results are considered by the Fund's independent investment advisers and reported to the Pension Fund Committee.

## TOTAL FUND PERFORMANCE

The following chart illustrates the performance of the Durham County Council Pension Fund, by Investment Manager, in comparison to the adopted benchmark for the 12 months to 31 March 2014.



The following table shows the performance of the total fund for the year ended 31 March 2014 compared to the fund's specific benchmark adopted in February 2008.

	Performance (%)	
Currency GBP	2013/14	Since February 2008
Total Plan	3.96	6.58
Total Plan Benchmark	5.13	8.03
Relative Performance	-1.17	-1.45

The figures show overall performance below the benchmark for the 12 month period and since inception (i.e. February 2008). The sources and reasons for this are discussed below.

It should be noted that the performance targets for the broad bonds, dynamic asset allocation and global property mandates are expressed as either a margin over a cash return or retail price inflation, however the short term performance is likely to diverge significantly from the target, as these assets have characteristics quite different from the target.

## INVESTMENT MANAGERS' PERFORMANCE

The following tables show performance for each of the Pension Fund's investment managers in turn. In all cases the manager's benchmark and performance target are shown and the benchmark figures quoted include the out-performance objective.

### ALLIANCEBERNSTEIN

AllianceBernstein manages the global bonds portfolio. It is important to note that the objective for this portfolio, and therefore its composition, is quite different from the matching bonds portfolio and this is reflected in the benchmark index.

	Performance (%)	
Currency GBP	2013/14	Since February 2008
Alliance Bernstein	1.39	4.48
GBP Libor +3% pa	3.53	4.48
Relative Performance	-2.14	0.00

In the last 3 months of 2013/14 the performance of AllianceBernstein's portfolio has been above target due to falling yields in all bond markets. In the last quarter of 2013/14,

AllianceBernstein achieved a positive contribution from most positions, notably from sector and security selection. The performance during 2013/14 still suffers from the rising bond yields during the first 3 quarters of 2013/14. AllianceBernstein's longer term record is satisfactory. This is an example of a mandate where the underlying asset class is not aligned to the target benchmark return.

### **BARING ASSET MANAGEMENT**

Barings manages the Dynamic Asset Allocation portfolio. This is a very broad mandate, giving the manager freedom to seek value across asset categories, currencies and commodities.

	<b>Performance (%)</b>	
<b>Currency GBP</b>	<b>2013/14</b>	<b>Since February 2008</b>
<b>Barings</b>	2.68	7.05
GBP Libor +4% pa	4.53	5.49
<i>Relative Performance</i>	-1.85	1.56

The delivery of this mandate, in particular, needs to be judged over at least a full market cycle, rather than any shorter period. Barings' performance has been below target for the last quarter of 2013/14. Barings suffered from positions in Japanese and UK equities, both of which were among the poorer performing markets. The return in the year was negatively impacted by the strength of sterling because not all of the non-sterling assets were currency hedged. For the longer term this portfolio has achieved returns comparable with those from equities but with lower volatility.

### **BLACKROCK**

BlackRock manages the UK equity portfolio. Their performance has been erratic, as might be expected from such a concentrated portfolio with an aggressive performance target.

	<b>Performance (%)</b>	
<b>Currency GBP</b>	<b>2013/14</b>	<b>Since February 2008</b>
<b>BlackRock</b>	8.84	7.52
FTSE All Share (Gross) +3% pa	12.36	9.95
<i>Relative Performance</i>	-3.52	-2.43

In the last quarter of 2013/14 BlackRock slightly outperformed the target return, however the 1 year and 3 year performance is below both the demanding target and the All Share Index. Since the mandate was established in 2008, BlackRock have delivered performance very slightly ahead of the All Share Index, but a long way short of the 3% target they were set.

The UK equity mandate is due to be terminated as the transition to global and emerging market managers proceeds.

As is to be expected, the passive global equity portfolio, also managed by BlackRock, has performed in line with its benchmark and in fact achieved a small positive outcome in 2013/14. The performance of this part of the portfolio is shown in the following table:

Currency GBP	Performance (%)	
	2013/14	Since February 2008
<b>BlackRock</b>	9.04	13.32
FTSE Aw Developed (Gross)	8.80	13.31
<i>Relative Performance</i>	<i>0.24</i>	<i>0.01</i>

#### CB RICHARD ELLIS INVESTORS (CBRE)

CBRE manages the global real estate portfolio. The mandate is subdivided into listed and unlisted holdings.

Currency GBP	Performance (%)	
	2013/14	Since February 2008
<b>CBRE - Unlisted</b>	8.34	0.56
Headline RPI +5% pa	7.56	8.26
<i>Relative Performance</i>	<i>0.78</i>	<i>-7.7</i>
<b>CBRE - Listed</b>	-3.82	3.73
Headline RPI +5% pa	7.56	8.26
<i>Relative Performance</i>	<i>-11.38</i>	<i>-4.53</i>

The unlisted holdings performed slightly above the target in the last quarter of the year and somewhat ahead of target over the last 12 months. Positive contributions came from some of the US holdings and the Airport Industrial Property Unit Trust. Corestate German

Residential continued to be a drag on performance. There was some rotation of investments in Europe and Asia as some funds returned capital, while others drew on commitments.

The listed holdings returns tend to be highly correlated with those from equity markets in general. However, in the last quarter, and over 2013/14, real estate shares somewhat underperformed the market average. The listed portfolio is exposed to US Real Estate Investment Trusts and Japanese Real Estate Operating Companies.

#### **ROYAL LONDON ASSET MANAGEMENT (RLAM)**

RLAM manages the liability matching bonds portfolio. This is the lowest risk element of the Fund's strategy, relative to liabilities.

	Performance (%)	
Currency GBP	2012/13	Since February 2008
<b>Royal London</b>	-3.35	7.69
FTSE index Linked >5 years +0.5% pa	-3.97	7.57
<i>Relative Performance</i>	0.62	0.12

RLAM have outperformed their target in 2013/14. Their position in off-benchmark securites, particularly US and Canadian inflation linked bonds, contributed to performance in the last quarter of 2013/14. Since their appointment in 2008 RLAM have performed just ahead of their target.



## SCHEME ADMINISTRATION REPORT

Durham County Council is the Administering Authority for the Durham County Council Pension Fund and the Scheme administration is the responsibility of their Corporate Director Resources. The costs of administering the Scheme are charged to the Pension Fund.

Resources staff assist the Corporate Director Resources in his statutory duty to ensure that the Pension Scheme remains solvent and is administered effectively, adhering to the Local Government Pension Scheme Regulations in order to meet any current and future liabilities.

The Pensions Administration Team comprises 15.9 full time equivalent staff who provide a wide range of services including:

- administration of the affairs of Durham County Council Pension Scheme and also provision of services in connection with the pensions of teachers and uniformed fire officers;
- calculation of pensions and lump sums for retiring members of the Local Government Pension Scheme and provision of early retirement estimates;
- administration of new starters in the Scheme;
- calculation of service credit calculations, outgoing transfer value calculations and divorce estimates for the Local Government and Fire Brigade Schemes;
- collection of employee and employer contributions to be invested into the Local Government Pension Scheme;
- maintenance of the database of pension scheme members and provision of annual benefit statements and deferred benefit statements;
- production of newsletters for active and retired members;
- calculation of deferred pensions and refunds for early leavers;
- preparation of Pensions Fund Committee reports relating to benefits related issues;
- undertaking the annual pension increase exercise;
- calculation of widows and dependants benefits for retired and active members;
- dealing with the administration of in-house AVCs;
- working with Pension Fund employers to assist them in understanding and managing the cost of participation in the Local Government Pension Scheme;
- liaison with the Actuary to provide information for the triennial valuation, annual accountancy disclosures and ad hoc costings for employers and prospective employers.

A team of four staff in Strategic Finance provide support to the Corporate Director Resources in his statutory role in relation to accounting and investment related activities for the Pension Fund, including:

- preparation of the Pension Fund Accounts for inclusion in Durham County Council's Statement of Accounts;
- preparation of the Annual Report and Accounts of the Pension Fund;
- liaison with External and Internal Audit;
- day-to-day accounting for the Pension Fund;
- completion of statistical and financial returns for Government and other bodies ;
- co-ordination of the production of FRS17/ IAS 19 information for employers;
- preparation of Pension Fund Committee reports relating to investments and accounting issues;
- co-ordination of reports for Quarterly Pension Fund Committee meetings and the Pension Fund's Annual Meeting;
- liaison with Investment Managers, Advisers and Actuary;
- appointment of Investment Managers, Advisers and Actuary;
- monitoring and Review of Investment Managers, Advisers and Actuary;
- preparation of the Statement of Investment Principles and Funding Strategy Statement;
- allocation of Cash to Investment Managers;
- rebalancing of Investment Managers to their asset allocations;
- investment of Pension Fund surplus cash balances;
- calculation of interest on all Managers' cash held by the Pension Fund;
- reconciliation of all Managers' purchases, sales and dividends received.

### **Internal Dispute Resolution Procedure**

The Pensions Advisory Services offer a free service to all members of the Pension Fund who have problems with their pensions. There are set procedures in the Local Government Pension Scheme Regulations for dealing with disputes about the pension scheme, namely the Internal Dispute Resolution Procedure. Under this procedure initial queries should be referred to the Employing Body or the Administering Authority's Pension Administration Team, who should be able to explain the reasons behind any decision made.

Following this, if a complainant has a dispute, the first stage of appeal is to refer it to the Specified Person (an independent Pensions Officer from another Local Authority Pension Fund). If still not satisfied after that, the complaint must be referred to the Administering Authority in writing as a second stage appeal. A further referral is available to the Pensions Ombudsman.

The following table summarises the number of disputes made through the Fund's Internal Dispute Resolution Procedure at each stage of appeal:

	<b>2013-14</b>	<b>2012-13</b>
First Stage Appeals	11	17
Upheld	5	3
Declined	6	13
Ongoing	0	1
Second Stage Appeals	1	4
Upheld	0	1
Declined	1	3
Ongoing	0	0

## **STATEMENT OF THE ACTUARY FOR THE YEAR ENDED 31 MARCH 2014**

### **INTRODUCTION**

The accounts summarise the transactions and net assets of the fund. They do not take account of liabilities to pay pensions and other benefits in the future. Actuarial valuations, which do take account of such liabilities, are carried out every three years.

The Scheme Regulations require that a full actuarial valuation is carried out every third year. The purpose of this is to establish that the Durham County Council Pension Fund (the Fund) is able to meet its liabilities to past and present contributors and to review employer contribution rates. The last full actuarial investigation into the financial position of the Fund was completed as at 31 March 2013 by Aon Hewitt Limited, in accordance with Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008.

The following Actuarial Position is a statement taken directly from the Fund's Actuary, Aon Hewitt Limited.

### **ACTUARIAL POSITION**

1. The valuation as at 31 March 2013 showed that the funding ratio of the Fund had increased since the previous valuation with the market value of the Fund's assets at that date (of £2,058.5M, after allowance for an outstanding bulk transfer value) covering 84% of the liabilities allowing, in the case of current contributors to the Fund, for future increases in pensionable pay.
2. The valuation also showed that the aggregate level of contributions required to be paid by participating employers with effect from 1 April 2014 is:
  - 13.7% of pensionable pay. This is the rate calculated as being sufficient, together with contributions paid by members, to meet the liabilities arising in respect of service after the valuation date.

**Plus**

  - Monetary amounts to restore the assets to 100% of the liabilities in respect of service prior to the valuation date over a recovery period of 18 years from 1 April 2014, amounting to £24.3M in 2014/15, and increasing by 3.9% p.a. thereafter.
3. In practice, each individual employer's position is assessed separately and contributions are set out in Aon Hewitt Limited's report dated 31 March 2014 (the

"actuarial valuation report"). In addition to the contributions shown above, payments to cover additional liabilities arising from early retirements (other than ill-health retirements) will be made to the Fund by the employers.

4. The funding plan adopted in assessing the contributions for each individual employer is in accordance with the Funding Strategy Statement. Different approaches adopted in implementing contribution increases and individual employers' recovery periods are set out in the actuarial valuation report.
5. The valuation was carried out using the projected unit actuarial method for most employers and the main actuarial assumptions used for assessing the funding target and the contribution rates were as follows.

Discount rate for periods in service	
Scheduled Bodies	5.4% p.a.
Admission Bodies	5.2% p.a.
Discount rate for periods after leaving service	
Scheduled Bodies	5.4% p.a.
Admission Bodies	3.9% p.a.
Rate of pay increases:	3.9% p.a.
Rate of increase to pension accounts	2.4% p.a.
Rate of increases in pensions in payment (in excess of Guaranteed Minimum Pension):	2.4% p.a.

The assets were valued at market value.

Further details of the assumptions adopted for the valuation were set out in the actuarial valuation report.

6. The valuation results summarised above are based on the financial position and market levels at the valuation date, 31 March 2013. As such the results do not make allowance for changes which have occurred subsequent to the valuation date.
7. The formal actuarial valuation report and the Rates and Adjustments Certificate setting out the employer contribution rates for the period from 1 April 2014 to 31 March 2017 were signed on 31 March 2014. Contribution rates will be reviewed at the next actuarial valuation of the Fund as at 31 March 2016.
8. This Statement has been prepared by the current Actuary to the Fund, Aon Hewitt Limited, for inclusion in the accounts of the Fund. It provides a summary of the results of their actuarial valuation which was carried out as at 31 March 2013. The

valuation provides a snapshot of the funding position at the valuation date and is used to assess the future level of contributions required.

This Statement must not be considered without reference to the formal actuarial valuation report which details fully the context and limitations of the actuarial valuation.

Aon Hewitt Limited does not accept any responsibility or liability to any party other than our client, Durham County Council, the Administering Authority of the Fund, in respect of this Statement.

9. The report on the actuarial valuation as at 31 March 2013 is available on request from Durham County Council, the Administering Authority of the Fund.

Aon Hewitt Limited

**29 May 2014**

## GOVERNANCE COMPLIANCE STATEMENT

Durham County Council is the Administering Authority for the Durham County Council Pension Fund.

The Council has delegated to the Pension Fund Committee various powers and duties in respect of its administration of the Fund.

This statement sets out the Fund's scheme of delegation and the terms of reference, structure and operational procedures of the delegation, and the extent of its compliance with guidance issued by the Secretary of State (CLG) under the provisions of regulation 31 of the Local Government Pension Scheme Regulations 2008.

The following sections set out the principles of governance as prescribed in the CLG guidance and describe the Fund's current arrangements for compliance.

Principle A – Structure	Fully compliant
<p>a) The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.</p> <p>b) That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.</p> <p>c) That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.</p> <p>d) That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.</p>	

The constitution of the Council delegates to the **Pension Fund Committee** “powers and duties arising from Section 7 of the Superannuation Act 1972 and Regulations made thereunder” regarding the administration of the Scheme and investment of funds, including:

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

The following function is delegated to the **Corporate Director of Resources** by the Council:

“To take all necessary actions of a routine nature to properly administer the financial affairs of the Council including ... the Council's functions as a pension fund administering authority under the Superannuation Act 1972 and associated regulations.”

The structure of the Pension Fund Committee was reviewed in December 2008 and revised with effect from 1 April 2009 to reflect the composition of Durham County Council as a unitary authority from that date. The structure of the Pension Fund Committee is as follows:

<b>Body / category of bodies represented</b>	<b>Number of Committee Members</b>
Durham County Council	11
Darlington Borough Council	2
Colleges	1
Scheduled Bodies	1
Admitted Bodies	1
Active Members	1
Pensioners	1
<b>Total</b>	<b>18</b>
<i>(plus 2 non-voting union observers)</i>	

A secondary committee or panel has not been established due to the full extent of representation on the Committee.



<b>Principle B - Representation</b>	<b>Fully compliant</b>
<p>a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:</p> <ul style="list-style-type: none"> <li>i) employing authorities (including non-scheme employers e.g. admitted bodies);</li> <li>ii) scheme members (including deferred and pensioner scheme members),</li> <li>iii) where appropriate, independent professional observers,</li> <li>iv) expert advisers (on an ad-hoc basis).</li> </ul> <p>b) That where lay members sit on a main or secondary committee they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.</p>	

The allocation of members to the Committee broadly reflects the number of active members, pensioners and deferred pensioners each of the larger employers has within the Fund.

The two Trade Union representatives are invited as observers.

The Committee does not consider it appropriate to appoint an independent professional observer to the Committee but these governance arrangements have been independently audited by AllenbridgeEPIC Investment Advisers on behalf of the Committee.

The Committee has appointed Philip Williams and PSolve Asset Solutions to provide independent investment advice.

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

<b>Principle C - Selection and role of lay members</b>	<b>Fully compliant</b>
<p>a) That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.</p> <p>b) That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.</p>	

The representatives from Durham County Council and Darlington Borough Council are appointed by decisions of the respective councils.

The representatives of the Colleges, other Statutory Bodies, and Admitted Bodies are selected by the Committee from nominations made by the employers and appointed for a period of 4 years.

The two scheme member representatives are selected by the Committee from applications received from the membership following advertisement in the newsletter - one from active scheme members and one from pensioner members.

All Committee members are made fully aware of their role and functions as set out in the terms of reference for the Committee and other documentation.

Applicants from the scheme membership are provided with an information pack setting out the duties and responsibilities of a Pension Fund Committee Member together with a description of the type of individual qualities and experience seen as essential or desirable for the role.

All members are also made aware that as well as having legal responsibilities for the prudent and effective stewardship of the Fund, in more general terms they have a clear fiduciary duty to participating employers, local tax payers and scheme beneficiaries in the performance of their responsibilities.

There is a standing agenda item at the start of each meeting inviting members to declare any financial or pecuniary interest related to specific matters on the agenda.

Principle D - Voting	Fully compliant
a) The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	

All members appointed to the Committee have voting rights.

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

<b>Principle E - Training/Facility Time/Expenses</b>	<b>Fully compliant</b>
<ul style="list-style-type: none"> <li>a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.</li> <li>b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.</li> <li>c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.</li> </ul>	

The Committee has established a policy on training, facility time and reimbursement of expenses which applies to all members of the Committee.

Consideration has been given to the adoption of annual training plans and the maintenance of a log of all such training undertaken.

<b>Principle F – Meetings (frequency/ quorum)</b>	<b>Fully compliant</b>
<ul style="list-style-type: none"> <li>a) That an administering authority's main committee or committees meet at least quarterly.</li> <li>b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.</li> <li>c) That an administering authority which does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.</li> </ul>	

The Pension Fund Committee meets four times a year and occasionally holds special meetings when required. The Pension Fund Committee also holds an Annual General Meeting each year to which all employers are invited.

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

<b>Principle G - Access</b>	<b>Fully compliant</b>
<p>a) That subject to any rules in the council's constitution all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.</p>	

All members of the Committee have equal access to committee papers, documents and advice to be considered at each meeting. Public documents are posted on the website.

<b>Principle H - Scope</b>	<b>Fully compliant</b>
<p>a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.</p>	

As set out in the terms of reference, the Committee regularly considers "wider issues" and not just matters relating to the investment of the Fund.

<b>Principle I - Publicity</b>	<b>Fully compliant</b>
<p>a) That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.</p>	

The Governance Compliance Statement is distributed to all employers, is reproduced in the Annual Report, and is published on the Council's website. The appointment of member representatives was advertised to all members for them to express an interest.

Approved by the Pension Fund Committee  
29 November 2010



## **INDEPENDENT REVIEW OF GOVERNANCE ARRANGEMENTS**

I have undertaken an independent review of the Governance Compliance Statement and other statutory statements relating to the investment and administration of the Durham County Council Pension Fund.

In my opinion, the Pension Fund is compliant with the statutory requirements for the publication and review of a Governance Compliance Statement and, overall, the Pension Fund Committee demonstrates a high standard of governance in the operation of its responsibilities.

I am also satisfied that the Pension Fund complies with the statutory requirements relating to the Funding Strategy Statement, the Statement of Investment Principles (subject to updating in respect of compliance with Myners Principles), and the Communications Policy Statement.

In my review I have identified a number of recommendations for the Pension Fund Committee to consider to enhance governance compliance, bringing documentation up to date with industry-wide practice, and to improve transparency.

The current regulatory framework and good practice relating to governance continues to develop, and proposals are under consideration by the Department for Communities and Local Government (CLG). These developments will need to be considered and implemented as requirements change.

My conclusion is that the arrangements now in place for independent advice and review provide a robust basis for the Committee to maintain its governance standards in an efficient and effective manner.

Peter Scales  
Senior Adviser  
AllenbridgeEPIC Investment Advisers

16 November 2010

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DURHAM COUNTY COUNCIL**

### **Opinion on the pension fund financial statements**

We have examined the pension fund financial statements for the year ended 31 March 2014, which comprise the Fund Account, the Net Assets Statement and the related notes.

### **Respective responsibilities of the Corporate Director Resources and auditor**

As explained more fully in the Statement of the Corporate Director Resources Responsibilities, the Corporate Director Resources is responsible for the preparation of the pension fund's financial statements in accordance with applicable United Kingdom law.

Our responsibility is to report to you our opinion on the consistency of the pension fund financial statements within the pension fund annual report with the pension fund financial statements in the statement of accounts of Durham County Council, and its compliance with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

We also read the other information contained in the pension fund annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the pension fund financial statements.

We conducted our work in accordance with guidance issued by the Audit Commission. Our report on the administering authority's full annual statement of accounts describes the basis of our opinion[s] on those financial statements.

### **Opinion on pension fund financial statements**

In our opinion, the pension fund financial statements are consistent with the full annual statement of accounts of Durham County Council for the year ended 31 March 2014 and comply with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

Cameron Waddell

Director and Engagement Lead

On behalf of Mazars LLP

The Rivergreen Centre

Aykley Heads

Durham

DH1 5TS

30 September 2014

## PENSION FUND ACCOUNTS AND DISCLOSURE NOTES

### FUND ACCOUNT

2012-13			2013-14	
£000	£000	Notes	£000	£000
DEALINGS WITH MEMBERS, EMPLOYERS AND OTHERS DIRECTLY INVOLVED IN THE FUND				
-93,884	Contributions receivable	8	-96,800	
-6,723	Transfers in from other pension funds	9	-2,623	
-5	Other income		-5	
-100,612				-99,428
95,978	Benefits payable	10	96,669	
9,053	Payments to and on account of leavers	11	32,300	
1,302	Administrative expenses	12	1,266	
	106,333			130,235
5,721	Net withdrawals/ -additions from dealings with members			30,807
RETURN ON INVESTMENTS				
-32,216	Investment income	13	-30,334	
-175,578	Profit and losses on disposal of investments and change in market value of investments	16	-50,990	
5,499	Investment management fees	15	5,122	
-202,295	Net returns on investments			-76,202
-196,574	NET INCREASE IN THE NET ASSETS AVAILABLE FOR BENEFITS DURING THE YEAR			-45,395



## NET ASSETS STATEMENT

2012-13		2013-14		
£000	£000	Notes	£000	£000
<b>INVESTMENT ASSETS</b>				
73,341		16	62,934	
435,804		16	500,898	
410,966		16	384,175	
<u>1,117,793</u>	2,037,904	16	<u>1,128,807</u>	2,076,814
408		16	390	
14,091		16	49,850	
20,882		16	26,241	
<u>13,739</u>	49,120	16	<u>47,205</u>	123,686
	2,087,024			2,200,500
<b>Other Investment Assets</b>				
4,974		16,19	4,813	
527		16,19	378	
<u>41,709</u>	47,210	16,19	<u>8,931</u>	14,122
<b>2,134,234</b>	<b>Total Investment Assets</b>			<b>2,214,622</b>
<b>INVESTMENT LIABILITIES</b>				
-11,984		16	-40,936	
<u>-39,881</u>		20	<u>-18,387</u>	
<b>-51,865</b>	<b>Total Investment Liabilities</b>			<b>-59,323</b>
<b>2,082,369</b>	<b>NET INVESTMENT ASSETS</b>			<b>2,155,299</b>
1,458	<b>Long Term Assets</b>	19		1,250
<b>Current assets</b>				
6,433		19	6,301	
<u>974</u>		19	<u>922</u>	
	7,407			7,223
<b>Current liabilities</b>				
-538		20	0	
<u>-5,236</u>		20	<u>-32,917</u>	
	-5,774			-32,917
<b>2,085,460</b>	<b>NET ASSETS OF THE SCHEME AVAILABLE TO FUND BENEFITS AT 31 MARCH</b>			<b>2,130,855</b>

The Pension Fund's accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the reported accounting period. The actuarial present value of promised retirement benefits, which does take account of such obligations, is disclosed in Note 25.

These accounts should therefore be read in conjunction with the information contained within these note

## 1. FUND OPERATION AND MEMBERSHIP

Durham County Council Pension Fund (the Fund) is part of the Local Government Pension Scheme (LGPS) administered by Durham County Council. The Council is the reporting entity for the Fund. The LGPS is a statutory scheme governed by regulations made under the Superannuation Act 1972.

With effect from 1 April 2014 the Fund is administered in accordance with the following secondary legislation:

- LGPS Regulations 2013 (as amended)
- LGPS (Transitional Provisions, Savings and Amendment) Regulations 2014
- LGPS (Management and Investment of Funds) Regulations 2009

During the reporting period (1 April 2013 to 31 March 2014) the following legislation governed the Fund:

- LGPS (Benefits, Membership and Contributions) Regulations 2007 (as amended)
- LGPS (Administration) Regulations 2008 (as amended)
- LGPS (Transitional Provisions) Regulations 2008 (as amended)
- LGPS (Management and Investment of Funds) Regulations 2009

The Pension Fund Committee has responsibility delegated from Durham County Council to discharge the powers and duties arising from Section 7 of the Superannuation Act 1972 and Regulations made thereunder, to ensure the effective stewardship of the Pension Fund's affairs. The delegation is wide ranging and covers the management of all of the Fund's activities, including the administration and investment of funds. The Committee meets at least quarterly, to assess performance and annually to consider wider matters.

The Corporate Director Resources is responsible for the administration of the Pension Fund. He is assisted by the Pensions Administration and Strategic Finance teams in his statutory duty to ensure the Pension Fund is administered effectively and remains solvent.

The Fund was established in 1974 to cover the future pension entitlement of all eligible employees of the County Council and former District Councils. The Fund excludes provision for teachers, police officers and firefighters for whom separate pension arrangements exist. A number of other scheduled and admitted bodies also participate in the Scheme.

The LGPS is a defined benefit occupational pension scheme to provide pensions benefits for pensionable employees of participating bodies. On retirement, contributors receive annual pensions and where applicable lump sum payments. Entitlement to these benefits arises mainly on the grounds of reaching retirement age and retirement through ill health, through early retirement schemes or being made redundant. Contributors who leave and who are not immediately entitled to these benefits may have their pension rights transferred or preserved until reaching retirement age. In a minority of cases refunds of contributions can be made.

The following table provides a summary of contributing members, pensioners in payment and deferred pensioners over the last five years.

	2009/10	2010/11	2011/12	2012/13	2013/14
Contributing Members	19,405	18,526	17,235	16,837	17,454
Pensioners in Payment	14,922	15,341	16,049	16,386	16,700
Pensioners Deferred	9,715	10,595	11,573	12,211	13,040

When comparing the numbers at 31 March 2014 to those at 31 March 2013, the number of pensionable employees in the Fund has increased by 617, the number of pensioners has increased by 314 and deferred pensioners have increased by 829.

Contributions represent the total amounts receivable from:

- employing authorities, at a rate determined by the Fund's Actuary, and
- pensionable employees, at a rate set by statute.

The Fund's total benefits and contributions are summarised in the following table:

2012-13			2013-14	
Benefits	Contributions		Benefits	Contributions
£000	£000		£000	£000
77,649	-64,694	Administering Authority	76,488	-65,776
16,570	-25,714	Scheduled Bodies	17,755	-26,962
1,759	-3,476	Admitted Bodies	2,426	-4,062
<b>95,978</b>	<b>-93,884</b>		<b>96,669</b>	<b>-96,800</b>

The names of all 110 contributing employers are as follows:

**Scheduled Bodies**

***Local Authorities:***

Durham County Council  
Darlington Borough Council

***Parish Councils:***

Brandon & Byshottles Parish Council  
Chilton Parish Council  
Easington Colliery Parish Council  
Easington Village Parish Council  
Fishburn Parish Council  
Framwellgate Parish Council  
Horden Parish Council  
Hutton Henry Parish Council  
Lanchester Parish Council  
Monk Haseden Parish Council  
Murton Parish Council  
North Lodge Parish Council  
Shotton Parish Council  
South Hetton Parish Council  
Thornley Parish Council  
Trimdon Foundry Parish Council  
Trimdon Parish Council  
Wheatley Hill Parish Council  
Wingate Parish Council

***Town Councils:***

Barnard Castle Town Council  
Bishop Auckland Town Council  
Ferryhill Town Council  
Great Aycliffe Town Council  
Greater Willington Town Council  
Peterlee Town Council  
Seaham Town Council  
Sedgefield Town Council  
Shildon Town Council  
Spennymoor Town Council  
Stanley Town Council

***Colleges:***

Bishop Auckland College  
Darlington College  
Derwentside College  
East Durham College  
New College Durham  
Queen Elizabeth 6th Form College

***Statutory Bodies:***

BRandH Academy Limited  
Carmel Education Trust  
Central Durham Joint Crematoria Committee  
Cleves Cross Primary School  
Dale and Valley Homes Ltd  
Durham & Darlington Fire and Rescue Authority  
Police and Crime Commissioner for Durham  
Easington Academy  
East Durham Homes Ltd  
Education Village  
Excel Academy Partnership (Framwellgate School)  
Federation of Abbey Schools Academy Trust  
Federation of Mowden Schools Academy Trust  
Firthmoor Primary School  
Glendene Arts Academy

***Statutory Bodies (continued):***

Heathfield Academy Trust  
Hummersknott Academy Trust  
Hurworth Primary  
Hurworth School Limited  
IT Systems & EVAT Partnership Ltd  
King James I Academy  
Longfield Academy Trust  
Ribbon Academy (formerly Murton Community School)  
New College Durham Academies Trust  
New Seaham Primary School  
Park View Academy  
Parkside Academy  
Reid Street Primary School  
Shotton Hall Academy Trust  
St Aidans C of E Academy  
St Bede's Catholic School & Sixth Form College  
St Bedes RC Primary  
St George's CE Academy  
St John's Catholic School & Sixth Form College  
St John's CE Primary School  
Staindrop School  
Teesdale School  
The Hermitage Academy Trust  
Tudhoe Learning Trust  
West Park Academy  
Woodham Academy

**Admitted Bodies:**

Barnard Castle School  
Blackwell Grange Golf Club Ltd  
Bowes Museum  
Bulloughs Cleaning Services Ltd  
Carillion (AMBS) Limited  
Carillion Services Limited  
Catering Academy Limited  
Cestria Community Housing  
Churchill Contract Services Limited  
Compass Group UK  
Creative Management Services  
Derwentside Homes  
Future Leisure in Coxhoe  
Harbour Support Services  
Investing in Children CIC  
KGB Cleaning & Support Services  
Leisureworks  
Livin plc (formerly Sedgefield Borough Homes)  
Mears Ltd  
Mellors Catering Services Limited  
Mitie Cleaning  
Mitie PFI Ltd  
Morrison Facilities Management Ltd  
Murton Welfare Association  
North East Council of Addiction (NECA)  
Taylor Shaw Longfield  
Taylor Shaw Primaries  
Teesdale Housing Association  
The Forge  
Three Rivers Housing Group  
Wates Construction Limited

## 2. BASIS OF PREPARATION

The Pension Fund accounts have been prepared in accordance with:

- ❖ International Financial Reporting Standards (IFRS)
- ❖ CIPFA Code of Practice on Local Authority Accounting in the UK 2013/14 (the Code)
- ❖ Financial Reports of Pension Schemes - A Statement of Recommended Practice (Revised 2007)

The accounts have been prepared on an accruals and going concern basis.

The financial statements summarise the transactions and the available net assets of the Pension Fund. They do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial valuations of the Fund, which do take account of such obligations, are carried out every three years. The Actuary completed the triennial review as at 31 March 2013, during 2013/14, the results of which determined the contribution rates from 1 April 2014 to 31 March 2017. Details of the latest valuation are included in Note 24.

## 3. ACCOUNTING POLICIES

### Significant Accounting Policies

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

### *Fund Account*

#### Contributions receivable

Contribution income is categorised and recognised as follows:

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

#### Transfers to and from other schemes

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

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

### **Pension benefits payable**

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

### **Administrative expenses**

All administration expenses are accounted for on an accruals basis. All costs of the Pensions Administration Team and a proportion of the costs of the Pension Fund Accounting Team are charged to the Pension Fund as administrative expenses.

### **Investment income**

Investment income is accounted for as follows:

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

### **Taxation**

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

**Investment Management Fees**

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

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

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

**Net Assets Statement****Valuation of Investments**

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

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

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

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

- Quoted equity securities which are traded on an exchange are accounted for on a bid market price basis, where Investment Managers provide valuations in this manner;
- Fixed interest securities that are traded on an exchange are accounted for at bid market price where Investment Managers provide valuations in this manner;
- Index linked securities are valued at bid market value where Investment Managers provide valuations in this manner;

- Unitised securities are valued at the closing bid price if bid and offer prices are reported by the relevant exchange and in the Investment Manager's valuation report. Single priced unitised securities are valued at the reported price;
- Unquoted equity investments are included based on an estimated price of the investments held. Investment Managers use valuation techniques to establish a price at the year end date based on an arm's length exchange given normal business considerations;
- Derivative contracts outstanding at the year end are included in the Net Assets Statement at fair value (as provided by Investment Managers) and gains and losses arising are recognised in the Fund Account as at 31 March. The value of foreign currency contracts is based on market forward exchange rates at the reporting date. The value of all other derivative contracts is determined using exchange prices at the reporting date.

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

### **Cash and Cash Equivalents**

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

### **Contingent Assets**

A contingent asset arises where an event has taken place that gives a possible asset which will only be confirmed by the occurrence of uncertain future events not wholly within the control of the Pension Fund. Contingent assets are not recognised in the Net Assets Statement however details are disclosed in Note 23.

### **Investment transactions**

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

### **Acquisitions costs of investments**

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

### **Financial liabilities**

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



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**Actuarial present value of promised retirement benefits**

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 19 and relevant actuarial standards. As permitted under IAS 26 the Pension Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the accounts (Note 25).

**Additional Voluntary Contributions (AVCs)**

The Fund provides an additional voluntary contribution (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. In accordance with LGPS Regulations, AVCs are not recognised as income or assets in the Pension Fund Accounts, however a summary of the scheme and transactions are disclosed in Note 21 to these accounts.

If, however, AVCs are used to purchase extra years' service from the Pension Fund, this is recognised as contribution income in the Fund's accounts on an accruals basis. Amounts received in this way can be found in Note 8 as additional contributions from members.

**4. ACCOUNTING STANDARDS THAT HAVE BEEN ISSUED BUT NOT YET ADOPTED**

The Code has introduced the following accounting standards which will be adopted in future years. They are not considered to have a significant impact on the Fund accounts:

- IAS 32 Financial Instruments Presentation – The Code refers to amended guidance when offsetting a financial asset and a financial liability. This is a presentational change applicable from 1 April 2014 and will not have a material effect on the Fund's accounts
- IFRS 13 Fair Value Measurement – This standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. It will be effective from 1 April 2015.

**5. CRITICAL JUDGEMENTS IN APPLYING ACCOUNTING POLICIES**

The preparation of the statements in conformity with IFRS requires management to make judgements, estimates and assumptions which affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. In applying the policies, the Pension Fund has to make certain judgements about complex transactions, or those involving uncertainty. Those with most significant effect are:

- the fair value of unquoted private equities is highly subjective and based upon forward looking estimates and judgements involving many factors. Investment Managers provide the values to be recognised in the Net Assets Statement.
- the pension fund liability is calculated every three years by the appointed actuary. Assumptions underpinning the valuations are agreed with the actuary; the estimate is subject to significant variances based on changes to the underlying assumptions.

## **6. ASSUMPTIONS MADE ABOUT THE FUTURE AND OTHER MAJOR SOURCES OF ESTIMATION UNCERTAINTY**

The Pension Fund Accounts contain estimated figures that are based upon assumptions made about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, the nature of estimation means that actual results may differ from the estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Items for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual differs from assumptions
Actuarial Valuation	<p>Estimation of the net liability to pay pensions depends on a number of complex judgements including the discount rate used, the salary increase projections, expected changes in retirement ages, mortality rates and returns on pension fund assets. A firm of actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied. Notes 24 and 25 summarise the results of the actuarial valuation.</p>	<p>The Actuary calculated the funding ratio to be 84% as at 31 March 2013 (the last triennial valuation). If the following figures were to differ from the assumptions used in the calculation, there would be a reduction in the funding ratio to:</p> <ul style="list-style-type: none"> <li>• 79% if life expectancy increases by 3 years</li> <li>• 70% if discount rate falls by 1%</li> <li>• 70% if inflation increases by 1%</li> <li>• 73% if equities fall by 25%</li> <li>• 80% if pensionable pay increases by 1%</li> </ul>
Fair Value of investments	<p>The Accounts are as at 31 March 2014 and all the investments held by the Fund are valued as at that date using the best estimate possible of 'fair value', as detailed in 'Significant Accounting Policies - Valuation of Investments'.</p>	<p>The use of estimates for investment values is greatest for those assets classified at Level 3 which means there is a risk that these investments may be over/under-stated in the accounts. The total value of Level 3 investments (explained in Note 17) is £108.7m at 31 March 2014 (£101.524m at 31/3/13). Every 1% increase/decrease in fair value would result in an increase/decrease in the value of the Fund by £1.087m (£1.015m at 31/3/13).</p>

## 7. POST NET ASSETS STATEMENT (BALANCE SHEET) EVENT

There have been no events after 31 March 2014 which require any adjustments to these accounts.

## 8. CONTRIBUTIONS RECEIVABLE

2012-13 £000		2013-14 £000
	<b>Employer contributions:</b>	
-43,861	Normal	-45,014
-120	Augmentation	-490
-28,306	Deficit funding	-29,630
	<b>Member contributions:</b>	
-21,257	Normal	-21,535
-340	Additional contributions	-131
<b>-93,884</b>		<b>-96,800</b>
-64,694	Administering Authority	-65,776
-25,714	Scheduled Bodies	-26,962
-3,476	Admitted Bodies	-4,062
<b>-93,884</b>		<b>-96,800</b>

## 9. TRANSFERS IN FROM OTHER PENSION FUNDS

2012-13 £000		2013-14 £000
-3,441	Group Transfers	0
-3,282	Individual Transfers	-2,623
<b>-6,723</b>		<b>-2,623</b>

## 10. BENEFITS PAYABLE

2012-13 £000		2013-14 £000
81,656	Pensions	84,383
17,484	Commutations and lump sum retirement benefits	15,454
1,815	Lump sum death benefits	1,763
-4,977	Recharged benefits	-4,931
<b>95,978</b>		<b>96,669</b>
77,649	Administering Authority	76,488
16,570	Scheduled Bodies	17,755
1,759	Admitted Bodies	2,426
<b>95,978</b>		<b>96,669</b>

## 11. PAYMENTS TO AND ON ACCOUNT OF LEAVERS

2012-13 £000		2013-14 £000
4	Refunds to members leaving service	4
1	Payments for members joining state scheme	0
4,491	Individual transfers to other schemes	4,579
4,557	Group transfers to other schemes	27,717
<b>9,053</b>		<b>32,300</b>

The £27.717m shown in the Group Transfers in 2013/14 is the amount payable at 31 March 2014 in relation to the bulk transfer of Durham Probation Service staff, from Durham County Council Pension Fund to Teesside Pension Fund.

## 12. ADMINISTRATION EXPENSES

2012-13 £000		2013-14 £000
1,054	DCC support costs	1,085
37	Legal fees	58
26	External Audit fees	26
25	Internal Audit fees	12
160	Actuary fees	85
<b>1,302</b>		<b>1,266</b>

During 2013/14 a rebate of £3,547 was received from the Audit Commission in respect of the 2012/13 audit fee.

## 13. INVESTMENT INCOME

2012-13 £000		2013-14 £000
-4,286	Interest from fixed interest securities	-1,717
-2,307	Income from index-linked securities	-3,827
-18,855	Dividends from equities	-17,300
-39	Interest on cash deposits	-35
-6,729	Income from pooled investment vehicles	-7,455
<b>-32,216</b>		<b>-30,334</b>

## 14. TAXATION

The Pensions SORP requires that any withholding tax that is irrecoverable should be disclosed in the Fund Account as a tax charge, however as Investment Managers have not been able to supply information for the full year, no amount of irrecoverable withholding tax has been disclosed.

### ❖ **United Kingdom Income Tax**

The Fund is an exempt approved Fund under Section 1(1) Schedule 36 of the Finance Act 2004, and is therefore not liable to UK income tax on interest, dividends and property income, or to capital gains tax.

### ❖ **Value Added Tax**

As Durham County Council is the administering authority for the Fund, VAT input tax is recoverable on most fund activities.

### ❖ **Foreign Withholding Tax**

Income earned from investments in stocks and securities in the United States, Australia and Belgium is exempt from tax. In all other countries dividends are taxed at source and, where the tax paid at source is greater than the rate of tax under the 'Double Taxation Agreement', the excess tax is reclaimable except in the case of Malaysia.

## 15. INVESTMENT MANAGEMENT FEES

Investment Managers' fees are based on the value of assets under management. A performance related fee, derived from a base fee plus a percentage of out-performance, is paid to three of the Fund's investment managers; an ad-valorem fee is payable to the other managers. All fees are payable in arrears.

Independent Advisers' fees are based on a retainer for attendance at Pension Fund Committee and Annual Meetings and the provision of advice. Fees for any additional work are based on a daily or hourly rate, as agreed in advance.

2012-13 £000		2013-14 £000
5,164	Manager Fees	4,834
158	Custody Fees	122
177	Adviser Fees	166
<b>5,499</b>		<b>5,122</b>

## 16. INVESTMENTS

### Analysis by Investment Manager

The following Investment Managers were employed in 2013/14 to manage the Pension Fund's assets:

- AllianceBernstein Limited (AllianceBernstein)
- Baring Asset Management Limited (Barings)
- BlackRock Investment Management UK Limited (BlackRock)
- CB Richard Ellis Collective Investors Limited (CBRE)
- Royal London Asset Management (RLAM)

The long-term strategic allocation as at 31 March was as follows:

31 March 2013 %	Investment Manager	Asset Class	31 March 2014 %
0	Aberdeen	Global equities	15
15	AllianceBernstein	Global Bonds	15
0	BNYM	Global equities	15
20	Barings	Dynamic Asset Allocation	20
37	Blackrock	Global equities	0
8	CBRE	Global property	8
0	Mondrian	Emerging Market Equities	7
20	Royal London	Investment grade sterling bonds	20
<b>100</b>			<b>100</b>

The Pension Fund Committee approved the appointment of three new Investment Managers on 1 May 2013, namely Bank of New York Mellon Investment Management Ltd (BNYM), Aberdeen Asset Management (Aberdeen) and Mondrian Investment Partners Ltd (Mondrian). The first two Managers will have responsibility for global equity mandates and the latter will manage an emerging market equity mandate. The re-allocation of the Fund's equity assets is due to start in October 2014.

In anticipation of the commencement of the new Investment Managers, the actual allocation varies from the long-term strategic allocation at 31 March 2014. The actual market values of investments held by each Investment Manager as at 31 March were as follows:

31 March 2013			31 March 2014		
£000	%	Investment Manager	£000	%	
301,217	14.67	AllianceBernstein	305,405	14.32	
397,393	19.35	Barings	418,159	19.60	
807,330	39.31	Blackrock	864,856	40.55	
135,285	6.59	CBRE	145,432	6.82	
0	0.00	Edinburgh Partners	0	0.00	
99	0.00	Other - NEL	71	0.00	
412,426	20.08	RLAM	399,010	18.71	
<b>2,053,750</b>	<b>100.00</b>		<b>2,132,933</b>	<b>100.00</b>	

The totals in the above table include all assets held by Investment Managers on behalf of the Fund, including cash and derivatives. The total as at 31 March 2014 excludes loans of £0.390m, cash invested by the administering authority of £26.241m, other investment assets of £14.122m and other investment liabilities of £18.387m (£0.408m, £20.882m, £47.210m and £39.881m respectively as at 31 March 2013).

Of the total value of net investment assets reported in the Net Assets Statement as at 31 March 2014, £2.133m (98.96%) is invested through Investment Managers (£2.054m or 98.63% of the total in 2012/13).

### Reconciliation of Movements in Investments 2013/14

Investment category	Value at 31 March 2013	Purchases at cost	Sales proceeds	Change in market value	Value at 31 March 2014
	£000	£000	£000	£000	£000
Fixed interest securities	73,341	419,890	-429,646	-651	62,934
Equities	435,804	188,238	-139,693	16,549	500,898
Index linked securities	410,966	2,002,231	-2,010,126	-18,896	384,175
Pooled investment vehicles	1,117,793	41,133	-66,833	36,714	1,128,807
	2,037,904	2,651,492	-2,646,298	33,716	2,076,814
Derivative contracts:					
Futures, margins & options	1,340	1,095	-472	2,753	4,716
Forward foreign currency	415			1,138	1,553
	<b>2,039,659</b>	<b>2,652,587</b>	<b>-2,646,770</b>	<b>37,607</b>	<b>2,083,083</b>
Other investment balances:					
Loans	408				390
Other cash deposits	34,973			13,383	76,091
Dividend accruals	4,974				4,813
Tax recovery	527				378
Other investment balances	1,828				-9,456
<b>Net Investment Assets</b>	<b>2,082,369</b>			<b>50,990</b>	<b>2,155,299</b>

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.



## Reconciliation of Movements in Investments 2012/13

Investment category	Value at 31 March 2012	Purchases at cost	Sales proceeds	Change in market value	Value at 31 March 2013
	£000	£000	£000	£000	£000
Fixed interest securities	44,332	339,972	-313,115	2,152	73,341
Equities	814,163	2,085,867	-2,352,246	-111,980	435,804
Index linked securities	367,949	1,642,392	-1,638,844	39,469	410,966
Pooled investment vehicles	585,487	1,642,480	-1,360,844	250,670	1,117,793
	1,811,931	5,710,711	-5,665,049	180,311	2,037,904
Derivative contracts					
Futures, margins & options	2,628		-141	-1,147	1,340
Forward foreign currency	969			-554	415
	1,815,528	5,710,711	-5,665,190	178,610	2,039,659
Other investment balances:					
Loans	425				408
Other cash deposits	60,657			-3,032	34,973
Dividend accruals	6,816				4,974
Tax recovery	516				527
Other investment balances	5,445				1,828
<b>Net Investment Assets</b>	<b>1,889,387</b>			<b>175,578</b>	<b>2,082,369</b>

## Analysis of Investments

2012-13		2013-14	
£000	£000	£000	£000
<b>ASSETS INVESTED THROUGH FUND MANAGERS</b>			
<b>Fixed interest securities</b>			
22,932		24,899	
22,256		0	
28,153		38,035	
	73,341		62,934
<b>Equities</b>			
402,039		444,881	
99		71	
33,666		55,946	
	435,804		500,898
<b>Index linked securities</b>			
371,987		351,857	
1,600		1,509	
37,379		27,531	
0		3,278	
	410,966		384,175
<b>Pooled Investment Vehicles</b>			
0		27,680	
24,875		13,095	
55,249		68,150	
889,394		878,029	
3,270		4,481	
39,551		28,044	
28,851		22,346	
76,603		86,982	
	1,117,793		1,128,807
<b>Derivative Contracts</b>			
13,739		47,205	
-11,984		-40,936	
	1,755		6,269
14,091	14,091	49,850	49,850
<b>2,053,750</b>	<b>NET ASSETS INVESTED THROUGH FUND MANAGERS</b>	<b>2,132,933</b>	
<b>OTHER INVESTMENT BALANCES</b>			
20,882	Short term investments (via DCC Treasury Management)	26,241	
408	Loans	390	
47,210	Other investment assets	14,122	
-39,881	Other investment liabilities	-18,387	
<b>2,082,369</b>	<b>NET INVESTMENT ASSETS</b>	<b>2,155,299</b>	

## Analysis of Derivatives

### Objectives and Policies for Holding Derivatives

Derivatives are financial instruments that derive their value from the price or rate of some underlying item. Underlying items include equities, bonds, commodities, interest rates, exchange rates and stock market indices.

The Fund uses derivatives to manage its exposure to specific risks arising from its investment activities. Derivatives may be used to gain exposure to an asset more efficiently than holding the underlying asset or hedge against the risk of adverse currency movement on the Fund's investments. The use of derivatives is managed in line with the investment management agreement agreed between the Pension Fund and its Investment Managers.

A summary of the derivative contracts held by the Pension Fund is provided in the following table:

2012-13 £000	£000	Derivative Contracts	2013-14 £000	£000
		<b>Forward foreign currency</b>		
2,942		Assets	1,688	
-2,527		Liabilities	-135	
	415	<b>Net Forward foreign currency</b>		1,553
		<b>Futures</b>		
9,493		Assets	40,945	
-9,457		Liabilities	-40,800	
	36	<b>Net Futures</b>		145
		<b>Options</b>		
0		Assets	165	
0		Liabilities	0	
	0	<b>Net Options</b>		165
		<b>Margins</b>		
1,304		Assets	4,406	
0		Liabilities	0	
	1,304	<b>Net Margins</b>		4,406
	<b>1,755</b>	<b>Net market value of derivative contracts</b>		<b>6,269</b>

The Pension Fund invests in the following types of derivatives:

**i. Forward Foreign Currency Contracts**

Currency is bought and sold by investment managers (Barings, CBRE and Royal London) for future settlement at a predetermined exchange rate. Such contracts are used to hedge against the risk of adverse currency movements on the Fund's investments. Contracts are by their nature over the counter and are primarily in US dollars, euros and sterling.

Settlement	Currency bought	Local Value	Currency sold	Local Value	Asset Value £000	Liability Value £000
less than 1 mth	GBP	3,483,821	CHF	-5,100,000	19	
1 to 6 mths	GBP	24,009,647	JPY	-4,052,000,000	399	
1 to 6 mths	GBP	52,041,910	USD	-86,700,000	16	
1 to 6 mths	GBP	8,586,510	USD	-14,250,000	36	
1 to 6 mths	GBP	5,756,845	USD	-9,600,000		-4
1 to 6 mths	GBP	1,926,371	USD	-3,178,077	19	
1 to 6 mths	GBP	15,028,380	EUR	-18,000,000	143	
1 to 6 mths	USD	72,050,260	GBP	43,549,110	304	
1 to 6 mths	EUR	25,177,669	GBP	21,127,111	301	
1 to 6 mths	AUD	9,457,448	GBP	5,180,176		-50
1 to 6 mths	JPY	1,127,648,685	GBP	6,724,202	149	
1 to 6 mths	AUD	1,246,853	GBP	674,266		-15
1 to 6 mths	USD	1,217,987	GBP	731,744	1	
1 to 6 mths	JPY	213,182,154	GBP	1,245,441	2	
1 to 6 mths	GBP	8,904,627	EUR	-10,640,000	104	
1 to 6 mths	GBP	6,815,450	USD	-11,255,000	60	
1 to 6 mths	GBP	3,534,268	USD	-5,822,000	40	
1 to 6 mths	EUR	7,953,000	GBP	-6,644,732		-66
1 to 6 mths	GBP	8,717,483	USD	-14,410,000	68	
1 to 6 mths	GBP	8,776,493	USD	-14,576,000	27	
					<b>1,688</b>	<b>-135</b>
<b>Net forward foreign currency contracts at 31 March 2014</b>						<b>1,553</b>

Settlement	Currency bought	Local Value	Currency sold	Local Value	Asset Value £000	Liability Value £000
1 to 6 mths	GBP	4,316,734	SEK	44,959,000		-236
1 to 6 mths	GBP	4,335,714	SEK	44,931,000		-214
1 to 6 mths	GBP	3,974,561	SEK	42,981,100		-378
1 to 6 mths	GBP	4,390,654	SEK	42,817,000	55	
1 to 6 mths	GBP	5,452,206	CAD	8,517,000		-68
1 to 6 mths	GBP	7,198,646	EUR	8,323,000	159	
1 to 6 mths	GBP	5,097,381	CAD	8,048,000		-119
1 to 6 mths	GBP	4,471,910	USD	6,766,000	16	
1 to 6 mths	GBP	4,306,909	USD	6,764,000		-148
1 to 6 mths	GBP	5,438,673	EUR	6,685,400		-216
1 to 6 mths	GBP	3,770,098	CAD	6,038,000		-143
1 to 6 mths	EUR	6,861,000	GBP	5,569,554	233	
1 to 6 mths	CAD	8,063,000	GBP	5,184,876	41	
1 to 6 mths	GBP	3,720,498	EUR	4,471,000		-61
1 to 6 mths	CAD	6,469,000	GBP	4,077,786	115	
1 to 6 mths	SEK	42,811,000	GBP	4,058,492	277	
1 to 6 mths	EUR	4,621,000	GBP	3,974,060		-66
1 to 6 mths	EUR	4,584,000	GBP	3,880,952		-4
1 to 6 mths	GBP	2,075,930	EUR	2,529,000		-63
1 to 6 mths	GBP	950,586	EUR	1,121,000	2	
less than 1 mth	USD	4,047,000	GBP	2,711,194		-46
less than 1 mth	GBP	3,493,098	AUD	5,071,000	14	
less than 1 mth	GBP	1,324,976	AUD	1,932,000		
less than 1 mth	USD	1,358,000	EUR	1,058,993		-3
1 to 6 mths	EUR	24,576,325	GBP	21,433,652	628	
1 to 6 mths	USD	84,118,546	GBP	56,167,663	746	
1 to 6 mths	JPY	529,865,132	GBP	3,694,621		-21
1 to 6 mths	GBP	8,495,114	EUR	9,890,000	128	
1 to 6 mths	GBP	22,226,993	USD	34,680,000		-618
1 to 6 mths	GBP	12,074,642	USD	18,250,000	53	
1 to 6 mths	GBP	6,634,667	USD	9,883,000	124	
1 to 6 mths	GBP	11,250,311	JPY	1,555,000,000	351	
1 to 6 mths	GBP	8,178,023	JPY	1,173,000,000		-44
1 to 6 mths	GBP	6,369,802	JPY	920,000,000		-79
					<b>2,942</b>	<b>-2,527</b>
<b>Net forward foreign currency contracts at 31 March 2013</b>						<b>415</b>

## ii. Futures

When there is a requirement to hold cash assets, but the Investment Manager does not want this cash to be out of the market, index based futures contracts are bought which have an underlying economic value broadly equivalent to the cash held in anticipation of cash outflow required. Outstanding exchange traded futures contracts, held by Barings, are as follows:

Type	Expires	Product Description	Currency	Market Value at 31 March 14	
				£000	£000
<b>Assets</b>					
Overseas equity	1 to 3 mths	SGX NIKKEI 225	JPY	8,709	
UK equity	1 to 3 mths	FTSE 100 (LIFFE)	GBP	13,634	
Overseas equity	1 to 3 mths	E MINI INDEX (CME)	USD	8,106	
Overseas equity	1 to 3 mths	EURO STOXX 50	EUR	10,496	
<b>Total assets</b>					40,945
<b>Liabilities</b>					
Overseas equity	1 to 3 mths	SGX NIKKEI 225	JPY	-8,633	
UK equity	1 to 3 mths	FTSE 100 (LIFFE)	GBP	-13,645	
Overseas equity	1 to 3 mths	E MINI INDEX (CME)	USD	-8,047	
Overseas equity	1 to 3 mths	EURO STOXX 50	EUR	-10,475	
<b>Total liabilities</b>					-40,800
<b>Net Futures Contracts at 31 March 2014</b>					145

	Expires	Product Description	Currency	Market Value at 31 March 13	
				£000	£000
<b>Assets</b>					
UK equity	1 to 3 months	FTSE 100 (LIFFE) (LG)	GBP	1,207	
Overseas equity	1 to 3 months	DOWJONESEURO STOXX 50	EUR	8,286	
<b>Total assets</b>					9,493
<b>Liabilities</b>					
UK equity	1 to 3 months	FTSE 100 (LIFFE) (LG)	GBP	-1,206	
Overseas equity	1 to 3 months	DOWJONESEURO STOXX 50	EUR	-8,251	
<b>Total liabilities</b>					-9,457
<b>Net Futures Contracts at 31 March 2013</b>					36

### iii. Options

In order to benefit from potentially greater returns available from investing in equities whilst minimising the risk of loss of value through adverse equity price movements, the Fund, through Barings, has bought a number of equity option contracts. These option contracts are to protect it from falls in value in the main markets in which it is invested. There were no option contracts held at 31 March 2013.

Type	Expires	Product Description	Currency	Market Value at 31 March 14
				£000
UK equity	1 to 6 months	FTSE 100 (LIFFE)	GBP	165
<b>Net Options at 31 March 2014</b>				<b>165</b>

Type	Expires	Product Description	Currency	Market Value at 31 March 13
				£000
UK equity				-
<b>Net Options at 31 March 2013</b>				<b>-</b>

#### iv. Margins

The value of margin amounts outstanding at 31 March, which are held by Barings, are as follows:

	Product Description	Currency	Market Value at 31 March 14	
			£000	£000
Assets	UBS	GBP	1,383	
	UBS	EUR	907	
	UBS	JPY	1,196	
	UBS	USD	920	
Net Margins at 31 March 2014				<u>4,406</u>

Type	Product Description	Currency	Market Value at 31 March 13	
			£000	£000
Assets	UBS	GBP	173	
	UBS	EUR	1,131	
Net Margins at 31 March 2013				<u>1,304</u>

#### Investments Exceeding 5% of the Market Value of the Fund

The following investments represented more than 5% of the Pension Fund's total net assets available for benefits:

- Aquila Life Fund S1 - a pooled fund managed by Blackrock, valued at £508.117m at 31 March 2014 which equates to 23.85% of the net assets available for benefits (£480.022m or 23.02% at 31 March 2013);
- Diversified Yield Plus fund - a pooled fund of broad bonds through AllianceBernstein. The value of this investment at 31 March 2014 was £305.405m i.e. 14.33% (£301.217m or 14.44% at 31 March 2013).

## 17. FINANCIAL INSTRUMENTS

### Classification of Financial Instruments

Accounting policies describe how different asset classes of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts (equal to fair value) of financial assets and liabilities by category and Net Assets Statement heading:

2012-13			2013-14		
Fair value through profit and loss £000	Loans and receivables £000	Financial liabilities at amortised cost £000	Fair value through profit and loss £000	Loans and receivables £000	Financial liabilities at amortised cost £000
<b>Financial assets</b>					
73,341			62,934		
435,804			500,898		
410,966			384,175		
1,117,793			1,128,807		
13,739			47,205		
	408			390	
	14,091			49,850	
	20,882			26,241	
47,210			14,122		
	8,865			8,473	
2,098,853	44,246	0	2,138,141	84,954	0
<b>Financial liabilities</b>					
-11,984			-40,936		
-39,881		-5,774	-18,387		-32,917
-51,865	0	-5,774	-59,323	0	-32,917
<b>2,046,988</b>	<b>44,246</b>	<b>-5,774</b>	<b>2,078,818</b>	<b>84,954</b>	<b>-32,917</b>
<b>2,085,460 Net Assets at 31 March</b>			<b>2,130,855</b>		

### Net Gains and Losses on Financial Instruments

31 March 2013 £000		31 March 2014 £000
<b>Financial Assets</b>		
178,610	Fair Value through profit and loss	37,607
-3,032	Loans and receivables	13,383
<b>Financial Liabilities</b>		
0	Fair Value through profit and loss	-
0	Loans and receivables	-
0	Financial liabilities measured at amortised cost	-
<b>175,578</b>	<b>Total</b>	<b>50,990</b>



## Valuation of Financial Instruments Carried at Fair Value

The valuation of financial instruments has been classified into three levels according to quality and reliability of information used to determine fair values.

### LEVEL 1

Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities, quoted fixed securities, quoted index linked securities and unit trusts. Listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

### LEVEL 2

Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

### LEVEL 3

Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include investments which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The following tables provide analyses of the financial assets and liabilities of the Fund as at 31 March 2014 and 31 March 2013, grouped into Levels 1, 2 and 3, based on the level at which the fair value is observable.

	Quoted market price	Using observable inputs	With significant unobservable inputs	
Values at 31 March 2014	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
<b>Financial Assets</b>				
Financial Assets at fair value through profit and loss	1,084,715	944,687	108,739	2,138,141
Loans and receivables	84,954	0	0	84,954
<b>Total Financial Assets</b>	<b>1,169,669</b>	<b>944,687</b>	<b>108,739</b>	<b>2,223,095</b>
<b>Financial Liabilities</b>				
Financial Liabilities at fair value through profit and loss	-18,387	-40,936	0	-59,323
Financial Liabilities at amortised cost	-32,917	0	0	-32,917
<b>Total Financial Liabilities</b>	<b>-51,304</b>	<b>-40,936</b>	<b>0</b>	<b>-92,240</b>
<b>Net Financial Assets</b>	<b>1,118,365</b>	<b>903,751</b>	<b>108,739</b>	<b>2,130,855</b>

	Quoted market price Level 1 £000	Using observable inputs Level 2 £000	With significant unobservable inputs Level 3 £000	Total £000
<b>Values at 31 March 2013</b>				
<b>Financial Assets</b>				
Financial Assets at fair value through profit and loss	1,054,544	942,785	101,524	2,098,853
Loans and receivables	44,246			44,246
<b>Total Financial Assets</b>	<b>1,098,790</b>	<b>942,785</b>	<b>101,524</b>	<b>2,143,099</b>
<b>Financial Liabilities</b>				
Financial Liabilities at fair value through profit and loss	-39,881	-11,984		-51,865
Financial Liabilities at amortised cost	-5,774			-5,774
<b>Total Financial Liabilities</b>	<b>-45,655</b>	<b>-11,984</b>	<b>0</b>	<b>-57,639</b>
<b>Net Financial Assets</b>	<b>1,053,135</b>	<b>930,801</b>	<b>101,524</b>	<b>2,085,460</b>

## 18. NATURE AND EXTENT OF RISK ARISING FROM FINANCIAL INSTRUMENTS

### Risk and Risk Management

The Pension Fund's activities expose it to a variety of financial risks. The key risks are:

- i. **MARKET RISK** the possibility that financial loss may arise for the Fund as a result of changes in, for example, interest rates movements;
- ii. **CREDIT RISK** the possibility that other parties may fail to pay amounts due to the Fund;
- iii. **LIQUIDITY RISK** the possibility that the Fund might not have funds available to meet its commitments to make payments.

The Fund's primary long-term risk is that its assets will fall short of its liabilities (i.e. promised benefits payable to members). The aim of investment risk management is to minimise the risk of an overall reduction in the value of the Fund and maximise the opportunity for gains across the whole fund portfolio. This is achieved through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows. The administering body manages these investment risks as part of its overall Pension Fund risk management programme.

The Fund's assets are managed by a number of Investment Managers, as disclosed in Note 16. By dividing the management of the assets between all managers controls risk further. Asset allocation benchmarks have been set and performance is monitored relative to the benchmarks. This is to ensure the Investment Manager does not deviate from the Pension Fund Committee's investment strategy.

The Fund has appointed a Global Custodian that performs a range of services including collection of dividends and interest from the Investment Managers, administering corporate actions that the Pension Fund may join, dealing with taxation issues and proxy voting when requested. It also ensures that the settlement of purchases and sales of the Fund assets are completed. The Custodian has stringent risk management processes and controls. Client accounts are strictly segregated to ensure that the Fund assets are separately identifiable. Conservative investment practices are ensured by the Custodian where they invest cash collateral.

The Fund also employs a specialised service as an independent check to ensure that all dividends receivable are compared against those collected by the Custodian and that they were received on the due date; any discrepancies are investigated.

In line with its Treasury Management Policy, Durham County Council, as administering authority, invests the short term cash balances on behalf of the Pension Fund. Interest is paid over to the Fund on a quarterly basis.

Durham County Council's overall risk management procedures focus on the unpredictability of financial markets and are structured to implement suitable controls to minimise these risks. The procedures for risk management are set out through a legal framework based on the Local Government Act 2003 and associated regulations. These require the Council to comply with the CIPFA Prudential Code, the CIPFA Treasury Management Code and CLG Guidance.

#### **i. MARKET RISK**

Market risk is the risk of loss from fluctuations in market prices, interest and foreign exchange rates. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix. The objective of the Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Fund and its investment advisers undertake appropriate monitoring of market conditions and benchmark analysis.

These risks are managed in two ways:

- the exposure of the fund to market risk is monitored through a factor risk analysis to ensure that risk remains within tolerable levels;
- specific risk exposure is limited by applying risk-weighted maximum exposures to individual investments.

### **Other Price Risk**

Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all such instruments in the market.

The Fund is exposed to share and derivative price risk. This arises from investments held by the fund for which the future price is uncertain. All securities investments present a risk of loss of capital. Except for shares sold short, the maximum risk resulting from financial instruments is determined by the fair value of the financial instruments. Possible losses, from shares sold short, is unlimited.

The Fund's Investment Managers mitigate this price risk through diversification and the selection of securities and other financial instruments is monitored by the Fund to ensure it is within limits specified in the Fund Investment Strategy.

### **Other Price Risk – Sensitivity Analysis**

In consultation with the Fund's investment advisers, an analysis of historical volatility, Investment Manager volatility and expected investment return movements during the financial year has been completed. From this, the Fund has determined that the potential market movements in market price risk, as shown in the following table, are reasonably possible for the 2014/15 reporting period and are consistent with one standard deviation in market prices. The analysis assumed that all other variables, in particular foreign currency exchange rates and interest rates, remain the same.

If the market price of the Fund investments were to increase/decrease in line with these potential market movements, the value of assets available to pay would vary as illustrated in the following table (the prior year comparator is also shown below):

Manager	Asset type	Asset value at 31 March 2014 £000	Potential market movements %	Value on increase £000	Value on decrease £000
Alliance Bernstein	Broad Bonds	305,405	6%	323,729	287,081
Barings	DAA	396,025	8%	427,707	364,343
BlackRock	Active UK Equity	350,878	16%	407,018	294,738
BlackRock	Passive UK Equity	508,117	15%	584,335	431,899
CBRE	Unlisted property	96,800	10%	106,480	87,120
CBRE	Listed property	24,433	22%	29,808	19,058
RLAM	UK Index Linked Gilts	395,085	9%	430,643	359,527
Other	UK Equity	71	22%	87	55
	Loans	390	0%	390	390
	Cash	76,091	0%	76,091	76,091
	Net derivative assets	6,269	0%	6,269	6,269
	Net investment balances	-4,265	0%	-4,265	-4,265
<b>Total change in net investment assets available</b>		<b>2,155,299</b>		<b>2,388,292</b>	<b>1,922,306</b>

Manager	Asset type	Asset value at 31 March 2013 £000	Potential market movements %	Value on increase £000	Value on decrease £000
Alliance Bernstein	Broad Bonds	301,217	6%	319,290	283,144
Barings	DAA	390,795	8%	422,059	359,531
BlackRock	Global Equity	803,427	21%	972,147	634,707
CBRE	Unlisted property	101,525	10%	111,678	91,373
CBRE	Listed property	29,874	24%	37,044	22,704
RLAM	Global Linked Gilts	410,967	8%	443,844	378,090
Other	UK Equity	99	24%	123	75
	Loans	408	0%	408	408
	Cash	34,973	0%	34,973	34,973
	Net derivative assets	1,755	0%	1,755	1,755
	Net investment balances	7,329	0%	7,329	7,329
<b>Total change in net investment assets available</b>		<b>2,082,369</b>		<b>2,350,650</b>	<b>1,814,089</b>

## Interest Rate Risk

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is routinely monitored by the administering authority (as part of its Treasury Management Service for investment of surplus cash), its managers, custodian and investment advisers in accordance with the Fund's risk management strategy. This includes monitoring the exposure to interest rates and assessment of actual interest rates against the relevant benchmarks. During periods of falling interest rates and where economic circumstances make it favourable, fixed rate investments may be taken for longer periods to secure better long term returns.

## Interest Rate Risk - Sensitivity Analysis

The Fund recognises that interest rates can vary and can affect income to the fund and the value of the net assets available to pay benefits. The following table shows the Fund's asset values having direct exposure to interest rate movements as at 31 March 2014 and the effect of a +/- 50 BPS change in interest rates on the net assets available to pay benefits (assuming that all other variables, in particular exchange rates, remain constant). The prior year comparator is also provided:

Asset type	Asset Values at 31 March 2014  £000	Change in year in the net assets available to pay benefits	
		+50 BPS £000	-50 BPS £000
Cash and cash equivalents	76,091	380	-380
Fixed interest securities	62,934	315	-315
<b>Total change in net investment assets available</b>	<b>139,025</b>	<b>695</b>	<b>-695</b>

Asset type	Asset Values at 31 March 2013  £000	Change in year in the net assets available to pay benefits	
		+50 BPS £000	-50 BPS £000
Cash and cash equivalents	34,973	175	-175
Fixed interest securities	73,341	367	-367
<b>Total change in net investment assets available</b>	<b>108,314</b>	<b>542</b>	<b>-542</b>

## Currency Risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than GBP (the functional currency of the Fund). The Fund holds both monetary and non-monetary assets denominated in currencies other than GBP. The Fund's currency rate risk is routinely monitored by the Fund and its investment advisers in accordance with the fund's risk management strategy, including monitoring the range of exposure to currency fluctuations.

## Currency Risk - Sensitivity Analysis

Having consulted with the Fund's independent investment advisers, the Fund considers the likely volatility associated with foreign exchange rate movements will range between 7% and 14%. For prudence, the Fund has applied a 14% fluctuation (as measured by one standard deviation) based on the adviser's analysis of long-term historical movements in the month end exchange rates over a rolling 12 month period. This analysis assumes that all other variables, in particular interest rates, remain constant.

The following table exemplifies, by Investment Manager, to what extent a 14% strengthening/ weakening of the pound, against the various currencies in which the fund holds investments, would increase/decrease the net assets available to pay benefits (a prior year comparator is also provided):

Manager	Currency exposure by asset type	Level of unhedged exposure	Total Volatility	Asset value at 31 March 14	Value on increase	Value on decrease
				£000	£000	£000
Alliance Bernstein	Broad Bonds	0%	0%	305,405	305,405	305,405
Barings	DAA	20%	3%	396,025	407,906	384,144
BlackRock	UK Equity	0%	0%	350,878	350,878	350,878
BlackRock	Global Equity	90%	13%	508,117	574,172	442,062
CBRE	Global Property	15%	2%	121,233	123,658	118,808
RLAM	UK Index Linked Gilts	0%	0%	395,085	395,085	395,085
Other	UK Equity	0%	0%	71	71	71
	Loans	0%	0%	390	390	390
	Cash	0%	0%	76,091	76,091	76,091
	Net derivative assets	0%	0%	6,269	6,269	6,269
	Net investment balances	0%	0%	-4,265	-4,265	-4,265
<b>Total change in net investment assets available</b>				<b>2,155,299</b>	<b>2,235,660</b>	<b>2,074,938</b>

Manager	Currency exposure by asset type	Level of unhedged exposure	Total Volatility	Asset value at 31 March 13	Value on increase	Value on decrease
				£000	£000	£000
Alliance Bernstein	Broad Bonds & PPIP	0%	0%	301,217	301,217	301,217
Barings	DAA	20%	3%	390,795	402,519	379,071
BlackRock	UK Equity	0%	0%	323,405	323,405	323,405
BlackRock	Global Equity	90%	12%	480,022	537,625	422,419
CBRE	Global Property	15%	2%	131,399	134,027	128,771
RLAM	Global Linked Gilts	0%	0%	410,967	410,967	410,967
Other	UK Equity	0%	0%	99	99	99
	Loans	0%	0%	408	408	408
	Cash	0%	0%	34,973	34,973	34,973
	Net derivative assets	0%	0%	1,755	1,755	1,755
	Net investment balances	0%	0%	7,329	7,329	7,329
<b>Total change in net investment assets available</b>				<b>2,082,369</b>	<b>2,154,324</b>	<b>2,010,414</b>

## ii. CREDIT RISK

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial assets and liabilities.

The Fund's entire investment portfolio (except derivatives) is exposed to some form of credit risk. The Fund minimises credit risk by undertaking transactions with a large number of high quality counterparties, brokers and institutions.

Investment Managers adopt procedures to reduce credit risk related to its dealings with counterparties on behalf of its clients. Before transacting with any counterparty, the Investment Manager evaluates both credit worthiness and reputation by conducting a credit analysis of the party, their business and reputation. The credit risk of approved counterparties is then monitored on an ongoing basis, including periodic reviews of financial statements and interim financial reports as required.

The Fund has sole responsibility for the initial and ongoing appointment of custodians. Uninvested cash held with the Custodian is a direct exposure to the balance sheet of the Custodian. Arrangements for investments held by the Custodian vary from market to market but the assets of the Fund are held in a segregated client account. As at 31 March 2014, this level of exposure to the Custodian is only 2.3% of the total value of the portfolio.

Surplus cash is invested by Durham County Council only with financial institutions which meet identified minimum credit criteria, in accordance with the Fitch, Moody's and Standard & Poors' Credit Ratings Services. The Council's Investment Strategy sets out the maximum amounts and time limits in respect of deposits placed with each financial institution; deposits are not made unless they meet the minimum requirements of the investment criteria.

The Fund believes it has managed its exposure to credit risk. No credit limits were exceeded during the reporting period and the Fund does not expect any losses from non-performance by any of its counterparties in relation to deposits.

The cash holding under its treasury management arrangements was £26.241m as at 31 March 2014 (£20.882m at 31 March 2013). This was held with the following institutions:



	Rating as at 31 March 2014	Balances £000	Rating as at 31 March 2013	Balances £000
<b>Bank Deposit Accounts</b>				
Bank of Scotland			F1	11,355
Barclays	F1	4,336	F1	4,731
The Co-operative Bank			F2	444
Natwest Bank	F1	2,601	F1	2,271
Santander UK Plc	F1	4,309		
<b>Fixed Term Deposits</b>				
Barclays				
Bank of Scotland	F1	10,407		
Nationwide Building Society	F1	4,336		
Natwest Bank			F1	1,892
UK Local Authorities	N/A	78		
<b>Income Bond</b>				
National Savings & Investments	N/A	174	N/A	189
<b>Total</b>		<b>26,241</b>		<b>20,882</b>

### iii. LIQUIDITY RISK

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. Steps are taken to ensure that the Fund has adequate cash resources to meet its commitments. Management prepares quarterly cash flow forecasts to understand and manage the timing of the Fund's cash flows. The appropriate strategic level of cash balances to be held forms part of the Fund Investment Strategy and rebalancing policy.

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

Durham County Council invests the cash balances of the Fund in line with its Treasury Management Policy and as agreed by the Pension Fund Committee. The Council manages its liquidity position to ensure that cash is available when needed, through the risk management procedures set out in the prudential indicators and treasury and investment strategy reports, and through a comprehensive cash flow management system.

Regulation 5 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, gives Durham County Council a limited power to borrow on behalf of the Pension Fund for up to 90 days. The Council has ready access to borrowings from the money markets to cover any day to day cash flow need. This facility is only used to meet timing differences on pension payments and as they are of a short-term nature, exposure to credit risk is considered negligible.

## 19. ANALYSIS OF DEBTORS

2012-13 £000		2013-14 £000
1,680	Central government bodies	1,556
5,649	Other local authorities	5,390
48,746	Other entities and individuals	15,649
<u>56,075</u>	<b>Total debtors</b>	<u>22,595</u>
	<b>Included in the Net Assets Statement as:</b>	
1,458	Long Term Assets	1,250
47,210	Other Investment Assets	14,122
7,407	Current Assets	7,223
<u>56,075</u>		<u>22,595</u>

The long term assets relate to the portion of the transfer value in from the Ministry of Justice for Magistrates' Courts staff which are repayable more than 12 months after the year end.

## 20. ANALYSIS OF CREDITORS

2012-13 £000		2013-14 £000
0	NHS Bodies	-39
-706	Central government bodies	-742
-1,343	Other local authorities	-29,132
-43,606	Other entities and individuals	-21,391
<u>-45,655</u>	<b>Total creditors</b>	<u>-51,304</u>
	<b>Included in the Net Assets Statement as:</b>	
-39,881	Other Investment Liability Balances	-18,387
-5,774	Current Liabilities	-32,917
<u>-45,655</u>		<u>-51,304</u>

Included in the amount due to Other Local Authorities in 2013/14 is £27.717m. This relates to the transfer value payable to Teesside Pension Fund for Durham Probation Service staff who have already transferred out of the Pension Fund.

All of the £51.304m is expected to be paid by the Pension Fund within 12 months after the year end.

## 21. ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVCs)

AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for individual contributors. The Pension Fund offers two types of AVC arrangement:

- Purchase of additional pension, which is invested as an integral part of the Fund's assets;
- Money purchase scheme, managed separately by Equitable Life, Standard Life and Prudential. AVCs may be invested in a range of different funds.

The table below refers only to the money purchase AVCs:

	Value at 31 March 2013 £000	* Purchases £000	Sales £000	Change in Market Value £000	Value at 31 March 2014 £000
Equitable Life	2,233	71	0	-90	2,214
Prudential	2,864	824	356	106	3,438
Standard Life	1,339	172	111	110	1,510
<b>Total</b>	<b>6,436</b>	<b>1,067</b>	<b>467</b>	<b>126</b>	<b>7,162</b>

\* Purchases represent the amounts paid to AVC providers in 2013/14.

The financial information relating to money purchase AVCs, as set out above, is not included in the Fund's Net Asset Statement or Fund Account in accordance with Regulation 5(2) c of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

## 22. RELATED PARTY TRANSACTIONS

Related parties are bodies or individuals that have the potential to control or influence the Pension Fund or to be controlled or influenced by the Pension Fund. Influence in this context is expressed in terms of a party:

- being potentially inhibited from pursuing at all times its own separate interests by virtue of the influence over its financial and operating policies; or
- actually subordinating its separate interests in relation to a particular transaction.

Related parties of the Pension Fund fall into three categories:

- a) Employer related
- b) Member related
- c) Key management personnel

**a) EMPLOYER RELATED**

There is a close relationship between an employer and the Pension Fund set up for its employees and therefore each participating employer is considered a related party.

The following table details the nature of related party relationships.

Transaction	Description of the Financial Effect	Amount	
		2012/13	2013/14
Contributions receivable	Amounts received from employers in respect of contributions to the Pension Fund	£93.884m	£96.800m
Debtors	Amounts due in respect of employers and employee contributions	£7.891m	£7.551m
Creditors	Amounts due to the Administering Authority in respect of administration and investment management expenses	£1.343m	£1.356m
Administration & Investment Management Expenses	The administration, and a small proportion of the investment management, of the Pension Fund is undertaken by officers of the County Council. The Council incurred the following costs, including staff time, which have been subsequently reimbursed by the Fund	£1.343m	£1.356m
Long term loans	The Pension Fund made loans to Durham County Council prior to January 1974 which earn interest of between 5.75% and 9.875% pa of the outstanding balance, in addition to capital repayments	Loans outstanding £0.274m	Loans outstanding £0.263m
Investment Income	Part of the Pension Fund's cash holding is invested in money markets by Durham County Council. The average surplus cash balance and interest earned were:	Balance= £20.395m Interest = £0.303m	Balance= £17.448m Interest = £0.068m

**b) MEMBER RELATED**

Member related parties include:

- Member and their close families or households
- Companies and businesses controlled by the Members and their close families which have a financial contractual relationship with any of the organisations that contract with the Pension Fund.

Durham County Council and Darlington Borough Council have a number of Members who are on the Pension Fund Committee. These Members are subjected to a declaration of interest circulation as with all Durham County Council Members. Each Member of the Pension Fund Committee is also required to declare their interests at the start of each meeting. There were no material related party transactions between any Members or their families and the Pension Fund.

There are 3 Members of the Pension Fund Committee who are in receipt of pension benefits from Durham County Council Pension Fund; a further 4 Members are active members of the Pension Fund.

### **c) KEY MANAGEMENT PERSONNEL**

Related parties in this category include:

- Key management i.e. senior officers and their close families
- Companies and businesses controlled by the key management of the Pension Fund or their close families.

Disclosure requirements for officer remuneration and members allowances can be found in the main accounts of Durham County Council.

There were no material related party transactions between any officers or their families and the Pension Fund.

## **23. CONTINGENT ASSETS**

### **a) PENSION CONTRIBUTIONS ON EQUAL PAY PAYMENTS**

Originally equal pay settlements were not deemed to be pensionable however, an element of choice has since been introduced. Individuals can choose to have their settlements considered to be pensionable. This provision has now been added to the agreements that individuals with pending equal pay settlements sign.

There is no certainty that an individual will pay pension contributions on their Equal Pay settlement. The agreements signed by individuals are 'open-ended' in that an individual's ability to determine their settlement as 'pensionable' is not time limited, so the timing of any liability to pay contributions are not certain. The level of contributions likely to be received by the Pension Fund, are unlikely to have a material effect on the Pension Fund Accounts.

### **b) FOREIGN INCOME DIVIDENDS (FIDs)**

The Pension Fund is involved in claims for tax reclaims due to EC Legislation. The outcome of the Court cases will determine the reclaim of taxes; neither the amount of income nor the timing of the income is certain.

Up until 1 July 1997 UK Pension Funds were entitled, under UK tax law, to reclaim tax credits attaching to dividends received from UK resident companies. However, Pension Funds which received dividends designated by UK companies as FIDs, or dividends received from overseas companies, were not entitled to a refundable tax credit. Since UK sourced dividends came with a 20 percent tax credit, the net investment income return

from UK companies paying such dividends was significantly higher than UK companies paying FIDs or dividends from overseas companies, for which no credit was available. As a result there was a disincentive for Pension Funds to invest in such companies.

The UK tax law which gave rise to these consequences was arguably contrary to EU law, notably Article 56EC, in that it treated UK Pension Funds investing directly into overseas companies, or UK companies paying FIDs, less favourably than UK companies paying ordinary dividends.

The legal arguments to support the strongest element of the FID and Manninen type claims (for EU sourced dividends and FIDs) are considered to be very good. The points in issue are currently being considered at the High Court via a Group Litigation Order containing over 65 UK Pension Funds, including Durham County Council Pension Fund.

### **c) WITHHOLDING TAX (WHT) CLAIMS**

Pension funds, investment funds and other tax exempt bodies across Europe have in recent years been pursuing claims against a number of EU Member States for the recovery of withholding taxes suffered on EU sourced dividend income. These claims were made in the light of the Fokus Bank (Case E-1/04) ruling in December 2004 on the grounds that the WHT rules of those Member States are in breach of the free movement of capital principle of the EC Treaty. The legal arguments used to support Fokus claims are strong and rely on existing case law. The EU Commission announced that it is taking action against a number of member states which operate discriminatory rules regarding the taxation of outbound dividends.

A test case in the Netherlands on behalf of a number of UK pension funds was successful and in January 2009 notification from the Dutch Tax Authorities was received that the claims brought by the test claimant for the recovery of withholding taxes going back to 2003 had been accepted and would be repaid in the near future. Following the ruling in the Netherlands which essentially states that the Dutch tax authorities should not have levied a “withholding tax” (WHT) on dividend payments to tax exempt bodies (such as UK pension funds) located within the European Union but outside the Netherlands, a similar process for reclaiming WHT in other EU Member States is now on-going.

As a result of a precedent for the change in WHT has been set by the Netherlands, other Member States have now reduced the level of WHT of non-residents; recovery is therefore probable, but the timing and amount of income is uncertain.

## 24. FUNDING ARRANGEMENTS

In line with the LGPS (Administration) Regulations 2008, the Fund's independent qualified actuary undertakes a funding valuation every 3 years for the purpose of setting employer contribution rates for the forthcoming triennial period. The last full valuation took place as at 31 March 2013.

The key elements of the funding policy are to:

- ensure the long term solvency of the fund, i.e. that sufficient funds are available to meet all pension liabilities as they fall due for payment;
- ensure that employer contribution rates are as stable as possible;
- minimise the long term cost of the scheme by recognising the link between assets and liabilities and adopting an investment strategy that balances risk and return;
- reflect the different characteristics of employing bodies in determining contribution rates where the administering authority considers it reasonable to do so;
- use reasonable measures to reduce the risk to other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.

At the 31 March 2013 actuarial valuation, the Fund was assessed as being 84% funded (80% at 31 March 2010). This corresponded to a deficit of £379.2m (£418.1m at 31 March 2010).

The aim is to achieve 100% solvency over a period of 18 years and to provide stability in employer contribution rates by spreading any increases in rates over a period of time. The required level of contributions to be paid into the Fund by participating bodies (in aggregate) with effect from 1 April 2014 is 13.7% of pensionable pay plus additional monetary amounts of £24.3m in 2014/15 and increasing by 3.9% p.a. thereafter. (In 2013/14 the aggregate employer contribution rate was 13.1% of pensionable pay plus an additional sum of £29.9m).

The key assumptions used by the actuary to calculate the past service liabilities and the cost of future benefit accrual are set out in the following table:

	Valuation as at 31 March 2013	Valuation as at 31 March 2010
<b>Financial Assumptions</b>		
Discount rate for periods in service	5.4% pa	6.8% pa
Discount rate for periods after leaving service	5.4% pa	6.8% pa
Rate of revaluation of pension accounts	2.4% pa	n/a
Rate of pension increases on:		
non Guaranteed Minimum Pensions	2.4% pa	3.3% pa
post 1988 Guaranteed Minimum Pensions	2.0% pa	2.7% pa
Pensionable pay increases	3.9% pa	5.3% pa
<b>Demographic Assumptions</b>		
Post-retirement mortality assumption (normal health) - base table	SAPS normal tables with scaling factors of 105% for men and women	SAPS normal tables with scaling factors of 105% for men and women
Post-retirement mortality assumption - future improvements	CMI 2012 core projections with long term annual improvement rate of 1.5%	CMI 2009 core projections with long term annual improvement rate of 1.25%
Retirement cash sum	Each member is assumed to surrender pension on retirement, so total cash received is 80% of the maximum amount permitted	Each member assumed to exchange 80% of their future service pension rights and 60% of their past service pension rights for additional lump sum of the maximum amount permitted

## 25. ACTUARIAL PRESENT VALUE OF PROMISED RETIREMENT BENEFITS

The CIPFA Code of Practice indicates that Pension Fund accounts should disclose the actuarial present value of promised retirement benefits as set out in the accounting standard IAS 26 and that the actuarial present value should be calculated on assumptions set in accordance with IAS 19 rather than on funding assumptions (set out in Note 24 to these accounts).

The Pension Fund Accounts do not take account of the liabilities to pay pensions and other benefits in the future. Instead, as permitted under IAS 26, the Pension Fund has opted to disclose the actuarial present value of promised retirement benefits by way of this note to the accounts. This requires the actuarial valuation of the liabilities on an IAS 19 basis to be prepared at triennial valuations only, the most recent being as at 31 March 2013.

The actuarial present value of promised retirement benefits has been calculated based on projected salaries and is included in the table below. The corresponding fair value of Fund Assets is also shown to indicate the level of deficit within the Fund when the liabilities are valued using IAS 19 assumptions. The figures for 2010 are provided for comparison purposes.



	Value as at 31 March 2013 £m	Value as at 31 March 2010 £m
Fair value of net assets	2,085	1,682
Actuarial present value of the promised retirement benefits	2,905	2,833
Surplus / -deficit in the Fund as measured for IAS26 purposes	-820	-1,151

As the liabilities above are calculated on an IAS 19 basis, they differ from those calculated for the triennial valuation because different assumptions are applied. The main IAS19 assumptions used are as follows:

	31 March 2013 (% p.a.)	31 March 2010 (% p.a.)
Discount rate	4.4	5.5
RPI Inflation	3.4	3.9
CPI Inflation	2.4	3.0
Rate of increase to pensions in payment *	2.4	3.9
Rate of increase to deferred pensions *	2.4	3.9
Rate of general increase in salaries **	3.9	5.4

\* In excess of Guaranteed Minimum Pension increases in payment where appropriate

\*\* In addition, we have allowed for the same age related promotional salary scales as used in the actuarial valuation of the Fund at the appropriate date

## 26. FUNDING STRATEGY STATEMENT

The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 require administering authorities to prepare a Funding Strategy Statement. The Funding Strategy Statement has been reviewed by the Pension Fund Committee during 2013/14 and will be amended during 2014/15 to incorporate the new Pensions Regulations 2014. The Funding Strategy Statement, which has been adopted by the Pension Fund Committee, is attached as Appendix 1.

The purpose of the Funding Strategy Statement is to:

- establish a clear and transparent fund specific strategy which will identify how employers' pension liabilities are best met going forward;
- support the regulatory requirement to maintain as nearly constant employer contribution rates as possible;
- take a prudent longer term view of funding the Fund's liabilities.

## **27. STATEMENT OF INVESTMENT PRINCIPLES**

In accordance with the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009 the Pension Fund has prepared and reviewed a written statement of its investment policy. This statement has been adopted by the Pension Fund Committee and is attached as Appendix 2. The Statement of Investment Principles sets out the principles for investing Fund monies.



## **Pension Fund**

# **Funding Strategy Statement**

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

**(A) STATUTORY BACKGROUND AND KEY ISSUES**

1. The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 come into effect on 1 April 2004. They originally provided the statutory framework from which Local Government Pension Schemes (LGPS) administering authorities are required to prepare a Funding Strategy Statement (FSS) by 31 March 2005. The requirements are at the date of writing this Statement now set out under Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 (the Administration Regulations).
2. Key issues:
  - After consultation with relevant interested parties involved with the Fund, e.g. local authority employers, admitted bodies, scheduled/resolution bodies, the administering authority is required to prepare and publish their funding strategy.
  - In preparing the FSS, the administering authority has to have regard to:
    - Guidance published by CIPFA in March 2004 entitled "Guidance on Preparing and Maintaining a Funding Strategy Statement and to the Fund's Statement of Investment Principles" and updated guidance published by CIPFA on 3 October 2012.
    - Its Statement of Investment Principles (SIP) published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the Investment Regulations).
  - The FSS must be revised and published whenever there is a material change in policy either on the matters set out in the FSS or the Statement of Investment Principles.
  - Each Fund Actuary must have regard to the FSS as part of the fund valuation process and the Fund Actuary has therefore been consulted on the contents of this FSS.
  - Benefits payable under the Scheme are secure, because they are guaranteed by statute. The FSS addresses the issue of managing the need to fund those

benefits over the long term, whilst at the same time, allowing for scrutiny and accountability through improved transparency and disclosure.

- The Scheme is a defined benefit final salary scheme. The benefits at the date of writing this Statement are specified in the governing legislation, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (Benefits Regulations). Constraints on the levels of employee contributions are also specified in the Benefits Regulations.
  - Employer contributions are determined in accordance with the Administration Regulations, which require that an actuarial valuation is completed every three years by the Fund Actuary.
3. This Statement has been reviewed in accordance with Regulation 35 of the Administration Regulations as part of the triennial valuation as at 31 March 2013

## **(B) PURPOSE OF THE FUNDING STRATEGY STATEMENT**

4. The purpose of this Funding Strategy Statement (FSS) is to document the processes by which the Administering Authority:
- establishes a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
  - supports the desirability of regulatory requirement of maintaining as nearly constant a common rate of employer contribution rates as possible; and
  - takes a prudent longer-term view of funding the Fund's liabilities.

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

## **(C) PURPOSE AND AIMS OF THE PENSION FUND**

5. The purpose of the fund is to:

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

6. The aims of the fund are to:

- **Comply with Regulation 36 of the Administration Regulations and specifically to adequately fund benefits to secure the Fund's solvency while taking account of the desirability of maintaining as nearly constant employer contribution rates as possible**

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

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

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

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

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

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

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

- **Manage employers' liabilities effectively**

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

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

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

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

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

- Taking advice from its professional advisers, e.g. the Fund Actuary, Investment advisers and investment managers;
- Controlling levels of investment in asset classes through the Statement of Investment Principles;



- Limiting default risk by restricting investment to asset classes recognised as appropriate for UK Pension Funds;
- Analysing the volatility and absolute return risks represented by those asset classes in collaboration with the Investment Adviser and Fund Managers, and ensuring that they remain consistent with the risk and return profiles anticipated in the funding strategy statement;
- Limiting concentration risk by developing a diversified investment strategy;
- Monitoring the mismatching risk, i.e. the risk that the investments do not move in line with the Fund's liabilities.

#### **(D) RESPONSIBILITIES OF THE KEY PARTIES**

7. Although a number of parties including investment fund managers and external auditors have responsibilities to the fund, the three parties whose responsibilities to the Fund are of particular relevance are the Administering Authority, the individual employers and the Fund Actuary:
8. The administering authority should:
  - Administer the Fund;
  - Collect employer and employee contributions as set out in the Administration Regulations;
  - Determine a schedule of due dates for the payment of contributions - Section 70(1)(a) of the Pensions Act 2004 suggests that Administering Authorities are now required to report breaches as defined in Section 70 (2) of the 2004 Act. This places monitoring of the date of receipt of employer contributions on the Administering Authority and therefore places a duty to report material late payments of contributions to the Pensions Regulator;
  - Take action to recover assets from admission bodies whose Admission Agreement has ceased and other bodies whose participation in the Fund has ceased;
  - Invest surplus monies in accordance with the regulations;
  - Pay from the Fund the relevant entitlements as set out in the Benefits Regulations;

- Ensure that cash is available to meet liabilities as and when they fall due;
- Manage the valuation process in consultation with the Fund's Actuary;

Ensure effective communications with the Fund's Actuary to:

- Ensure that the Fund Actuary is clear about the content of the Funding Strategy Statement;
  - Ensure reports are made available as required by guidance and regulation;
  - Agree timetables for the provision of information and valuation results;
  - Ensure provision of accurate data; and
  - Ensure that participating employers receive appropriate communications.
- Consider the appropriateness of interim valuations;
  - Prepare and maintain an FSS and a SIP, both after proper consultation with interested parties;
  - Monitor all aspects of the fund's performance and funding and amend the FSS and SIP regularly as part of the on-going monitoring process;
  - Effectively manage any potential conflicts of interest arising from its dual role as both Administering Authority and as a Scheme Employer.

9. The individual employers should:

- Deduct contributions from employees' pay correctly;
- Pay all contributions, including their own as determined by the actuary, promptly by the due date;
- Develop a policy on certain discretions and exercise discretions within the regulatory framework, ensuring that the Administering Authority has copies of current policies covering those discretions;

- Make additional contributions in accordance with agreed arrangements in respect of, for example, additional membership or pension, augmentation of scheme benefits and early retirement strain;
- Notify the administering authority promptly of all changes to membership, or as may be proposed, which affect future funding;
- Noting, and if desired responding to, any consultation regarding the Funding Strategy Statement, the Statement of Investment Principles, or other policies.

10. The fund actuary should:

- Prepare triennial valuations including the setting of employers' contribution rates after agreeing assumptions with the administering authority and having regard to the FSS;
- Prepare advice and calculations in connection with bulk transfers, individual benefit-related matters, valuations on the cessation of admission agreements or when an employer ceases to employ any active members and bonds and other forms of security for the Administering Authority against the financial effect on the Fund of the employer's default. Such advice will take account of the funding position and Funding Strategy Statement, as well as other relevant matters when instructed to do so;
- Assist the Administering Authority in assessing whether employer contributions need to be revised between actuarial valuations as required by the Regulations;
- In response to a request from the Administering Authority, assess the impact of Regulatory changes on costs;
- Ensure that the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the Administering Authority.

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

### **Risk based approach**

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

12. A risk based approach entails carrying out the actuarial valuation on the basis of the assessed likelihood of meeting the funding objectives, rather than relying on a 'deterministic' approach which gives little idea of the associated risk. In practice, three key decisions are required for the risk based approach:
- what the Solvency Target should be (the funding objective - where the Administering Authority wants the Fund to get to);
  - the Trajectory Period (how quickly the Administering Authority wants the Fund wants to get there); and
  - the Probability of Funding Success (how likely the Administering Authority wants it to be now that the Fund will actually achieve the Solvency Target by the end of the Trajectory Period).
13. These three choices, supported by complex risk modelling carried out by the Fund Actuary, define the appropriate levels of contribution payable now and by extension, the appropriate valuation approach to adopt now. Together they measure the riskiness of the funding strategy.
14. These three terms are considered in more detail below.

### **Solvency and 'funding success'**

15. The Administering Authority's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term. The Solvency Target is the amount of assets which the Fund wishes to hold at the end of the Trajectory Period (see later) to meet this aim.
16. The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target.
17. For Scheduled Bodies, and certain other bodies, of sound covenant whose participation is indefinite in nature, appropriate actuarial methods and assumptions are taken to be measurement by use of the Projected Unit method of valuation, and using assumptions such that, if the Fund's financial position continued to be assessed by use of such methods and assumptions, and contributions were paid in accordance with those methods and assumptions, there would be a chance of at least 80% that the Fund would continue to be 100% funded over a time period considered appropriate at the time of assessment. The level of funding implied by this is the Solvency Target. For the purpose of this Statement, the required level of chance is defined as the Probability of Maintaining Solvency.

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

### **Probability of Funding Success**

19. The Administering Authority deems funding success to have been achieved if the Fund, at the end of the Trajectory Period, has achieved the Solvency Target. The Probability of Funding Success is the assessed chance of this happening based on the level of contributions payable by members and employers.
20. Consistent with the aim of enabling employers' contribution rates to be kept as nearly constant as possible, the required chance of achieving the Solvency Target at the end of the relevant Trajectory Period for each employer or employer group can be altered at successive valuations within an overall envelope of acceptable risk. The Administering Authority will not permit contributions to be set following a valuation that have an unacceptably low chance of achieving the Solvency Target at the end of the relevant Trajectory Period.

### **Funding Target**

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

- Contribution rates are set by use of the Projected Unit valuation method for most employers. The Projected Unit method is used in the actuarial valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period;
- For employers who no longer admit new members, the Attained Age valuation method is normally used. This means that the contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.

### **Application to different types of body**

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

- **Scheduled Bodies and certain other bodies of sound covenant**  
The Administering Authority will adopt a general approach in this regard of assuming indefinite investment in a broad range of assets of higher risk than low risk assets for Scheduled Bodies and certain other bodies which are long term in nature.
- **Admission Bodies and certain other bodies whose participation is limited**  
For Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after cessation the Administering Authority will have specific regard to the potential for participation to cease (or to have no contributing members), the potential timing of such cessation, and any likely change in notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date of cessation (i.e. whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities).

### **Full Funding and Solvency**

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

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

### **Recovery Periods**

26. The Trajectory Period in relation to an employer is the period between the valuation date and the date on which solvency is targeted to be achieved.
27. Where a valuation shows the Fund to be in surplus or deficit against the Funding Target, employers' contribution rates will be adjusted to reach the solvent position over a number of years. The Recovery Period in relation to an employer or group of employers is therefore a period over which any adjustment to the level of contributions in respect of a surplus or deficiency relative to the Funding Target used in the valuation is payable. As noted earlier, the valuation method, including the components of Funding Target, future service costs and adjustment for surplus or deficiency simply serve to set a level of contributions payable, which in turn dictates the chance of achieving the Solvency Target at the end of the Trajectory Period. For simplicity, the Trajectory Period for the largest employer (or employer group) in the Fund and the Recovery Period are both set to be the same.
28. The Recovery Period applicable for each employer is set by the Fund Actuary in consultation with the Administering Authority and the employer, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.
29. The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefits payments over a long period of time. For employers of sound covenant, the Administering Authority is therefore prepared to agree recovery periods that are longer than the average future working lifetime of the membership of that employer. In general for employers that are closed to new entrants and are of sufficient term the recovery period is set to be the estimated future working lifetime of the active membership (i.e. the estimated period of time until the last active member leaves or retires). The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible. However, the Administering Authority also recognises the risk involved in relying on long Recovery and Trajectory Periods and has agreed with the Actuary a maximum recovery period of 30 years for both, for employers which are assessed by the Administering Authority as being a long term secure employer. It is the intention of the Administering Authority to agree with employers a Recovery Period of as short a time as possible within this 30 year limit having regard to the affordability of the revised contribution rate in general taking into account the legislative requirements of securing solvency and maintaining as nearly a constant a contribution rate as possible. A period of 18

years has been used for Durham County Council, the largest employer in the Fund. Trajectory and Recovery Periods for other employers or employer groups may be shorter and may not necessarily be the same as each other, in order to suitably balance risk to the Fund and cost to the employer.

30. For each individual employer the following will also be taken into account:

- covenant and strength of any guarantee relating to an employer and hence the risk of default
- length of participation in the Fund
- whether the employer is closed to new entrants or is likely to have a contraction in its membership of the Fund

## **Stepping**

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

## **Grouping**

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

33. The Administering Authority recognises that grouping can give rise to cross subsidies from one employer to another over time. Employers may be grouped entirely, such that all of the risks of participation are shared, or only partially grouped such that only specified risks are shared. The Administering Authority's policy is to consider the position carefully at initial grouping and at each valuation and to notify each employer that is grouped which other employers it is grouped



with and details of the grouping method used. If the employer objects to this grouping, it will be set its own contribution rate.

34. Where employers are grouped together for funding purposes, this will only occur with the consent of the employers involved.
35. All employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service – in other words, the cost of such benefits is shared across the employers in the Fund. Such lump sum benefits can cause funding strains which could be significant for some of the smaller employers without insurance or sharing of risks. The Fund, in view of its size, does not see it as cost effective or necessary to insure these benefits externally and this is seen as a pragmatic and low cost approach to spreading the risk.

### **Notional sub-funds**

36. In order to establish contribution rates for individual employers or groups of employers it is convenient to notionally subdivide the Fund as a whole between the employers (or group of employers where grouping operates), as if each employer had its own notional sub-fund within the Fund.
37. This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, or ownership of any particular assets or groups of assets by any individual employer or group.

### **Roll-forward of sub-funds**

38. The notional sub-fund allocated to each employer will be rolled forward allowing for all cash flows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income allocated as set out below. In general no allowance is made for the timing of contributions and cash flows for each year are assumed to be made half way through the year with investment returns assumed to be uniformly earned over that year.
39. Further adjustments are made for:
  - A notional deduction to meet the expenses paid from the Fund in line with the assumption used at the previous valuation;
  - Allowance for any known material internal transfers in the Fund (cash flows will not exist for these transfers). The Fund Actuary will assume an estimated cash flow equal to the value of the liabilities determined consistent with the Funding

Target transferred from one employer to the other unless some other approach has been agreed between the two employers;

- Allowance for lump sum death in service and other benefits shared across all employers in the Fund (see earlier);
- An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund which will take into account any gains or losses related to the orphan liabilities.

40. In some cases information available will not allow for such cash flow calculations. In such a circumstance:

- Where, in the opinion of the Fund Actuary, the cash flow data which is unavailable is of low materiality, estimated cash flows will be used;
- Where, in the opinion of the Fund Actuary, the cash flow data which is unavailable is material, the Fund Actuary will instead use an analysis of gains and losses to roll forward the notional sub-fund. Analysis of gains and losses methods are less precise than use of cash flows and involve calculation of gains and losses relative to the surplus or deficiency exhibited at the previous valuation. Having established an expected surplus or deficiency at this valuation, comparison of this with the liabilities evaluated at this valuation leads to an implied notional asset holding.

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

### **Fund maturity**

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

43. In certain circumstances, for secure employers considered by the Administering Authority as being long term in nature, contribution adjustments to correct for any disclosed deficiency may be set as a percentage of payroll. Such an approach carries an implicit assumption that the employer's payroll will increase at an assumed rate. If payroll fails to grow at this rate, or declines, insufficient corrective action will have been taken. To protect the Fund against this risk, the Administering

Authority will monitor payrolls and where evidence is revealed of payrolls not increasing at the anticipated rate, the Administering Authority will consider requiring defined streams of capital contributions rather than percentages of payroll.

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

## **(F) SPECIAL CIRCUMSTANCES RELATED TO CERTAIN EMPLOYERS**

### **Interim reviews**

45. Regulation 38(4) of the Administration Regulations provides the Administering Authority with a power to carry out valuations in respect of employers who are expected to cease at some point in the future, and for the Actuary to certify revised contribution rates, between triennial valuation dates.
46. The Administering Authority's overriding objective at all times in relation to employers is that, where possible, there is clarity over the Funding Target for that body, and that contribution rates payable are appropriate for that Funding Target. However, this is not always possible as any date of cessation of participation may be unknown (for example, participation may be assumed at present to be indefinite), and also because market conditions change daily.
47. The Administering Authority's general approach in this area is as follows:
  - Where the date of cessation is known, and is more than 3 years hence, or is unknown and assumed to be indefinite, interim valuations will generally not be carried out at the behest of the Administering Authority;
  - For Transferee Admission Bodies falling into the above category, the Administering Authority sees it as the responsibility of the relevant Scheme Employer to instruct it if an interim valuation is required. Such an exercise would be at the expense of the relevant Scheme Employer unless otherwise agreed;
  - A material change in circumstances, such as the date of cessation becoming known, material membership movements or material financial information coming to light may cause the Administering Authority to informally review the situation and subsequently formally request an interim valuation;

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

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

## **Guarantors**

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

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

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

## **Bonds and other securitisation**

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

52. Where the level of risk identified by the assessment is such as to require it the admission body shall enter into an indemnity or bond with an appropriate party. Where it is not desirable for an Admission Body to enter into an indemnity or bond,

the body is required to secure a guarantee in a form satisfactory to the Administering Authority from an organisation who either funds, owns or controls the functions of the admission body.

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

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

### **Subsumed liabilities**

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

55. In such circumstances the liabilities are known as subsumed liabilities (in that responsibility for them is subsumed by the accepting employer). For such liabilities the Administering Authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of the liabilities of the accepting employer. Generally this will mean assuming continued investment in more risky investments than Government bonds.

### **Orphan liabilities**

56. Where an employer is ceasing participation in the Fund such that it will no longer have any contributing members, unless any residual liabilities are to become subsumed liabilities, the Administering Authority will act on the basis that it will have no further access for funding from that employer once any cessation valuation, carried out in accordance with Administration Regulation 38, has been completed and any sums due have been paid. Residual liabilities of employers from whom no further funding can be obtained are known as orphan liabilities.
57. The Administering Authority will seek to minimise the risk to other employers in the Fund that any deficiency arises on the orphan liabilities such that this creates a cost for those other employers to make good the deficiency. To give effect to this, the Administering Authority will seek funding from the outgoing employer sufficient to enable it to match the liabilities with low risk investments, generally Government fixed interest and index linked bonds.
58. To the extent that the Administering Authority decides not to match these liabilities with Government bonds of appropriate term then any excess or deficient returns will be added to or deducted from the investment return to be attributed to the other employer's notional assets.

### **Cessation of participation**

59. Where an employer ceases participation, a cessation valuation will be carried out in accordance with Administration Regulation 38. That valuation will take account of any activity as a consequence of cessation of participation regarding any existing contributing members (for example any bulk transfer payments due) and the status of any liabilities that will remain in the Fund.
60. In particular, the cessation valuation will distinguish between residual liabilities which will become orphan liabilities, and liabilities which will be subsumed by other employers.

- For orphan liabilities the Funding Target in the cessation valuation will anticipate investment in low risk investments such as Government bonds;
- For subsumed liabilities the cessation valuation will anticipate continued investment in assets similar to those held in respect of the subsuming employer's liabilities.

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

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

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

### **General Principles and diversification**

63. The Fund believes that the emphasis of investment over the long term should be on real assets, particularly equities and property. These are most likely to maximise the long term returns. The balance between UK and Overseas equities is, however, a matter of investment judgement. The Fund should also be diversified to include other real assets, such as Index-Linked and 'monetary' assets, such as Bonds and Cash.
64. The neutral benchmark proportions of the various asset classes have been determined by the Fund in consultation with the Investment Advisers and are reviewed at least once every three years to coincide with the Triennial Actuarial Valuation.
65. The active Investment managers are expected to adopt an active asset allocation policy to take advantage of the shorter term relative attractions of the various asset types.
66. The Administering Authority has produced this Funding Strategy Statement having taken a view on the level of risk inherent in the investment policy set out in the Statement of Investment Principles (SIP) and the funding policy set out in this document.

67. The SIP sets out the investment responsibilities and policies relevant to the Fund.
68. The Administering Authority will continue to review both documents to ensure that the overall risk profile remains appropriate.

#### **(H) IDENTIFICATION OF RISKS AND COUNTER-MEASURES**

69. The Administering Authority seeks to identify all risks to the Fund, will monitor the risks and take appropriate action to limit the impact of them wherever possible.

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

70. Investment

These include:

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

71. The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks;
- fixed income - yield curve, credit risks, duration risks and market risks;
- alternative assets – liquidity risks, property risk, alpha risk;
- money market – credit risk and liquidity risk;
- currency risk;
- macroeconomic risks.

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



## 72. Employer

These include:

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

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

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

## 73. Liability

These include:

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

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

## 74. Regulatory

These include:

- Changes to general and LGPS specific regulations, e.g. more favourable benefits package, potential new entrants to the scheme, e.g. part-time employees;
- Changes to national pension requirement and/or Inland Revenue rules.

The LGPS is currently going through major restructural change. The Administering Authority will keep up to date with all proposed changes and will prepare for LGPS 2014, and, if appropriate, request the Actuary to assess the impact on costs of the changes. The Administering Authority will notify employers of the likely impact of changes.

75. Liquidity and maturity

These include:

- An increased emphasis on outsourcing and alternative models for service delivery may result in active members leaving the LGPS;
- Transfer of responsibility between different public sector bodies;
- Scheme changes which might lead to increased opt-outs;
- Spending cuts and their implications.

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

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

76. Governance

These include:

- Administering authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements);
- Administering authority not advised of an employer closing to new entrants;
- An employer ceasing to exist with insufficient funding or adequacy of a bond.

The Administering Authority requires regular communication with employers to ensure that it is made aware of any such changes in a timely manner.

## 77. Choice of Solvency and Funding Targets

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

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

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

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

## 79. Smoothing of Assets

These include:

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

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

80. Recovery Period

These include:

- Permitting surpluses or deficiencies to be eliminated over a recovery period rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements.

The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of Recovery Period where appropriate. Details of the Administering Authority's policy are set out earlier in this Statement.

81. Stepping

These include:

- Permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient in the early years of the process.

The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the number of permitted steps as appropriate. Details of the Administering Authority's Policy are set out earlier in this Statement.

**(I) MONITORING AND REVIEW**

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



## Pension Fund

# Statement of Investment Principles

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## **1 Introduction**

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

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

## **2 Investment Responsibilities**

The County Council, as Administering Authority, has delegated the investment arrangements of the Pension Fund to the Pension Fund Committee (the “Pension Fund Committee”) who decide on the investment policy most suitable to meet the liabilities of the Pension Fund and the ultimate responsibility for the investment policy lies with it. The Committee is made up of elected representatives of the County Council, Darlington Borough Council, Further Education Colleges, Other Statutory Bodies, Admitted Bodies and Member Representatives.

The Pension Fund Committee has full delegated authority to make investment decisions.

### **2.1 The Pension Fund Committee has responsibility for:**

- Determining overall investment strategy and strategic asset allocation and ensuring that investments are sufficiently diversified, are not over concentrated in any one type of investment, and that the Pension Fund is invested in suitable types of investments;
- Preparing policy documents including the Statement of Investment Principles. Monitoring compliance with the Statement and reviewing its contents following any strategic changes and at least every three years;
- Appointing the investment managers, custodian, the Pension Fund actuary and any independent external advisers felt to be necessary for the good stewardship of the Pension Fund;

- Reviewing on a regular basis the investment managers' performance against established benchmarks, and satisfying themselves as to the investment managers' expertise and the quality of their internal systems and controls;
- Reviewing on a regular basis the performance of the independent external advisers;
- In cases of unsatisfactory performance of the investment managers and independent external advisers, taking appropriate action;
- Reviewing policy on social, environmental and ethical matters and on the exercise of rights, including voting rights; and
- Reviewing the funds allocated to investment managers on a regular basis to ensure that the strategic asset allocation is maintained (i.e.rebalancing).

## **2.2 The investment managers are responsible for:**

- The investment of the Pension Fund assets in respect of which they are appointed in compliance with applicable rules and legislation, the constraints imposed by this document and the detailed Investment Management Agreement covering their portion of the Pension Fund's assets;
- Stock selection within asset classes;
- Preparation of quarterly reports, including a review of investment performance;
- Attending meetings of the Pension Fund Committee as requested;
- Assisting the Corporate Director, Resources and Pension Fund Committee in the preparation and review of this document; and
- Where specifically instructed, voting in accordance with the Pension Fund's policy.

## **2.3 The Global Custodian is responsible for:**

- Its own compliance with prevailing legislation;
- Providing the administering authority with quarterly valuations of the Pension Fund's assets and details of all transactions during the quarter;
- Collection of income, tax reclaims, exercising corporate administration and cash management;
- Such other services as the Pension Fund shall procure, for example, in connection with performance measurement and reporting or fund accounting.

## **2.4 The Independent Advisers are responsible for:**

- Assisting the Corporate Director, Resources and Pension Fund Committee in determining the overall investment strategy, the strategic asset allocation and that the Pension Fund is invested in suitable types of investment, and ensuring that investments are sufficiently diversified;
- Assisting the Corporate Director, Resources and Pension Fund Committee in the preparation and review of Policy documents;
- Assisting the Corporate Director, Resources and Pension Fund Committee in their regular monitoring of the investment managers' performance;
- Assisting the Corporate Director, Resources and Pension Fund Committee in the selection and appointment of investment managers, custodians and Pension Fund Actuary;
- Advising and assisting the Corporate Director, Resources and the Pension Fund Committee on other investment related issues, which may arise from time to time; and
- Providing continuing education and training to the Pension Fund Committee.

## **2.5 The Actuary is responsible for:**

- Providing advice as to the structure of the Pension Fund's liabilities, the maturity of the Pension Fund and its funding level in order to aid the Pension Fund Committee in balancing the short term and long-term objectives of the Pension Fund;
- Undertaking the statutory triennial valuation of the Fund's assets and liabilities.

## **2.6 The Corporate Director, Resources is responsible for:**

- Ensuring compliance with this document and bringing breaches thereof to the attention of the Pension Fund Committee;
- Ensuring that this document is regularly reviewed and updated in accordance with the Regulations;
- Exercising delegated powers granted by the County Council to:
  - Administer the financial affairs in relation to the County Council's functions as a pension fund administering authority;
  - Exercise those discretions under the Local Government Pension Scheme Regulations 1997 as appear from time to time in Pension Fund Statements of Policy; and



- Authorise, in cases of urgency, the taking of any action by an investment manager of the Pension Fund which is necessary to protect the interests of the Pension Fund;
- Managing the cash balances of the Pension Fund which the Investment Managers have not invested.

### **3 Authorised Investments**

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

#### **3.1 Types of Investment**

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

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

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

The 2009 Regulations now prevent the administering authority from investing the Pension Fund's cash that is not required immediately along with its own cash. The Pension Fund Committee has agreed that as part of its investment strategy it will

allow the administering authority to invest, in the short term, on its behalf in line with the administering authority's Treasury Management Strategy.

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

### **3.2 Investment Risk**

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

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

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

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

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

### **3.3 Realisation of Investments**

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

### **3.4 Approval has been given to investment as follows:**

#### **In-house Management**

- **Midland Enterprise Fund for the North East Exempt Unit Trust**
  - Small, private and growing companies in the North East of England
  - £200,000 invested
  
- **Capital North East**
  - Start up and development capital for businesses in the North East:
  - £400,000 invested, up to £500,000 may be invested.

#### **External Investment Management**

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

#### 4 Allocation Strategy

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

<b>Asset Class</b>	<b>Permitted Assets</b>	<b>Benchmark &amp; Performance Target</b>	<b>Proportion of Total Fund *</b>
Conventional Bonds	Investment grade sterling bonds	FTSE Over 5 Year Index-Linked Gilt Index +0.5%	20%
Broad Bonds	Global bonds	UK 3-month LIBOR +3.0%	15%
Global Equities	Global Equities	MSCI All Country World Index (unhedged) in GBP terms +3% MSCI World index +2.5%	30%
Emerging Market Equities	Emerging Market Equities	MSCI Emerging Markets Net Index +2.5%	7%
Dynamic Asset Allocation	All major asset classes with the ability to take derivative positions	UK 3-month LIBOR +4.0%	20%
Global Property	Global property	UK Retail Price Inflation +5.0%	8%

\* Excluding in-house managed funds

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

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

**5 Stock Selection**

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

**6 Cash Management**

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

**7 Investments Requiring Prior Approval**

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

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

**8 Socially Responsible Investing**

The Pension Fund Committee must act with the best financial interests of the beneficiaries, present and future, in mind. The Pension Fund Committee believes that companies should be aware of the potential risks associated with adopting practices that are socially, environmentally or ethically unacceptable. As part of the investment decision-making process, Investment Managers are required to consider such practices and assess the extent to which this will detract from company performance and returns to shareholders.

**9 Corporate Governance**

Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. The quarterly report from investment managers should include details of voting activity.

**10 Fee Structure**

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

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

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

The administering authority fee for Treasury Management will be based upon a flat fee for the service provided to the Pension Fund.

## 11 Reporting Requirements

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

- Investment Managers' views on the UK or other relevant economies and the proposed asset allocation for the past, present and future quarter;
- Reports on any new investment policy issues requiring the approval of the Pension Fund Committee;
- Performance during the previous quarter, previous twelve months, three years and five years;
- A Portfolio valuation, including details of individual holdings;
- Investment transactions schedule for the previous quarter;
- Portfolio distribution and the changes in the markets - summarised by:
  - type of investment;
  - sector;
  - geographic area as appropriate;
- Performance of any collective investment funds or internal pooled funds in which investments are held;
- Underwriting commitments relevant to the Portfolio;
- The cash position of the Pension Fund;
- Voting actions and forthcoming activity;
- Any material matters reported to the Financial Conduct Authority (FCA) or such other appropriate authority, in respect of the Portfolio or which reasonably might be brought to the attention of the Pension Fund Committee;
- Any material matters in respect of the interface with the Custodian;
- Investment or ancillary activities carried out in relation to the Portfolio where there arose a material risk of damage to the interests of the Pension Scheme or where a material risk of damage may arise in the future;
- Dealing errors and action taken;
- Any breach of confidentiality;
- Any breach of their Investment Management Agreement.

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

## **Appendix A - Principles**

This appendix sets out the extent to which Durham County Council as the Administering Authority of the Durham County Council Pension Fund complies with the six principles of investment practice set out in the document published in November 2012 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012", in future, compliance with guidance given by the Secretary of State will be reported.

### **Principle 1 — Effective decision-making**

Fully compliant: Investment decisions are made by those with the skill, information and resources necessary to take them effectively. A programme covering investment issues is being developed for new members joining the Pension Fund Committee and training is provided to all members.

### **Principle 2 – Clear objectives**

Fully compliant: The overall investment objective for the Pension Fund is set out in the Funding Strategy Statement.

### **Principle 3 – Risk and Liabilities**

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

### **Principle 4 – Performance Assessment**

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

### **Principle 5 – Responsible Ownership**

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

Explicit written mandates agreed with all investment managers. Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. Normal practice is to allow the Investment Managers to follow their in-house voting policy unless otherwise instructed by the Pension Fund



Committee. The mandates do not specifically incorporate the principle of the US Department of Labor Interpretative Bulletin on activism.

### **Principle 6 – Transparency and Reporting**

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

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

**Appendix B - Investment Managers**

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

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

<b>Investment Manager</b>	<b>%</b>	<b>Asset Classes</b>	<b>Investment Style</b>
Aberdeen	15	Global Equities	Active
BNY Mellon	15	Global Equities	Active
Mondrian	7	Emerging Market Equities	Active
AllianceBernstein	15	Global Bonds	Active
RLAM	20	Investment grade sterling and non-sterling bonds	Active
CBRE	8	Global Property	Active
Barings	20	Dynamic Asset Allocation - all major asset classes with derivative overlay	Active

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

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

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

## Aberdeen

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

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Global Equity	MSCI All Country World Index (unhedged)

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

<b>Portfolio</b>	<b>%</b>
World Equity Fund	100

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

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

**BNY Mellon**

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Global Equity	MSCI World

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

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

<b>Portfolio</b>	<b>%</b>
Long Term Global equity Fund	100

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

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

## Mondrian

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Emerging Market Equities	MSCI Emerging Markets Net Index

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

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

<b>Portfolio</b>	<b>%</b>
Emerging Market Equities	100

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

	<b>Range</b>
Investments in Real Estate Investment Trusts (REITS)	Maximum of 20% (client to be informed at any greater than 10%)
Individual Securities	Maximum of 5% in single stock
Sector restrictions	Maximum of 25% of portfolio in single industry
Cash holdings	Maximum of 5%

## AllianceBernstein

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

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

The benchmark allocation is as follows:

Asset Class	Benchmark
Broad Bonds	UK 3-month LIBOR

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

Portfolio	%
Diversified Yield Plus Fund	100

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

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

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

- 1 month holding period
- 99% confidence level.

The limitations that apply to the investments are detailed below:

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

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

**RLAM**

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

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Conventional Bonds	FTSE Over 5 Year Index-Linked Gilt Index

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

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

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

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

\*Includes government and non-government bonds

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

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



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

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

**CBRE**

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

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Global Property	UK Retail Price Inflation

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

<b>Portfolio</b>	<b>%</b>
CB Richard Ellis RPI +5%	100

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

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

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

## Baring Asset Management

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

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Dynamic Asset Allocation	UK 3-month LIBOR

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

<b>Portfolio</b>	<b>%</b>
Extended Risk Solutions	100

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

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

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

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

\* Equities and Commodities, aggregate maximum 80%

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

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

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

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

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

## COMMUNICATIONS POLICY STATEMENT

Durham County Council is the administering authority for the Durham County Council Pension Fund. This Communication Policy Statement has been drawn up to comply with regulation 106B of the Local Government Pension Scheme Regulations 1997 (as amended) and to ensure the Council offers clear communication to stakeholders of the Local Government Pension Scheme.

### ***WHO WE COMMUNICATE WITH***

- Scheme members (active members, pensioners and deferred members);
- Representatives of scheme members;
- Prospective scheme members;
- Employers participating in the scheme;
- Advisors (for example actuaries, investment advisors, Local Government Pensions Committee);
- Other bodies (for example prospective employing authorities and their representatives).

### ***KEY OBJECTIVES***

- To ensure communication is clear, factual and concise;
- To ensure communication is designed and delivered in a manner appropriate to its audience;
- To ensure that the correct information reaches the right people at the right time.

## COMMUNICATING WITH SCHEME MEMBERS

Scheme members need access to detailed information about the scheme and their own benefits to allow them to make informed choices about their own pension benefits.

The Council provides:

- Scheme literature  
The pension section produces a summary guide to benefits in the scheme along with specific guides for certain circumstances, such as how divorce can affect scheme benefits or on the internal dispute resolution procedure.
- Annual benefit statements  
All active members are sent a benefit statement each year setting out the benefits they have earned in the scheme up to 31 March that year.  
A combined benefit statements is issued to active members, which includes information on an individual's state pension entitlement (where provided by the

Department for Work and Pensions). Combined benefit statements are provided to the active members of approximately 20 employers and the intention is to extend this to cover all employers where possible.

All deferred members are sent a benefit statement each year setting out the current value of their deferred benefits payable at the earliest date on or after age 60 that unreduced benefits can be paid to them. The statement also sets out the effect of pension increases on their benefits since they left service.

- Newsletters

All active members and pensioners are sent a copy of each issue of the relevant newsletter.

Once a year the newsletters include information on the performance of the Fund.

- Telephone helpline

All newsletters contain contact telephone numbers for general enquiries. Active members, pensioners and deferred members can contact the Pensions Group by telephone between 8:30am and 4:30pm on weekdays.

## **COMMUNICATING WITH EMPLOYERS PARTICIPATING IN THE SCHEME**

Employers need to be kept up to date with developments in the scheme and need to be informed of consultation exercises that could influence the future of the scheme.

Employers are sent written information on scheme developments as and when changes are proposed to the scheme. Employers are often sent copies of circulars provided by the Employers' Organisation or are directed to copies of these circulars via web-links.

Meetings with individual employers are arranged as necessary or as requested to deal with any significant pension issues that arise. Support is provided to employers who want to provide further pension information to their employees - this includes pre-retirement seminars and mid-life seminars.

All employers are invited to attend the Annual Meeting of the Pension Fund Committee. Copies of the annual report and accounts for the Pension Fund are distributed at this meeting and are also sent to all employers in the scheme.

## **COMMUNICATING WITH PROSPECTIVE MEMBERS**

Employers are provided with pension packs to give to prospective members. These contain a summary of the benefits of scheme membership along with a starter form, information comparing the scheme with other pension options, a nomination form, an opt-out form and an authorisation form for investigating potential pension transfers into the scheme.

## **COMMUNICATING WITH REPRESENTATIVES OF SCHEME MEMBERS**

The Pension Group produces a summary guide to benefits in the scheme along with specific guides for certain circumstances, such as how divorce can affect scheme benefits or on the internal dispute resolution procedure. This information is available to representatives of scheme members.

The Pension Group telephone helpline is also available between 8:30am and 4:30pm on weekdays for any queries representatives of scheme members may have.

The main local government unions are represented on the Pension Fund Committee. This means they are sent agenda items and minutes from the meetings as well as being able to attend the meetings (albeit in a non-voting capacity).

**FUND PUBLICATIONS**

<b>COMMUNICATION DOCUMENT</b>	<b>AVAILABLE TO</b>	<b>WHEN PUBLISHED</b>
Starter Packs	Prospective members	When required
Summary scheme guide	Prospective members Active members	When required
Newsletter: Pensions News	Active members	When required
Annual benefit statement	Active members Deferred members	Once a year
Newsletter: Years Ahead	Pensioners	When required
Payslips	Pensioners	Once a year or upon a change to net pension of more than £2
P60s	Pensioners	Once a year
Pension Increase Information	Pensioners	Once a year
Update letter on changes to regulations and other issues	Employers	When required
Valuation report	Employers	Every three years
Report and accounts	All stakeholders	Once a year – distributed to all employers and available on the DCC website and on request to all



## PARTICIPATING BODIES AND CONTRIBUTION RATES

The contribution rates of participating bodies are shown below, expressed as a percentage of employees' pensionable pay and an additional annual payment where applicable:

Employer	Employer Contributions		Employer	Employer Contributions	
	% of pensionable pay	Additional Annual Payment (£)		% of pensionable pay	Additional Annual Payment (£)
Barnard Castle Town Council	18.7%		Shotton Hall Academy Trust	11.9%	17,900
Bishop Auckland College	12.9%	54,000	Shotton Parish Council	18.7%	
Bishop Auckland Town Council	18.7%		South Hetton Parish Council	18.7%	
BRandH Academy Limited	14.3%	7,700	Spennymoor Town Council	18.7%	
Brandon & Byshottles Parish Council	18.7%		St Aidan's CE Academy	13.1%	44,000
			St Bede's Catholic School & Sixth Form College	17.1%	62,700
Carmel Education Trust	17.0%	52,200			
Central Durham Joint Crematoria Committee	18.7%		St Bede's RC Primary School	17.9%	15,000
Chilton Town Council	18.7%		St George's CE Academy	19.4%	8,100
			St John's Catholic School & Sixth Form College	15.0%	51,000
Cleves Cross Primary School	17.0%	14,700	St John's CE Primary School	18.0%	5,600
Co Durham & Darlington Fire & Rescue	12.7%	146,000	Staindrop School	16.6%	31,300
Dale & Valley Homes Limited	12.2%	16,000	Stanley Town Council	18.7%	
Darlington Borough Council	13.1%	2,555,904	Teesdale School	15.1%	30,900
Darlington College	12.8%	94,000	The Excel Academy Partnership	15.1%	44,700
Derwentside College	13.7%	80,000	The Federation of Abbey Schools Academy Trust	15.9%	13,600
			The Hermitage Academy	13.6%	29,900
Durham County Council	13.1%	23,597,000	Thornley Parish Council	18.7%	
Easington Academy	17.6%	31,600	Trimdon Foundry Parish Council	18.7%	
Easington Colliery Parish Council	18.7%		Trimdon Parish Council	18.7%	
Easington Village Parish Council	18.7%		Tudhoe Learning Trust	15.0%	71,500
East Durham College	12.4%	54,000	West Park Academy	13.9%	7,300
East Durham Homes Limited	12.9%	574,000			
Education Village	16.6%	112,000	Wheatley Hill Parish Council	18.7%	
Federation of Mowden Schools Academy Trust	15.3%	10,700	Wingate Parish Council	18.7%	
Ferryhill Town Council	18.7%		Woodham Academy	17.3%	43,400
Firthmoor Primary School	17.6%	15,600	Barnard Castle School	22.2%	170,000
Fishburn Parish Council	18.7%		Blackwell Grange Golf Club Ltd	13.1%	
Framwellgate Moor Parish Council	18.7%		Bowes Museum	47.0%	
Glendene Arts Academy	14.5%	45,900	Bulloughs Cleaning Services Limited	19.0%	
Great Aycliffe Town Council	18.7%		Carillion (AMBS) Limited	19.0%	
Greater Willington Town Council	18.7%		Carillion Services Limited	21.5%	
Heathfield Academy Trust	18.9%	27,500	Catering Academy Limited	12.9%	
Horden Parish Council	18.7%		Cestria Community Housing	12.7%	
Hummersknott Academy Trust	15.4%	60,600	Churchill Contract Services Limited	28.0%	
Hurworth Primary School	17.4%	11,300	Compass Contract Services (UK) Ltd	23.5%	2,900
Hurworth School Limited	12.0%	10,400	Creative Management	13.1%	
Hutton Henry Parish Council	18.7%		Derwentside Homes	14.4%	
IT Systems & EVAT Partnership Ltd	16.6%		Future Leisure in Coxhoe	14.7%	
King James I Academy, Bp Auckland Ltd	14.4%	46,000	Harbour Support Services	13.1%	
Lanchester Parish Council	18.7%		Investing in Children CIC	13.1%	
Longfield Academy Trust	15.9%	114,900	KGB Cleaning & Support Services Ltd	27.4%	
Monk Hesledon Parish Council	18.7%		Leisureworks	13.5%	41,000
Murton Parish Council	18.7%		Livin Housing Limited	12.5%	
New College Durham	13.0%	181,000	Mears Limited	5.9%	
New College Durham Academies Trust	19.0%	110,600	Mellors Catering Services Limited	19.0%	
New Seaham Academy	20.8%	4,900	MITIE Cleaning Limited	24.9%	550
North Lodge Parish Council	18.7%		MITIE PFI Limited	25.2%	3,800
Durham Police and Crime Commissioner	11.4%	840,000	Morrison Facility Services Limited		
Park View Community School	15.2%	41,400	Murton Welfare Association	20.5%	2,700
Parkside Academy	18.3%	50,800	North East Council of Addiction	29.3%	
Peterlee Town Council	18.7%		Taylor Shaw Longfield	22.2%	1,800
Queen Elizabeth Sixth Form College	14.3%	10,400	Taylor Shaw Primary		
Reid Street Primary School	15.4%	13,600	Teesdale Housing Association	22.1%	34,000
Ribbon Academy Trust	16.2%	43,000	The Forge	21.1%	
Seaham Town Council	18.7%		Three Rivers Housing	20.3%	2,700
Sedgefield Town Council	18.7%		Wates Construction Limited	18.8%	
Shildon Town Council	18.7%				

## MEMBERSHIP STATISTICS

The following table provides details of the number of pensionable employees in the scheme and the number of pensioners.

	Summary of Pensionable Employees				Summary of Pensioners			
	at 31/3/13	Newcomers during year	Leavers during year	at 31/3/14	at 31/3/13	New pensioners during year	Pensioner deaths during year	at 31/3/14
<b>Durham County Council</b>	10,751	1,301	944	11,108	13,208	615	494	13,329
<b>Darlington Borough Council</b>	1,897	182	357	1,722	1,606	109	43	1,672
<b>Town Councils</b>	136	13	6	143	95	9	3	101
<b>Parish Councils</b>	58	0	3	55	41	4	6	39
<b>Joint Crem. Comm</b>	5	0	1	4	7	3	0	10
<b>Statutory Bodies</b>								
Bishop Barrington Academy	2	0	2	0	0	0	0	0
BRandH Academy Limited	28	7	6	29	0	1	0	1
Carmel College	57	9	7	59	1	1	0	2
Co Durham & Darlington Fire & Rescue	102	10	21	91	31	8	0	39
Dale and Valley Homes	52	6	3	55	4	1	0	5
Durham Police & Crime Commissioner	866	70	41	895	310	23	6	327
Easington Academy	32	3	1	34	0	0	0	0
East Durham Homes	131	5	8	128	72	5	2	75
Education Village	112	8	14	106	1	2	0	3
Firthmoor Primary	0	15	0	15	0	0	0	0
Framwellgate Moor School	33	10	5	38	0	1	0	1
Glendene Academy	34	6	0	40	0	0	0	0
Heathfield Academy Trust	2	22	4	20	0	0	0	0
Holy Family RC Primary	0	11	1	10	0	1	0	1
Hummersknott (Skerne Pk)	0	34	3	31	0	3	0	3
Hummersknott Academy Trust	63	13	7	69	1	1	0	2
Hurworth Primary	0	20	3	17	0	0	0	0
Hurworth School Limited	38	2	6	34	1	0	0	1
Investing in Children	0	8	0	8	0	0	0	0
King James I Academy	60	11	15	56	2	5	0	7
IT Sys & EVAT Partnerships	0	9	0	9	0	0	0	0
Longfield Academy Trust	83	7	10	80	4	4	1	7
Marchbank Academy	0	1	0	1	0	0	0	0
Murton Community Primary School	32	5	4	33	0	1	0	1
New College Durham Academies Trust	89	23	18	94	1	2	0	3
New Seaham Primary	0	9	1	8	0	0	0	0
Northwood Primary School	27	0	27	0	0	0	0	0
Park View Academy	32	9	5	36	3	1	0	4
Parkside Sports College	40	4	4	40	0	3	1	2
Reid Street Primary School	19	8	0	27	0	0	0	0
Rydal Academy	0	39	2	37	0	0	0	0
St Augustines	0	13	2	11	0	0	0	0
St Aidans Academy	45	1	2	44	1	1	0	2
St Bedes Academy	37	4	2	39	0	0	0	0
St Bedes RC Primary	3	20	5	18	0	1	0	1
St George CE	5	18	1	22	0	0	0	0
St John's Catholic School & Sixth Form College	41	23	6	58	0	2	0	2
St John's CE Primary School	7	9	1	15	0	0	0	0
Staindrop School	27	1	2	26	2	0	0	2

## Appendix 5: Membership Statistics

	Summary of Pensionable Employees				Summary of Pensioners			
	at 31/3/13	Newcomers during year	Leavers during year	at 31/3/14	at 31/3/13	New pensioners during year	Pensioner deaths during year	at 31/3/14
Teesdale Education Trust	29	10	8	31	0	2	0	2
The Academy at Shotton Hall	36	0	0	36	1	0	0	1
The Fed. Of Mowden Schools	5	15	1	19	0	0	0	0
Tudhoe Learning Trust	0	73	1	72	0	1	0	1
The Federation of Abbey Schools Academy Trust	29	8	0	37	0	0	0	0
The Hermitage Academy Trust	38	15	4	49	1	1	0	2
West Park Academy	30	18	8	40	0	0	0	0
Woodham College	34	5	1	38	1	0	0	1
<b>Colleges</b>								
Bishop Auckland College	129	22	17	134	56	2	0	58
Darlington College	184	56	37	203	92	14	3	103
Queen Elizabeth 6th Form	56	4	9	51	10	4	0	14
Derwentside College	80	47	19	108	70	8	1	77
New College Durham	270	54	36	288	121	13	4	130
East Durham & Houghall	188	25	19	194	60	25	1	84
<b>Admitted Bodies</b>								
Barnard Castle School	47	0	2	45	28	0	0	28
Blackwell Grange Golf Club	0	3	1	2	0	0	0	0
Bowes Museum	7	0	0	7	11	0	0	11
Carillion	10	1	0	11	2	0	0	2
Catering Academy Ltd	0	2	0	2	0	0	0	0
Cestria	113	10	9	114	20	3	1	22
Churchill Services Ltd	0	7	0	7	0	0	0	0
Cleves Cross Primary	0	14	0	14	0	0	0	0
Commission for New Towns	0	0	0	0	7	0	0	7
Compass Group UK	4	0	1	3	3	1	0	4
Creative Management	2	0	0	2	0	0	0	0
Creative Management 2013	0	3	0	3	0	0	0	0
Derwentside Homes	180	5	10	175	45	8	1	52
F.L.I.C	6	0	0	6	0	0	0	0
Hobson Golf Club	0	0	0	0	0	0	0	0
KGB Cleaning	2	0	0	2	1	0	0	2
Kier Support Services	30	0	30	0	4	2	0	6
Leisureworks	28	0	3	25	21	1	0	22
Mears	80	1	8	73	24	8	0	32
Mitie Cleaning	1	0	0	1	1	0	0	1
Mitie PFI	1	0	0	1	2	0	0	2
Morrisons	72	0	1	71	7	2	0	9
Murton Welfare Association	3	0	0	3	0	0	0	0
Peterlee Fire Company	1	0	1	0	1	0	0	1
Sedgefield Homes	142	12	12	142	23	5	0	28
Taylor Shaw	42	0	0	42	5	1	0	6
Teesdale Housing	8	0	1	7	2	0	0	2
The Forge	2	0	0	2	0	0	0	0
Three Rivers Housing	2	0	0	2	0	0	0	0
Wates Construction Ltd	0	27	0	27	0	0	0	0
<b>Former Employers</b>	0	0	0	0	376	8	36	348
<b>Totals</b>	<b>16,837</b>	<b>2,406</b>	<b>1,789</b>	<b>17,454</b>	<b>16,386</b>	<b>916</b>	<b>603</b>	<b>16,700</b>

## DISTRIBUTION OF INVESTMENTS

### UK EQUITIES

The following twenty largest holdings account for 82.05% of the Fund's investment in UK equities and 16.93% of the total Fund investments:

<i><b>Holding</b></i>	<i><b>Market Value as at 31 March 2014</b></i>
	<b>£000</b>
Next	31,667
Compass Group	31,206
British American Tobacco	27,891
Reckitt Benckisser	26,350
British Sky Broadcasting	25,055
Wolseley	24,291
Rio Tinto	22,586
B G Group	20,266
Reed Elsevier	20,183
Easyjet	17,239
Johnson Matthey	15,390
Melrose	15,375
Standard Chartered	14,986
Shire	14,610
Hargreaves Lansdown	14,126
Barclays	12,437
Merlin Entertainment	8,378
M & G Securities	8,291
Berkley Group	8,277
Tullow Oil	6,383
	<b>364,987</b>

## FIXED INTEREST HOLDINGS

The following ten largest holdings account for 58.9% of the Fund's fixed interest holdings and 12.22% of the total portfolio:

<i><b>Holding</b></i>	<i><b>Market Value as at 31 March 2014</b></i>
	<b>£000</b>
Treasury 0.125% Index Linked 22/03/29	39,017
Treasury 1.125% Index Linked 11/37	31,578
Treasury 0.625% Index Linked 22/11/42	28,047
Treasury 0.125% Index Linked 22/03/68	28,973
Treasury 0.75% Index Linked 11/47	27,710
Treasury 2% Index Linked 26/01/35	26,194
Treasury 0.5% Index Linked 22/03/68	21,459
Treasury 2.5% Index Linked 17/07/24	21,278
Treasury 1.25% Index Linked 11/55	20,549
Treasury 4.125% Index Linked 22/07/30	18,533
	<b>263,338</b>

## FUNDS AND UNITS

The following ten holdings account for 81.34% of the Fund's holdings in Managed and Unitised Funds and 42.6% of the total Fund investments:

<i><b>Holding</b></i>	<i><b>Market Value as at 31 March 2014</b></i>
	<b>£000</b>
Aquila Life World Equity Fund	508,117
Alliance Bernstein Diversified Yield	305,405
Neuburger Berman High Yield Bonus	21,344
Legal and General Unit Trusts	15,937
Axa Framlington UK Opp	12,941
Muzinich Fund USA	12,505
Casenove UK Opp	12,106
Baring Component Far East (ex Jap)	12,063
RWC Partners	9,485
Baring Agricultural Fund	8,315
	<b>918,218</b>

## OVERSEAS HOLDINGS

The following ten largest overseas equity holdings account for 23.56% of the Fund's investment in overseas equities and 0.61% of the total portfolio:

<i><b>Holding</b></i>	<i><b>Market Value as at 31 March 2014</b></i>
	<b>£000</b>
Mitsui Fudosan	2,460
Mitsubishi UFJ Financial	1,558
Toyota Motor Corp	1,439
Takeda Pharm	1,242
Sumitomo Mitsui Corp	1,211
East Japan Railway	1,209
Hitachi	1,070
Tokyo Gas	1,035
Daiwa Securities	983
Honda Motor Co.	972
	<b>13,179</b>

## PROPERTY HOLDINGS

The following holdings in property comprise 40.1% of the Fund's investment in Property and 2.7% of the total portfolio:

<i><b>Holding</b></i>	<i><b>Market Value as at 31 March 2014</b></i>
	<b>£000</b>
Capital Finance	11,938
Prime Property Fund	10,961
Old Mutual	6,287
Hines US Core Office Fund	5,666
AMP Capital Wholesale	5,257
CBRE Asia Alpha Plus 2	4,704
Industrial Property	4,468
Henderson UK Shopping Centre	4,236
Airport Industrial Properties	4,108
CBRE Asia Alpha Plus 1	3,988
	<b>61,613</b>



## **GLOSSARY OF TERMS**

### **Accounting Period**

The period of time covered by the Statement of Accounts, normally 12 months starting on 1 April. The end of the period is the Balance Sheet/ Net Assets Statement date.

### **Accounting Policies**

The principles, conventions, rules and practices applied that specify how transactions and other events should be reflected in the financial statements.

### **Accounting Standards**

Accounting standards are authoritative statements of how particular types of transactions and other events should be reflected in financial statements and accordingly compliance with accounting standards will normally be necessary for financial statements to give a true and fair view.

### **Accruals**

The concept that income, and expenditure are recognised as they are earned or incurred, not as money is received or paid.

### **Actuary**

An actuary is an expert on pension scheme assets and liabilities. Every three years, the Actuary for the Local Government Pension Scheme determines the rate of employer contributions due to be paid to the Pension Fund.

### **Actuarial Basis**

The technique applied when estimating the liabilities to be recognised for defined benefit pension schemes in the financial statements.

### **Actuarial Gains**

These may arise on a defined benefit pension scheme's liabilities and assets. A gain represents a positive difference between the actuarial assumptions and actual experience (e.g. liabilities during the period were lower than estimated).

### **Actuarial Losses**

These may arise on a defined benefit pension scheme's liabilities and assets. A loss represents a negative difference between the actuarial assumptions and actual experience (e.g. liabilities during the period were higher than estimated).

### **Added Years**

Additional years of service awarded discretionally to increase the benefits to employees taking early retirement.

### **Additional Voluntary Contributions (AVCs)**

An option available to individuals to secure additional pension benefits by making regular payments in addition to the contributions payable to the Pension Fund on basic earnings.

### **Admitted Bodies**

Organisations that take part in the Local Government Pension Scheme with the agreement of the Pension Fund. Examples of such bodies are companies providing services that were once provided by local authorities in the Pension Fund.

### **Annual Governance Statement**

The statement gives assurance that appropriate mechanisms are in place to direct and control the activities of the County Council.

### **Amortisation**

Amortisation is the equivalent of depreciation for intangible assets.

### **Apportionment**

A way of sharing costs using an appropriate method, e.g. floor area for an accommodation-related service.

### **Appropriation**

The transfer of sums to and from reserves, provisions, and balances.

**Asset Allocation**

The distribution of the Fund's assets between asset classes and/ or world markets.

**Audit of Accounts**

An independent examination of the Pension Fund's financial affairs.

**Balanced Management**

A type of multi-asset management where a manager is responsible for all asset classes. A fund using this style is a "balanced" fund.

**Benchmark**

A yardstick against which the investment policy or performance of a fund manager can be compared.

**Bonds**

A type of investment in certificates of debt issued by the government of a company. These certificates represent loans which are repayable at a future specified date with interest.

**Chartered Institute of Public Finance and Accountancy (CIPFA)**

The principal accountancy body dealing with local government finance.

**Code**

The Code of Practice on Local Authority Accounting. A publication produced by CIPFA constituting proper accounting practice for Local Authorities.

**Contingent Asset**

Potential benefits that the Pension Fund may reap in the future due to an event that has happened in the past.

**Contingent Liabilities**

Potential costs that the Pension Fund may incur in the future due to something that has happened in the past.

**Corporate Governance**

The promotion of corporate fairness, transparency and accountability. The structure specifies the responsibilities of all stakeholders involved and the rules and procedures for making decisions.

**Creditors**

Persons or bodies to whom sums are owed by the Pension Fund.

**Custody**

Safe-keeping of securities by a financial institution. The Custodian keeps a record of client investments and may also collect income, manage cash, process tax claims and provide other services according to client instructions.

**Debtors**

Persons or bodies who owe sums to the Pension Fund.

**Deferred Pension**

The inflation-linked retirement benefits payable from normal retirement age to a member of the Fund who has ceased to contribute as a result of leaving employment or opting out of the pension scheme before normal retirement age.

**Defined Benefit Scheme**

Defined benefit pension schemes prescribe the amounts members will receive as a pension regardless of contributions and investment performance. Employers are obliged to fund any shortfalls.

**Depreciation**

The fall in the value of an asset, as recorded in the financial records, due to wear and tear, age and obsolescence.

**Derivative**

Contracts that derive their value from an underlying financial asset. Often used as a hedge against changes in value.

**Dividend**

Part of a company's after tax earnings, distributed to shareholders in the form of cash or shares.

**Equities**

Ordinary shares in UK and overseas companies traded on a stock exchange. Shareholders have an interest in the profits of the company and are entitled to vote at shareholder's meetings.

**Fair Value**

The value for which an asset can be exchanged or a liability can be settled in a market related transaction.

**Financial Instrument**

A contract that gives rise to a financial asset in one entity and a financial liability, or equity instrument, in another.

**Fitch**

Fitch Ratings is a rating agency providing credit ratings research and risk analysis of financial institutions across the world. Credit ratings are used by investors as indications of the likelihood of receiving the money owed to them in accordance with the terms on which they invested.

**Fixed Interest Securities**

Investments in government (in the main) and company stocks which guarantee a fixed rate of interest. The securities represent loans that are repayable at a future date but which can be traded on a recognised stock exchange before the repayment date.

**FIDs and Manninen**

A claim has been lodged for Durham County Council Pension Fund and other Pension Funds for repayment of tax credits overpaid on Foreign Income Dividends (FIDs) and other dividends, referred to by name of the person whose case set the precedent, Manninen.

**Futures**

A contract made to purchase or sell an asset at an agreed price on a specified future date.

**GAAP**

Generally Accepted Accounting Practice.

**Gilts**

The familiar name given to sterling, marketable, fixed interest securities or bonds issued by the British Government.

**Impairment**

Impairment of an asset is caused either by a consumption of economic benefits e.g. physical or deterioration in the quality of the service provided by the asset. A general fall in prices of a particular asset or type of asset is treated as a revaluation.

**Index Linked Securities**

Investments in government stock that guarantee a rate of interest linked to the rate of inflation. These securities represent loans to government which can be traded on recognised stock exchanges.

**Investment**

An asset which is purchased with a view to making money by providing income, capital appreciation, or both.

**Investment Properties**

Interest in land and/or buildings in respect of which construction work and development have been completed and which are held for their investment potential rather than for operational purposes, any rental income being negotiated at arms length.

**LAAP Bulletin**

CIPFA's Local Authority Accounting Panel (LAAP) periodically issues bulletins to local authority practitioners, providing guidance on topical issues and accounting developments and, when appropriate, clarification on the detailed accounting requirements.

**Liabilities**

An obligation to transfer economic benefits. Current liabilities are usually payable within one year.

**Managed Fund**

A type of investment where a number of investors pool their money into a fund, which is managed by a professional fund manager.

**Market Value**

The monetary value of an asset as determined by current market conditions.

**Materiality**

An expression of the relative significance of a particular issue in the context of the organisation as a whole.

**Mid-market price**

The mid-point between the bid price and the offer price for a security based on quotations for transactions of normal market size by recognised market-makers or recognised trading exchanges.

**Minority Interest**

The interest in a subsidiary entity that is attributable to the share held by, or on behalf of persons other than the reporting authority.

**Moody's**

Moody's Investor Service is a rating agency, providing credit ratings, research, and risk analysis of financial institutions across the world. Credit ratings are used by investors as indications of the likelihood of receiving the money owed to them in accordance with the terms on which they invested.

**Myners' Principles**

A set of principles issued by Government which Pension Schemes are required to consider and to which they must publish their degree of compliance.

**Net Realisable Value**

The expected sale price of stock in the condition in which it is expected to be sold. This may be less than cost due to deterioration, obsolescence or changes in demand.

**Non Current Assets**

Tangible or intangible assets that yield benefits to the authority and the services it provides for a period of more than one year. Tangible assets have physical substance, for example land, buildings and vehicles. Intangible assets do not have physical substance but are identifiable and controlled by the authority through custody or legal rights, for example software licences.

**Passive Management**

A style of management that seeks to achieve performance equal to market or index returns.

**Pooled Fund**

A pooled fund pools investors' money and invests in a portfolio of shares, bonds and cash.

**Portfolio**

A number of different assets considered and managed as a whole by an investment manager, to an agreed performance specification.

**Prior Period Adjustment**

Those material adjustments relating to prior years' accounts, that are reported in subsequent years arising from changes in accounting policies or from the correction of fundamental errors. They do not include minor corrections or adjustments of accounting estimates made in prior years.

**Provisions**

Provisions represent sums set aside to meet any specific future liabilities or losses arising from contractual obligations or as a result of past events. These events are likely or certain to be incurred and a reliable estimate can be made of the amount of the obligation.

**Prudential Code**

The Government removed capital controls on borrowing and credit arrangements with effect from 1st April 2004 and replaced them with a Prudential Code under which each local authority determines its own affordable level of borrowing. The Prudential Code requires authorities to set specific prudential indicators on an annual basis.

**Public Works Loans Board (PWLB)**

A government agency providing long and short-term loans to local authorities at interest rates only slightly higher than those at which Government itself can borrow.

**Return**

The total gain from holding an investment over a period, including income, and increase or decrease in market value.

**Risk**

Risk is the variability of returns. Investments with a greater risk usually promise higher investment returns.

**Scheduled Bodies**

County and Borough Councils and other similar bodies whose staff automatically qualify to become members of the Pension Fund.

**Section 151 Officer**

The officer designated under Section 151 of the Local Government Act 1972 to have overall responsibility for the administration of the financial affairs of the County Council and the preparation of the County Council's Statement of Accounts.

**SIP**

The Statement of Investment Principles details the policy which controls how a pension fund invests.

**Statements of Recommended Accounting Practice (SORP)**

A publication produced by CIPFA, recognised by the Accounting Standards Board (ASB), that provides comprehensive guidance on the content of the County Council's Statement of Accounts.

**Transfer Values**

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

**Treasury Management Policy and Strategy**

A plan outlining the approach to treasury management activities. This includes setting borrowing and investment limits to be followed for the following year and is published annually in the Medium Term Financial Plan document.

**Unit Trusts**

A unit trust is a pooled fund in which small investors can buy and sell units. The pooled fund purchases investments and the returns are passed on to the unit holders. It enables a broader spread of investments than investors could achieve individually.

## CONTACTS FOR FURTHER INFORMATION

**For further information on issues relating to the Pension Fund, please contact the Corporate Director - Resources.**

*Telephone*                      03000 260 000

*E-mail*                              [HELP@DURHAM.GOV.UK](mailto:HELP@DURHAM.GOV.UK)

or you can write to:

Corporate Director Resources  
Durham County Council  
County Hall  
DURHAM  
DH1 5UE

or visit Durham County Council's website at [durham.gov.uk](http://durham.gov.uk)