



# Hertfordshire County Council Pension Fund Annual Report and Statement of Accounts 2015/16

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## Introduction

### 1. Foreword

This report provides information for employers and other interested parties on how the Hertfordshire Pension Fund ("Pension Fund") has been managed during the year 1 April 2015 to 31 March 2016.

This report summarises the main features of the Pension Fund, providing:

- a brief outline of the Local Government Pension Scheme ("Scheme")
- the Administering Authority Report which outlines the management and administrative arrangements for the Pension Fund
- the financial statements comprising of the Fund Account and Net Assets Statement for the year 2015/16 with comparative information for the previous year. The Fund Account shows the change in net assets available for benefits during the year. The Net Assets Statement discloses the net assets of the Pension Fund at 31 March 2016
- an Investment Report which sets out the Pension Fund's Investment Policy and the level of performance achieved.

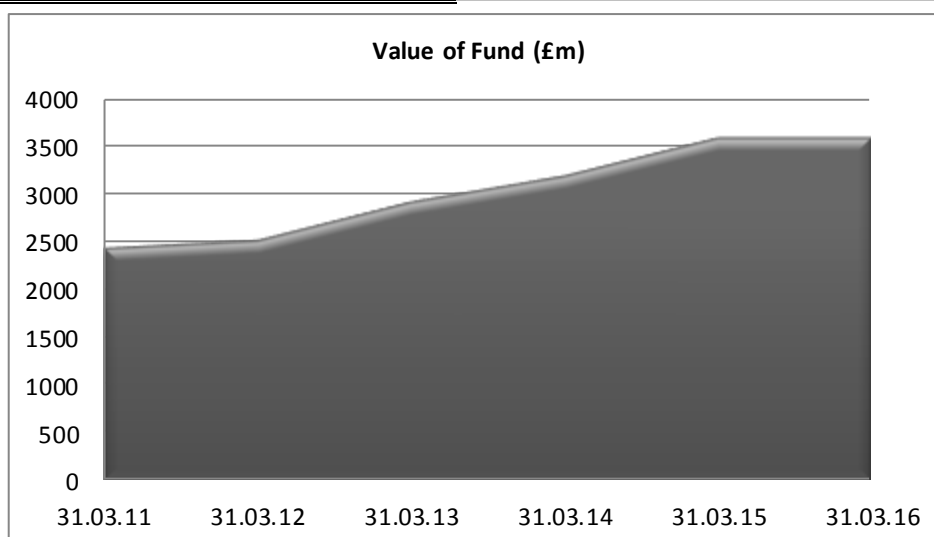
Over the year, the value of the Pension Fund increased slightly from £3,581m at 31 March 2015 to £3,584m at 31 March 2016. The return achieved on the Pension Fund's investments during 2015/16 net of fees was -0.2% which reflected general market conditions over the year and was in line with the benchmark return of -0.1%. A review of world markets is provided as part of the Investment report on page 59.

Over 2015/16, membership of the Pension Fund has continued to increase, both in terms of the number of scheme employers and contributing members. The number of contributing members has increased from 32,992 at 31 March 2015 to 35,384 at 31 March 2016. The number of scheme employers also increased from 265 at 31 March 2015 to 279 at 31 March 2016 as a result of schools converting to academy status and new employers seeking admission to the Pension Fund following the outsourcing of service contracts from scheme employers.

### 2. Financial Summary

The table below provides a five year summary of the Pension Fund accounts and a graph showing the movement in the value of the Pension Fund over this period. This shows the net assets available to fund benefits at 31 March each year.

2011/12 £000s	2012/13 £000s	2013/14 £000s	2014/15 £000s		2015/16 £000s
2,421,651	2,520,578	2,907,904	3,175,783	Value of the Pension Fund at 1 April	3,581,039
24,487	19,220	39,045	(18,538)	Net additions / (withdrawals) from dealing with those directly involved in the scheme	13,430
(13,185)	(13,819)	(16,512)	(16,164)	Management expenses	(15,927)
87,625	381,925	245,346	439,958	Net returns on investments	5,708
98,927	387,326	267,879	405,256	Increase / (Decrease) in the Pension Fund during the year	3,211
2,520,578	2,907,904	3,175,783	3,581,039	Value of the Pension Fund at 31 March	3,584,250



### 1. Background to the Scheme

#### Legal Framework

The Scheme is a statutory scheme, established by Act of Parliament, the Superannuation Act 1972. The Scheme is governed by the Public Services Pensions Act 2013 and is administered in accordance with the following secondary legislation:

- Local Government Pension Scheme Regulations 2013
- Local Government Pension Scheme (Transitional Provisions, Savings & Amendment) Regulations 2014
- Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended)

The Scheme is run by administering authorities in accordance with these regulations. In Hertfordshire the Administering Authority is Hertfordshire County Council.

#### Eligibility

The Scheme is available to all employees of local authorities other than teachers, fire-fighters and police officers for whom separate arrangements apply. Employees are able to join the Scheme if they have a contract of employment of three months or more duration.

Other specified bodies providing public services are included by statute or may apply for admission.

#### Employers

At 31 March 2016 there were 279 employers in the Pension Fund. Participating employers can be scheduled bodies or admitted bodies, as defined below:

- **Scheduled bodies.** There are two types of scheduled bodies listed in the Scheme regulations. Employees of employers, such as the County Council (including maintained schools), Academies and District and Borough Councils, are able to join the Scheme as of right. Employees of other organisations, such as Parish and Town Councils are able to join the Scheme if the employer designates that they can.
- **Admitted bodies.** These are voluntary, charitable and, in certain circumstances, private sector organisations carrying out scheduled bodies' contracts, where staff can become members of the Scheme by virtue of an Admission Agreement between the Pension Fund and the relevant body. At 31 March 2016 there were 60 active admitted bodies participating in the Pension Fund.

A full list of employing bodies in the Pension Fund is shown in Appendix 1 at page 64.

The table below provides an analysis of scheduled and admitted bodies at 31 March 2016 and an analysis of active employers and employers that have ceased (these are employers with no active members but with outstanding liabilities). Admitted bodies may have more than one Admission Agreement in the Pension Fund relative to the service contracts they hold with scheduled bodies.

Type of Body	Active	Ceased	Total
Scheduled bodies	155	3	158
Admitted bodies	60	61	121
<b>Total</b>	<b>215</b>	<b>64</b>	<b>279</b>

### 2. Funding

The Scheme is a funded scheme, financed by contributions from employees and employers and by earnings from investments. The Pension Fund has published a Funding Strategy Statement (shown in Appendix 2 at page 68, which sets out the Pension Fund's strategy for meeting employers' pension liabilities). The aim of the funding strategy is to ensure the long-term solvency of the Pension Fund and to ensure that sufficient funds are available to meet all benefits as they fall due for payment.

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## Scheme Administration

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### Employees' Contributions

During 2015/16, employees paid contributions at a rate based on their earnings, including contractual and non-contractual overtime and additional hours. From 1 April 2014, the Scheme moved from a final salary scheme to a career average revalued earnings (CARE) scheme. As part of the CARE scheme, employees can elect to move to the 50/50 option which allows employees to pay half the normal contributions in return for half the normal pension benefits.

The rates and salary bandings applicable during 2015/16 are shown in the table below.

Band	Range	Contribution Rate
1	£0 - £13,600	5.50%
2	More than £13,601 up to £21,200	5.80%
3	More than £21,201 up to £34,400	6.50%
4	More than £34,401 up to £43,500	6.80%
5	More than £43,501 up to £60,700	8.50%
6	More than £60,701 up to £86,000	9.90%
7	More than £86,001 up to £101,200	10.50%
8	More than £101,201 up to £151,800	11.40%
9	More than £151,800	12.50%

### Employers' Contributions

Employers' contributions are payable at rates specified by the Pension Fund Actuary and are reviewed each triennial valuation. Rates are adjusted to reflect changes in the employer's membership profile and funding level in the Pension Fund (see page 17 for further details).

### Investment Income

The cash, which is not immediately required to pay pensions and other benefits, is invested and provides an additional source of income for the Pension Fund.

## 3. Benefits

The Scheme is a salary-related defined benefit scheme which guarantees to provide benefits which are a specified fraction of a Scheme member's pay. Benefits are not affected by variations in investment performance.

Full details of benefits payable are explained in the Scheme booklet which is available from the Pension Fund website at [www.yourpension.org.uk/agencies/HCC/](http://www.yourpension.org.uk/agencies/HCC/)

The following provides the main provisions of the benefit package for the Scheme.

### Age of Retirement

The normal pension age in the Scheme is linked to State Pension Age, with a minimum of age 65. The Scheme also makes provisions for the early payment of benefits and members can choose to retire and draw their pension at any time from age 55. Benefits paid before normal pension age will be reduced to reflect that benefits will be paid over a longer period of time.

### Retirement Benefits

From 1 April 2014, the Scheme moved from a final salary scheme to a career average revalued earnings (CARE) scheme details of which are accessible from the Pension Fund website at [www.yourpension.org.uk/agencies/HCC/](http://www.yourpension.org.uk/agencies/HCC/).

For membership after 1 April 2014, members build up a pension at a rate of 1/49<sup>th</sup> of the amount of pensionable pay they receive in each scheme year. The amount of pension built up during the scheme year is added to their pension account and revalued at the end of each year in line with inflation. Up to 25% of the capital value of benefits can be taken as a lump sum at a 12:1 commutation rate, i.e. £12 lump sum for every £1 of pension given up.

Benefits built up before 1 April 2014 are protected and are calculated using membership in the Scheme prior to 1 April 2015 and the member's final pay when they leave the Scheme.

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## Scheme Administration

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For membership built up between 1 April 2008 and 31 March 2014, the annual pension is based on final pensionable pay multiplied by  $1/60^{\text{th}}$  for each year of Scheme membership. The final pensionable pay is the wage or salary on which contributions were paid over the last 12 months of service. Up to 25% of the capital value of benefits can be taken as a lump sum at a 12:1 commutation rate, i.e. £12 lump sum for every £1 of pension given up.

For membership accrued to 31 March 2008, members will receive an annual pension based on final pensionable pay multiplied by  $1/80^{\text{th}}$  for each year of Scheme membership and a lump sum of three times annual pension. Up to 25% of the capital value of benefits can be taken as a lump sum at a 12:1 commutation rate, i.e. £12 lump sum for every £1 of pension given up.

### Additional Benefits

The Scheme offers several ways for members to increase their benefits:

- Additional Pension Contributions to purchase additional Scheme pension benefits.
- Contributions to a money purchase Additional Voluntary Contribution scheme ("AVC"), provided by the Standard Life Assurance Company or the Equitable Life Assurance Society.

### III Health Retirement

A three tier ill health retirement provision is available which is dependent on the likelihood of a member being capable of undertaking any gainful employment in the future. Benefits are calculated in the same way as for normal retirements, with an enhancement for members in tiers 1 and 2 to compensate for premature retirement. Members in tier 3 who are likely to be capable of undertaking gainful employment within three years of retiring must undergo a medical review after 18 months. At the end of the three year period the member will either have their pension benefits deferred to age 65 or move to tier 2 following a medical assessment.

### Death in Service

A lump sum death grant of three year's assumed pensionable pay is payable. Pensions are also payable to surviving spouses, civil partners, or to eligible nominated co-habiting partners (subject to qualifying conditions) and dependent children.

### Death after Retirement

Spouses', civil partners', eligible co-habiting partners' and dependent children's pensions are payable based on the former employee's pensionable pay or pension. In addition, if death occurred before the pension has been paid for ten years; the balance will be paid as a lump sum.

**The benefits detailed above are guidelines only and members should apply to London Pensions Fund Authority, the Scheme Administrator, for individual estimates of benefits payable.**

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## Administering Authority Report

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### 1. Management

Hertfordshire County Council (the "County Council") is the Administering Authority of the Pension Fund and administers the Scheme on behalf of the participating employers and members.

The Local Authority (Functions & Responsibilities) (England) Regulations 2000 (as amended), state that functions relating to the Scheme are the responsibility of the full Council. The County Council has delegated these functions to the Pensions Committee and to the County Council's Chief Finance Officer, the Director of Resources.

The membership of the Pensions Committee is made up of ten County Council members and three District Council representatives. All employers and a staff representative, nominated by UNISON, are invited to attend meetings as observers.

The Administering Authority has established a Pension Board in accordance with Section 5 of the Public Service Pensions Act 2013. The Board assists the Pension Fund in securing compliance with the Scheme regulations and other legal and regulatory requirements. The membership of the Pensions Board is made up of four employer representatives and four member representatives.

The Pension Fund's Governance Compliance Statement on pages 7 -11 set out the delegation of functions and terms of reference for the Pensions Committee and Pensions Board. It also outlines the Pension Fund's compliance with statutory guidance issued by the Secretary of State for Communities and Local Government.

#### Pensions Committee Membership during 2015/16

##### County Council Members:

C Hayward (Chairman)	R Sangster
R Henry	D Scudder
D Lloyd	A Searing
J King	A Stevenson
R Parker	D Williams (Vice-Chairman)

##### District Council Representatives (non-voting):

K Ayling	J Ranger
J Lloyd	

#### Pensions Board Membership during 2015/16

##### Employer representatives:

D Ashley (Chairman)	D Graham (from September 2015)
A Cameron (April – September 2015)	S Moore (April – October 2015)
G Clay	P Neville (from October 2015)

##### Member representatives:

D Devereux	K Harding
J Digby (Vice-Chairman)	W Ogley

### 2. Governance Compliance Statement

This statement is prepared in accordance with regulation 55 of the Local Government Pension Scheme Regulations 2013, which require administering authorities to maintain and publish a governance compliance statement. It has been prepared by the Administering Authority in consultation with appropriate interested persons.

This statement was approved by the Pensions Committee on 5 February 2016.

#### Delegation of Functions

The Administering Authority for the Local Government Pension Scheme in Hertfordshire is Hertfordshire County Council (the "County Council"). Management of the Local Government Pension Scheme is a non-executive function.

The Local Authority (Functions & Responsibilities) (England) Regulations 2000 (as amended), state that the functions relating to the Local Government Pension Scheme are the responsibility of the full Council. The County Council has delegated these functions to the Pensions Committee, whose members can make decisions without reference to the full Council.

The Pensions Committee are responsible for the functions set out in the following regulations:

- Local Government Pension Scheme Regulations 2013
- Local Government Pension Scheme (Transitional Provisions, Savings & Amendment) Regulations 2014
- Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

In parallel to this, the County Council has delegated functions relating to the Pension Fund to the County Council's Chief Finance Officer, the Director for Resources, as specified in Annex 3 of the County Council's Constitution.

The County Council has established a Pension Board in accordance with Section 5 of the Public Service Pensions Act 2013. In accordance with Sections 5(1) and (2) of the Act and section 106 of the Local Government Pension Scheme regulations 2013, the role of the Board is to:

- Secure compliance with:
  - The Local Government Pensions Scheme regulations;
  - Other legislation relating to the governance and administration of the Local Government Pension Scheme; and
  - The requirements imposed by the Pension Regulator in relation to the Local Government Pension Scheme;and to
- Ensure the effective and efficient governance and administration of the Local Government Pension Scheme.

#### Terms of Reference

The functions relating to the management and governance of the Pension Fund have been delegated as follows.

The Pensions Committee is responsible for policy matters including:

- Setting and monitoring performance objectives for the Pension Fund
- Approval and review of the overall investment strategy of the Pension Fund
- Approval and review of asset allocation decisions
- Performance monitoring Investment Managers and investments
- Appointing (and, when necessary, dismissing) Investment Managers
- Appointing (and, when necessary, dismissing) Investment Consultants
- Appointing (and, when necessary, dismissing) the Pension Fund Actuary
- Appointing (and, when necessary, dismissing) the Pension Fund Custodian
- Setting and approving Administering Authority discretions for the Local Government Pension Scheme
- Approval of key policies and statements:
  - Statement of Investment Principles
  - Funding Strategy Statement
  - Governance Compliance Statement
  - Communications Strategy Statement
- Agreeing and monitoring actions to address findings from any review of Pension Fund activities



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## Administering Authority Report

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The Pension Board is responsible for:

- Scrutinising the progress of actions to meet the performance objectives of the Pension Fund
- Reviewing and monitoring the training plan of the Pensions Board and elected members and officers with delegated responsibilities for the management and administration of the Pension Fund
- Reviewing and monitoring the performance of external business partners, including the pensions administration service, the actuary, the custodian and the investment consultant
- Reviewing and monitoring the Risk Register and risk monitoring of scheme employers
- Reviewing the implementation of revised policies and procedures, including the Administering Authority discretions
- Reviewing the compliance of projects commissioned by the Pensions Committee, including the Triennial Valuation of the Pension Fund
- Ensuring pension rules and regulations are being complied with, when officers are making decisions on pension matters
- Scrutinising data quality
- Reviewing internal audit reports
- Assisting in the development of improved customer services
- Reviewing compliance of Investment Managers with Investment Management Agreements
- Reviewing progress of agreed actions to address findings from any review of the Pension Fund activities.

All other operational decisions in the administration and management of the Pension Fund including exercising the Administering Authority's Discretions are delegated to the County Council's Chief Finance Officer, the Director of Resources.

### Membership, Voting and Meetings

The membership, voting rights and frequency of meetings of the Pensions Committee and Pensions Board are set out in the table below:

	Pensions Committee	Pensions Board
<b>Membership</b>	Ten County Council members (in proportion to the political representation of the full Council) and three (non-voting) District Council representatives elected by the Hertfordshire Local Government Association.	Four employer representatives and four member representatives
<b>Chairman</b>	Elected by full Council	Elected by the Pension Board and rotated annually between member and employer representatives
<b>Observers</b>	Staff representative, nominated by UNISON	
<b>Voting</b>	County Council Members, as elected Members of the Administering Authority, have voting rights in accordance with the Local Government (Committee and Political Groups) Regulations 1990 SI No 1553 5 (1)(d).	All employer and member representatives have voting rights
<b>Meetings per annum</b>	Six	Four

Further information on the constitution of the Pension Board, including the appointment of employer and member representatives, standards and conflicts of interest can be found in Annex 3 of the County Council's Constitution.

### Training

The Pensions Committee agreed a training policy for the Pensions Committee and Board at their meeting on 13 November 2015. This sets out the training objectives of the Pension Fund, the application of the policy and details of how training will be delivered. The policy includes the training plan for the Pensions Committee and Board which will be developed and updated on an annual basis.

## Administering Authority Report

### Compliance with Statutory Guidance

The following table provides a summary of how the Pension Fund complies with the statutory guidance issued by the Secretary of State for Communities and Local Government.

Pension Fund Compliance Statement	
Principle	Compliance and Comments
<b>A. Structure</b>	
a) The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointment Council.	Full
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.	Full
c) That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Not applicable
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.	Not applicable
<b>B. Representation</b>	
a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:	
i) employing authorities (including non-scheme employers, e.g. admitted bodies):	Full  The County and District Councils, whose employees make up 68% of the active membership, are represented on the Pensions Committee.  The Pensions Board is made up of four employer representatives and four scheme member representatives
ii) scheme members (including deferred and pensioner scheme members);	Full  UNISON has a place on the Pensions Committee to represent all Scheme members.
iii) independent professional observers, and	No
iv) expert advisors (on an ad-hoc basis)	Full  The Pension Fund's Investment Adviser, Actuary and Administrator attend the Pensions Committee when appropriate.

## Administering Authority Report

Pension Fund Compliance Statement	
Principle	Compliance and Comments
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	Full
<b>C. Selection and Role of Lay Members</b>	
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.	Full
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.	Full
<b>D. Voting</b>	Full
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.	The policy is clear that only County Council members can vote. The Pensions Committee believes that the voting arrangements are justified, because in practice the vast majority of decisions are reached by consensus.
<b>E. Training/Facility Time/Expenses</b>	Full
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.	Training is provided internally and externally and offered to all Pensions Committee members. Reimbursement of expenses is covered by the members' allowance schemes in their authority.
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.	Full
c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Full
<b>F. Meetings (frequency/quorum)</b>	
a) That an administering authority's main committee or committees meet at least quarterly.	Full
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.	Not applicable
c) That administering authorities who do not include lay members in their formal governance arrangements, provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Full

## Administering Authority Report

Pension Fund Compliance Statement	
Principle	Compliance and Comments
<b>G. Access</b> 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.	Full
<b>H. Scope</b> a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Full
<b>I. Publicity</b> 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.	Full

### 3. Risk Management

Responsibility for the risk management of the Pension Fund rests with the Pensions Committee and is assisted by the Pensions Board in the monitoring of risks.

Key risks are incorporated in the Pension Fund's Risk Register, which was approved by the Pensions Committee on 26 February 2014 as part of the Funding Strategy Statement.

Four key risks to the Pension Fund have been identified:

- The Pension Fund's Investment Strategy does not deliver the long term projected investment returns and/or does not comply with legislation.
- The funding level of the Pension Fund deteriorates.
- Employers default on meeting their obligations to the Pension Fund and the Scheme.
- The Pension Fund and its third party providers do not comply with regulations, statute or procedure.

A number of underlying risk control mechanisms are in place that aim to manage these risks and these are detailed in the Funding Strategy Statement on pages 68. Risks are monitored on a regular basis and quarterly reports are presented to the Pensions Committee and Board, providing an update on the status of these risks. The quarterly reports and minutes of the Pensions Committee and Board meetings are accessible from

<https://cmis.hertfordshire.gov.uk/hertfordshire/Calendarofcouncilmeetings.aspx>.

Investment risk and return objectives for the Pension Fund are set out in the Investment Strategy which is reviewed at regular intervals to ensure that it will achieve the objectives. Note 6.14 of the Financial Statements provides details on the nature and extent of risks arising from financial instruments and how these are managed.

Employers are monitored against a risk monitoring framework that aims to identify employers at an early stage who are at risk of defaulting on their obligations to the Pension Fund. A quarterly update is provided to the Pensions Committee and Board.

### 4. Administration

Hertfordshire County Council is the Administering Authority of the Pension Fund and administers the Scheme in conjunction with the contracted business services listed below.

**Scheme Administrator providing scheme administration services for members in conjunction with the County Council:**

- London Pensions Fund Authority (LPFA)

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## Administering Authority Report

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### **Investment Managers during 2015/16 investing funds on behalf of the Pension Fund:**

- Allianz Global Investors Europe GmbH
- Baillie Gifford & Co.
- CBRE Global Collective Investors (UK) Limited
- Global Thematic Partners, LLC
- HarbourVest Partners, LLC
- Henderson Global Investors Limited
- JP Morgan Asset Management (UK) Limited
- Jupiter Asset Management Limited
- LGT Capital Partners (Ireland) Limited
- Legal & General Assurance (Pensions Management ) Limited
- Pantheon Ventures UK LLP
- Permira Advisers, LLP
- Royal London Asset Management Limited
- Standard Life Investments Limited
- TTP Venture Managers Limited

### **Custodian maintaining and managing investment records and safeguarding the Pension Fund's assets:**

- BNY Mellon Asset Servicing B.V.

### **Consulting Actuary providing actuarial services:**

- B McKay, Fellow of the Institute and Faculty of Actuaries, for and on behalf of Hymans Robertson LLP

### **Investment Consultant providing investment advice:**

- Mercer Limited

### **Corporate Governance Adviser providing voting services:**

- Research, Recommendations and Electronic Voting Limited

### **Performance Measurement Consultants providing independent reporting on investment performance:**

- BNY Mellon Asset Servicing B.V.

### **Additional Voluntary Contributions providers for members wishing to increase benefits:**

- The Equitable Life Assurance Society
- Standard Life Assurance Company

### **External Auditor:**

- Richard Page, for and on behalf of Ernst & Young LLP

### **Banker:**

- Barclays Bank, plc

### **The Pension Fund is a member or subscriber of the following bodies:**

- Local Authority Pension Fund Forum
- Local Government Pension Committee
- National Association of Pension Funds

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## Administering Authority Report

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### Key contacts

#### Administering Authority

For Investments

Patrick Towey  
Herts Finance Service  
Hertfordshire County Council  
Postal Point CHO 327  
County Hall, Pegs Lane  
Hertford, SG13 8DQ

01992 555148

[pensions.team@hertfordshire.gov.uk](mailto:pensions.team@hertfordshire.gov.uk)

#### Scheme Administrator

For Benefits and Administration

Taryn Mutter  
London Pensions Fund Authority  
Hertfordshire Pension Team  
Postal Point CHO 033  
County Hall, Pegs Lane  
Hertford, SG13 8DQ

01992 555466

[hertscc@lpfa.org.uk](mailto:hertscc@lpfa.org.uk)

#### Legal Adviser

Kathryn Pettitt  
Chief Legal Officer, Hertfordshire County Council

### Administration Strategy

The Pension Fund has published an Administration Strategy ("Strategy") that sets out the responsibilities of the Pension Fund and employers and defines the required performance standards expected of the Pension Fund and its employers and also provides details of the charges that will be levied for non-compliance.

The Strategy has been prepared in accordance with regulation 59 of the Local Government Pension Scheme Regulations 2013. This enables a Local Government Pension Scheme Fund to prepare an administration strategy to support the delivery of a high quality administration service.

The Strategy was produced in consultation with employers and subsequent revisions are made in consultation with employers and approved by the Pensions Committee. The latest version was approved by the Pensions Committee on 27 February 2015 and implemented on 1 April 2015 and is accessible from the Pension Fund website at <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>

### Annual Performance Report

A set of key performance indicators has been agreed and approved by the Pensions Committee and these are used to measure and report on the performance of the Administering Authority, the outsourced pensions administration service provider LPFA and employers. Performance is reported to the Pensions Committee and Board on a quarterly basis and the reports and minutes from these meetings are accessible from <https://cmis.hertfordshire.gov.uk/hertfordshire/Calendarofcouncilmeetings.aspx>.

### Performance of the Administering Authority

The following table provides details of the Pension Fund's management costs shown as a unit cost per member (contributors, deferred and pensioner) and as a percentage of Net Assets, with comparative data for 2014/15.

	2014/15	2015/16	Trend
Total management costs per member	£176.74	£165.92	▼
Administrative expenses per member	£15.27	£16.18	▲
Total management costs as a percentage of Net Assets	0.45%	0.44%	▼

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## Administering Authority Report

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The Administering Authority is measured against performance and compliance with statutory requirements placed on administering authorities for the administration of pension funds. Performance of the Administering Authority is reviewed by periodic Internal Audit review and by the volume of complaints or internal disputes raised against the Administering Authority. The following provides details of performance for 2015/16:

- The annual external audit was carried out between February and August 2015 by Ernst & Young LLP. This reviewed the 2014/15 Annual Report and Accounts to provide a true and fair opinion on the financial statements. Ernst & Young LLP issued a positive Audit Results Report with no recommendations for improvements.
- The annual assurance audit was carried out in December 2015 and January 2016 by the Shared Internal Audit Service. The audit reviewed controls and procedures for pensions administration. The audit report was issued in March 2016 with substantial assurance that effective controls are in operation.
- As part of the annual external review of the 2015/16 Annual Report and Accounts, during March 2016, Ernst & Young LLP carried out an assessment of internal controls. Ernst & Young LLP's findings from the assessment will be published in September 2016 as part of the 2015/16 Audit Results Report for the Pension Fund.
- During 2015/16 there were two Internal Disputes against the Administering Authority; One of these was upheld and one is in progress. A copy of the internal disputes resolution procedure is accessible from the Pension Fund website, <http://www.yourpension.org.uk/Hertfordshire/Information-for-members/Custom-Care-Complaints>
- In common with the majority of LGPS schemes, the Pension Fund breached the statutory deadline of 31 August 2015 for the issue of the 2015 Annual Benefit Statements for LGPS members. This was due to this being the first year of the production of statements under the new CARE arrangements and the timetable for production being moved forward. The Administering Authority responded to the Pensions Regulator providing details of actions to resolve the issues for 2015 and ensure that the 2016 exercise will be carried out in accordance with statutory deadlines.

### Performance of the Pensions Administration Service

Performance of the pensions administration service delivered by the LPFA is measured against targets set out in the Service Level Agreement and against the number of complaints raised about service delivery. The following provides details of performance for 2015/16:

- During 2015/16 seven complaints were received; Six of these were upheld and resolved and one is in progress.
- Efficiency of the pensions administration service is measured against Service level Agreement performance targets which are monitored and reported on a monthly basis. The following chart sets out results for 2015/16 for key service tasks.

Pensions Administration Task	Annual Total	Standard <sup>1</sup>	Within Standard
Joiners to the LGPS	3,254	6 working days	99.1%
Pensions transfers in and out	1,752	6 working days	98.7%
Processing pensions benefits for retirements and deaths	4,386	5 working days	99.3%
Providing deferred members with a benefit statement	5,120	30 working days	19.1% <sup>2</sup>
Processing refunds of pensions contributions	1,656	5 working days	95.7%
Providing estimates of retirement benefits	2,973	5 working days	97.5%

<sup>1</sup> From receipt of accurate information

<sup>2</sup> Performance in relation to the provision of deferred member benefit statements is being managed under a project to improve timely notification of leavers by scheme employers.

### Performance of Employers

Employers' performance in administering the Scheme is measured against targets set out in the Administration Strategy and compliance with performance standards. The following provides details of performance for 2015/16:

- A total of 42 charges were levied against 27 employers (13% of active employers) for late submission of contribution returns or late payment of monthly contributions for contributions. Interest was levied on employers for late payment of contributions in accordance with regulation 70 of the Local Government Pension Scheme Regulations 2013.
- 93% of active employers paid contributions by the due date each month.
- 83% of active employers submitted monthly contribution returns by the due date.

To ensure compliance with the statutory deadline for the issue of the 2015/16 Annual Benefit Statements to LGPS members, the Pension has worked with scheme employers to ensure they understand their responsibilities under the Scheme and the sanctions that may apply if requirements are not met and has implemented a communication plan for advising scheme employers of the requirements, timescales and support available for the 2015/16 exercise.

### 5. Communication

The Pension Fund has published a Communication Policy Statement which sets out how it communicates with employers and representatives of employers, Scheme members and prospective Scheme members. It was approved by the Pensions Committee on 27 February 2015.

#### Communication Policy Statement

This Statement is prepared in accordance with regulation 61 of the Local Government Pension Scheme Regulations 2013, which requires an Administering Authority to prepare, maintain and publish a statement on its policy for communicating with members and employing authorities.

#### Employers

The following media is used to communicate with employers in the Pension Fund:

- **Annual General Meeting**  
All employers are invited to attend, to listen to presentations on topical issues and to raise questions about the Pension Fund.
- **Monthly Newsletters and Ad Hoc Bulletins**  
All employers receive monthly newsletters which provide information, advice and guidance about administering the Scheme. Ad hoc bulletins are also published to advise employers about specific issues that require attention or action, e.g. changes to Scheme regulations.
- **Annual Report and Accounts**  
A copy is available from the Pension Fund website, [www.yourpension.org.uk/agencies/HCC/](http://www.yourpension.org.uk/agencies/HCC/)
- **Hertfordshire Chief Finance Officers' Meeting**  
The Chief Finance Officer for the County Council keeps in contact with the District and Borough Councils through these meetings and keeps them up to date with pension matters.
- **Pensions Committee and Board Reports and Minutes**  
These are available on request to employers who wish to see them. They are also available from the Hertfordshire County Council website, <https://cmis.hertfordshire.gov.uk/hertfordshire/Calendarofcouncilmeetings.aspx>
- **On-line Self Service Portal**  
The on-line self-service portal is accessible from the Pension Fund website providing employers with access to information about the LGPS, forms and guides for administering the Scheme and the facility to submit monthly and annual returns electronically.
- **General Advice and Help**  
County Council staff and LPFA (the Pension Fund's outsourced scheme administrator) are available to give advice on the telephone, by letter or by email. Comprehensive information and guidance is also accessible from the Pension Fund website at [www.yourpension.org.uk/agencies/HCC/](http://www.yourpension.org.uk/agencies/HCC/)

#### Scheme Members

The following media is used to communicate with Scheme members:

- **Telephone Helpline**  
LPFA provides a telephone helpline for all enquiries from Scheme members on any aspect of their pension arrangements.
- **Annual Benefit Statements**  
All active and deferred Scheme members receive an Annual Benefit Statement setting out the level of benefits that have been built up, along with a forecast of benefits at retirement.
- **Internet**  
The Pension Fund website provides information about Scheme benefits. Scheme members may also have access to information about their pension benefits by subscribing to an on-line service.



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## Administering Authority Report

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- **Information Letters**

Information about changes in regulations is provided to employees via their employers in a range of media, including email and letter.

- **Payslips**

All pensioners receive at least three payslips each year and messages are included whenever there is new information to be communicated.

- **Newsletter for Pensioners**

An annual newsletter is mailed to pensioners and two in-year newsletters are published and are accessible from the Pension Fund website.

### **Prospective Scheme Members**

The methods used to ensure that prospective members are aware of the Scheme and its benefits are:

- **Job Advertisements**

Many employers advertise the benefits of the Scheme in their job advertisements.

- **Scheme Booklet**

All new starters in the employing organisations in the Pension Fund are provided with a Scheme booklet which summarises the benefits available from the Scheme.

- **Induction Sessions**

Employers in the Pension Fund are encouraged to include pensions in their induction sessions for new starters.

### 6. Actuarial Valuation Report

The Pension Fund is financed by contributions from employees and employers and by investment income earned on accumulated funds not immediately required for the payment of benefits and expenses. The Pension Fund Actuary reports periodically to the County Council on the Pension Fund's solvency and to identify the contributions payable by employers to the Pension Fund in the future to meet the funding objectives of the Pension Fund.

The Pension Fund has published a Funding Strategy Statement (see page 68), which sets out the Pension Fund's strategy for meeting employers' pension liabilities. The aim of the funding strategy is to ensure the long-term solvency of the Pension Fund and to ensure that sufficient funds are available to meet all benefits as they fall due for payment. The Pension Fund Actuary takes account of the Funding Strategy Statement when advising on the level of employer contributions to be paid.

#### **Actuarial Statement for 2015/16 Provided by Hymans Robertson LLP**

This statement has been prepared in accordance with Regulation 57(1)(d) of the Local Government Pension Scheme Regulations 2013. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

#### **Description of Funding Policy**

The funding policy is set out in the Administering Authority's Funding Strategy Statement, dated March 2014. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Pension Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/ dependants' benefits as they fall due for payment;
- not to restrain unnecessarily the Investment Strategy of the Pension Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Pension Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return. This will also minimise the costs to be borne by Council taxpayers;
- to reflect the different characteristics of different employers in determining contribution rates. This requires that the Pension Fund has a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council taxpayer from an employer defaulting on its pension obligations.

The Funding Strategy Statement sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is still a better than 50-60% chance that the Fund will return to full funding over 20 years.

#### **Funding Position as at the last formal funding valuation**

The most recent actuarial valuation carried out under Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008 was as at 31 March 2013. This valuation revealed that the Fund's assets, which at 31 March 2013 were valued at £2,908 million, were sufficient to meet 82% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2013 valuation was £617 million.

Individual employers' contributions for the period 1 April 2014 to 31 March 2017 were set in accordance with the Pension Fund's funding policy as set out in its Funding Strategy Statement.

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## Administering Authority Report

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### Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2013 Valuation Report dated 28 March 2014.

#### Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

#### Assumptions

A market-related approach was taken to valuing the liabilities for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2013 Valuation were as follows:

Financial assumptions	31 March 2013	
	% per annum Nominal	% per annum Real
Discount rate	4.8%	2.3%
Pay increases	3.8%	1.3%
Price inflation/Pension increases	2.5%	0

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Pension Fund's VitaCurves with improvements in line with the CMI\_2010 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.3 years	24.5 years
Future Pensioners	24.3 years	26.7 years

Copies of the 2013 Valuation Report and the Funding Strategy Statement are accessible from the Pension Fund website, [www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx](http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx)

#### Experience over the period since April 2013

Real bond yields have fallen dramatically placing a higher value on liabilities however this has been offset by strong asset returns. The impact on the deficit and funding level will be assessed at the next formal actuarial valuation.

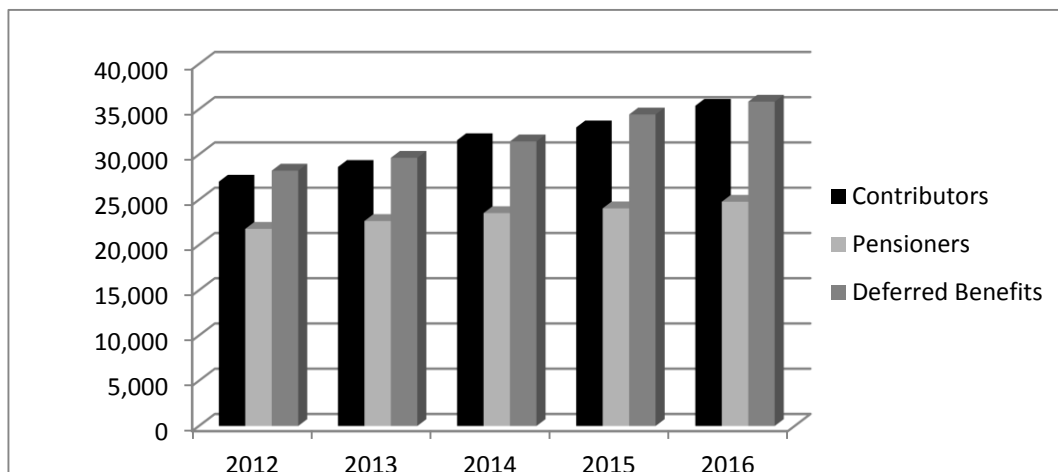
The next actuarial valuation will be carried out as at 31 March 2016. The Funding Strategy Statement will also be reviewed at that time.

Julie West FFA  
Fellow of the Institute and Faculty of Actuaries  
For and on behalf of Hymans Robertson LLP  
12 May 2016

Hymans Robertson LLP  
20 Waterloo Street  
Glasgow

## 7. Membership

The following graph shows the changes in membership over the last five years and the following table analyses the membership between member groups along with comparative figures for 2015.



31 March 2015		31 March 2016
32,992	Contributors	35,384
24,045	Pensioners	24,776
34,419	Deferred benefits (former contributors)	35,835
<b>91,456</b>	<b>Total Members</b>	<b>95,995</b>

The 2014/15 membership figures have been updated from those published in the 2014/15 Annual Report following late notifications of changes of membership. This is to ensure that the most accurate figures available are reported.

Changes in contributor members during the year	
Admissions	6,946
Retirements	(675)
Other leavers	(3,879)
<b>Total net movement</b>	<b>2,392</b>

The table below shows an analysis of the membership of the Pension Fund between the Administering Authority, admitted bodies and other employers at 31 March 2016.

	Contributors	Pensioners	Deferred Benefits
Administering Authority	20,082	13,143	23,488
Admitted Bodies	2,157	1,949	1,522
Other scheduled bodies	13,145	9,684	10,825
<b>Total</b>	<b>35,384</b>	<b>24,776</b>	<b>35,835</b>

### 1. Statement of Responsibilities

#### **Hertfordshire County Council's Responsibilities**

Hertfordshire County Council is the Administering Authority of the Pension Fund. The Administering Authority is required to:

- make arrangements for the proper administration of the financial affairs of the Pension Fund and to secure that one of its officers has responsibility for the administration of those affairs. In this Administering Authority that officer is the Chief Finance Officer;
- manage the affairs of the Pension Fund to secure economic, efficient and effective use of the Pension Fund's resources and safeguard its assets; and
- approve the Statement of Accounts.

#### **The Chief Finance Officer's Responsibilities**

The Chief Finance Officer is responsible for the preparation of the Pension Fund's statement of accounts in accordance with proper practices as set out in the Chartered Institute of Public Finance and Accountancy (CIPFA) and Local Authority (Scotland) Accounts Advisory Committee (LASAAC) Code of Practice on Local Authority Accounting in the United Kingdom.

In preparing this statement of accounts, the Chief Finance Officer has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with the Code of Practice.

The Chief Finance Officer has also:

- kept proper accounting records which were up to date;
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

### **2. Independent Auditor's Report to the Members of Hertfordshire County Council on the Pension Fund's financial statements**

We have examined the pension fund financial statements for the year ended 31 March 2016, which comprise the:

- Fund Account;
- Net Assets Statement; and
- Statement of Accounting Policies and related notes 6.1 to 6.21.

This report is made solely to the members of Hertfordshire County Council, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the authority and the authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

#### **Respective responsibilities of the Chief Finance Officer and the auditor**

As explained more fully in the Statement of the Chief Finance Officer's Responsibilities set out on page 20, the Chief Finance Officer 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 Hertfordshire County Council, and its compliance with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

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. The other information consists only of the Introduction, Scheme Administration Report, Administering Authority Report, Investment Report and Appendices.

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

#### **Opinion**

In our opinion, the pension fund financial statements are consistent with the full annual statement of accounts of Hertfordshire County Council for the year ended 31 March 2016 and comply with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

Richard Page (senior statutory auditor)  
for and on behalf of Ernst & Young LLP, Appointed Auditor  
Bristol

Date

## Financial Statements

### 3. Fund Account

2014/15				2015/16	
£000s	£000s		Note	£000s	£000s
32,994		Contributions receivable from members	6.1	33,834	
123,538		Contributions receivable from employers	6.1	127,914	
6,897		Transfers in from other schemes	6.2	3,647	
3		Other income		4	
	<b>163,432</b>	<b>Additions from dealings with those directly involved in the Scheme</b>			<b>165,399</b>
(110,232)		Pensions		(114,070)	
(22,656)		Commutation of pensions and lump sum retirement benefits		(24,081)	
(1,957)		Lump sum death benefits		(3,593)	
	<b>(134,845)</b>	<b>Benefits payable to members</b>	6.3		<b>(141,744)</b>
(108)		Refunds of contributions		(507)	
(64)		State scheme premiums		(293)	
(46,953)		Transfers out to other schemes	6.4	(9,425)	
	<b>(47,125)</b>	<b>Payments to and on account of leavers</b>			<b>(10,225)</b>
	<b>(18,538)</b>	<b>Net additions / (withdrawals) from dealings with those directly involved in the Scheme</b>			<b>13,430</b>
(1,396)		Administrative costs		(1,553)	
(777)		Oversight and governance costs		(845)	
(13,991)		Investment management expenses	6.5	(13,529)	
	<b>(16,164)</b>	<b>Management expenses</b>			<b>(15,927)</b>
51,402		Investment Income	6.6	49,107	
(2,609)		Taxes on income		(2,528)	
391,165		Profits and losses on disposals of investments and changes in value of investments	6.7	(40,871)	
	<b>439,958</b>	<b>Net return on investments</b>			<b>5,708</b>
	<b>405,256</b>	<b>Net increase / (decrease) in the net assets available for benefits during the year</b>			<b>3,211</b>

## Financial Statements

### 4. Net Assets Statement

31 March 2015			Note	31 March 2016	
£000s	£000s			£000s	£000s
		<u>Equities</u>			
654,690		UK Equities		635,030	
719,844		Overseas Equities		456,887	
		<u>Pooled investment vehicles</u>			
248,294		Property		269,692	
1,351,041		Unit trusts		1,639,024	
447,386		Other managed funds		499,602	
		<u>Derivatives</u>			
472		Forward foreign exchange contracts	6.9	858	
135,154		Cash deposits		56,642	
11,049		Other investment balances		11,075	
	<b>3,567,930</b>	<b>Total investment assets</b>	6.8a		<b>3,568,810</b>
		<u>Derivatives</u>			
(59)		Forward foreign exchange contracts	6.9	(734)	
(7,687)		Other investment balances		(1,146)	
	<b>(7,746)</b>	<b>Total investment liabilities</b>			<b>(1,880)</b>
	<b>3,560,184</b>	<b>Total investment assets and liabilities</b>	6.8a		<b>3,566,930</b>
3,727		Long term assets	6.10	2,956	
	<b>3,727</b>	<b>Total non current assets and liabilities</b>			<b>2,956</b>
22,779		Current assets	6.11	18,831	
(5,651)		Current liabilities	6.12	(4,467)	
	<b>17,128</b>	<b>Total current assets and liabilities</b>			<b>14,364</b>
	<b>3,581,039</b>	<b>Net assets of the Scheme available to fund benefits as at 31 March</b>			<b>3,584,250</b>

O Mapley  
Director of Resources



### 5. Statement of Accounting Policies

#### Basis of Preparation

The accounts have been prepared in accordance with the provisions of the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 which is based upon International Financial Reporting Standards, as amended for the UK public sector.

The accounts summarise the transactions and net assets of the Pension Fund. The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of promised retirement benefits at the Net Assets Statement date is detailed in section 6.15.

#### Valuation of Assets

Financial assets are included in the net asset statement on a fair value basis as at the reporting date. A financial asset or liability is recognised in the net asset statement on the date the Pension Fund becomes party to the contractual acquisition of the asset or to the liability. From this date, any gains or losses arising from changes in the fair value of the asset or liability are recognised in the Fund Account. The values on investments as shown in the net assets statement have been determined as follows:

- Market-quoted securities, for which there is a readily available market price, are valued at bid price at the close of business on the net asset date.
- Fixed interest securities are recorded at net market value based on their current yields.
- Pooled investment vehicles are valued at the closing bid price if both bid and offer prices are quoted by the respective Investment Managers. If only a single price is quoted, investments are valued at the closing single price. In the case of pooled investment vehicles that are accumulation funds, the change in market value also includes income which is reinvested in the fund, net of applicable withholding tax.
- Unquoted investments for which market quotations are not readily available are valued having regard to the latest dealings, professional valuations, asset values and other appropriate financial information.
- Indirect private equity investments are interests in limited partnerships and are stated at the partnership's estimate of fair value. Investments are valued based on the Pension Fund's share of the net assets of the private equity fund. For private equity limited partnerships there is usually a time delay in receiving information from the private equity Investment Managers. The valuations shown in the Net Assets Statement for these investments are the latest valuations provided to the Pension Fund, adjusted for cash movements between the valuation date and the net asset date.
- Forward foreign exchange contracts are stated at fair value which is determined as the gain or loss that would arise from closing out the contract at the balance sheet date by entering into an equal and opposite contract.
- Investment assets and liabilities include cash balances held by the Investment Managers and debtor and creditor balances in respect of investment activities as these form part of the net assets available for investment.
- Rights issues are processed on ex date. If the value of the rights on ex date is 15% or more of the value of the underlying security, cost is allocated from the parent to the rights. If the value is less than 15%, the rights are allocated at zero cost.

#### Cash and Cash Equivalents

Cash is cash in hand and deposits with any financial institution, repayable without penalty and on notice of not more than 24 hours. Cash equivalents comprise investments that are held to meet short-term liabilities rather than for investment or other purposes. Bank overdrafts, repayable on demand and which form an integral part of the County Council's treasury management function, are also included as a component of cash and cash equivalents.

#### Foreign Currency Translation

All investments are shown in sterling. Dividends, interest, purchases and sales of investments in foreign currencies have been accounted for at the spot market rate at the date of transaction. End of year spot market exchange rates are used to value foreign currency cash balances, market values of overseas investments and purchases and sales outstanding at the net asset date.

Gains and losses on exchange arising from foreign currency investment and cash balances are included within the Fund Account for the year.

#### Management Expenses

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended), allows the Administering Authority to charge directly to the Pension Fund any costs or expenses incurred in administering it. Management expenses are accounted for on an accruals basis and disclosed in accordance with the 2014 CIPFA

guidance 'Accounting for Local Government Pension Scheme Management costs' and analysed between administrative costs, oversight and governance costs and investment management expenses.

Fees of the external Investment Managers are agreed in the respective mandates governing their appointment. Fees are based on the market value of the portfolio under management. Where an Investment Manager's fee note has not been received for the final period, an estimate based on the market value of their mandate as at the end of the year is used for inclusion in the Fund Account. In 2015/16, £428,119 was based on such estimates.

Investment management expenses include transaction costs relating to the purchase and sale of investments.

### VAT

The Pension Fund is exempt from VAT and is therefore able to recover such deductions. Investment management and administrative expenses are therefore recognised net of any recoverable VAT.

### Benefits Payable

Pension and lump sum benefits payable include all amounts known to be due as 31 March 2016. Any amounts due but unpaid are disclosed in the Net Assets Statement as current liabilities.

### Contributions

Normal contributions both from members and employers are accounted for on an accruals basis, at the percentage rate certified by the Pension Fund Actuary in the payroll period to which they relate. Employer deficit funding contributions are accounted for on an accruals basis in accordance with the period to which they relate or are due, or on a cash basis if the payment is an additional contribution in excess of the minimum required by the Pension Fund Actuary and set out in the Rates and Adjustments Certificate.

Pension strain contributions and employers' augmentation contributions are accounted for in the period in which the liability arises. Any amount due in year but unpaid is classed as a current financial asset.

### Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have joined or left the Pension Fund during the financial year and are calculated in accordance with Scheme regulations. Transfer values are treated on a cash basis when they are paid or received, which is normally when the member liability is accepted or discharged. Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase Scheme benefits are accounted for on a receipts basis and are included in transfers in. Bulk transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

### Investment Income

Investment income earned by the Pension Fund on its investments is recognised as follows:

- Interest income is recognised in the Fund Account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.
- Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the Net Assets Statement under other investment balances.
- Investment income earned on pooled investment vehicles that are accumulation funds, where income is retained and automatically reinvested, are shown as changes in the value of investments in the Fund Account.
- Income from private equity investments are reported on the quarterly valuations provided by the private equity Investment Managers. Income is recognised in the period in which the valuation is received.
- Distributions from other pooled investment vehicles are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the Net Asset Statement under other investment balances.
- Changes in the value of investment income are accounted for as income and comprise all realised and unrealised profits and losses during the year.

### Taxation

The Pension 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. Tax is deducted from dividends paid on UK equities, which is not recoverable. Income from overseas investments suffers a withholding tax in the country of origin, unless exemption is permitted. Provision is made for the estimated sums to be recovered and income grossed up accordingly. Irrecoverable tax is accounted for as a Pension Fund expense as it arises.

### Security Lending

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) permit the Pension Fund to lend up to 35% of its securities from its portfolio of stocks to third parties in return for collateral. The Pension Fund has set a limit of 20% of the total Fund value. The securities on loan are included in the Net Assets Statement to reflect the Pension Fund's continuing economic interest of a proprietorial nature in these securities.

### Additional Voluntary Contribution Investments

The County Council has arrangements with the Standard Life Assurance Company and the Equitable Life Assurance Society to enable employees to make Additional Voluntary Contributions (AVCs) to enhance their pension benefits. AVCs are invested separately from the Pension Fund's main assets and the assets purchased are specifically allocated to provide additional benefits for members making AVCs. As these contributions do not form part of the Pension Fund's investments, the value of AVC investments are excluded from the Pension Fund's Net Assets Statement in accordance with regulation 4(2)(c) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

### Prior period adjustments

There were no material prior period adjustments in 2015/16 that require disclosure.

### Events after the Net Asset Date

The impact of the UK's vote to leave the European Union on the future valuation of the Pension Fund remains uncertain. There may be some short term volatility in equity markets and bond markets prices may also be impacted. However, whilst these impacts are short term in nature, the liabilities of the fund are over the long term. The Fund will continue to review its investment strategy in light of the changing economic and market conditions, to ensure that the strategy continues to deliver the risk and return objectives of the Fund.

### Critical judgements in applying accounting policies

In applying the accounting policies set out above, the Pension Fund has had to make certain judgements about complex transactions or those involving uncertainty about future events. The critical judgements made in the accounts are:

- **Valuation of private equity investments:** Unquoted private equities are valued by the Investment Managers using the International Private Equity and Venture Capital Valuation Guidelines. These are inherently based on forward looking estimates and judgements involving many factors.
- **Pension fund liability:** The Pension Fund liability is calculated every three years by the Pension Fund Actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with IAS19. Assumptions underpinning the valuations are agreed with the Actuary and are summarised in note 6.15. This estimate is subject to significant variances based on changes to the underlying assumptions.

### Assumptions made about the future and other major sources of estimation uncertainty

Preparation of financial statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities as at the net asset date and the amounts reported for revenues and expenses during the year. Estimates and assumptions are made taking into account historical experience, current trends and other relevant factors. However, the nature of estimation means that actual outcomes could differ from those assumptions and estimates. The key judgements and estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are:

- **Valuation of private equity investments:** The valuations for private equity investments shown in the Net Assets Statement are based on the latest valuations provided to the Pension Fund, adjusted for cash movements between the valuation date and the net asset date. This may result in a variance between the valuation included in the Financial Statements and the actual value of the Pension Fund's investments as at 31 March 2016 issued by each of the private equity Investment Managers. At 31 March 2016 private equity investments totalled £160.3million (including private equity investments held within the Global Alternatives Fund).
- **Contractual commitments:** Commitments to the private equity funds are made in local currency (sterling, euros and US dollars). The total remaining commitment to each private equity fund at 31 March 2016 has been converted to base currency, based on exchange rates applicable at the net asset date. The exact timing and amounts of when the Pension Fund's commitment will be drawn down is uncertain and therefore the actual payments made by the Pension Fund may be different from the estimates.

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- **Actuarial present value of promised retirement benefits:** Estimation of the liability to pay retirement benefits depends on a number of complex judgements relating to the discount rate used to value the liabilities, the rate at which salaries increase, and changes in retirement ages and mortality rates. The consulting actuary to the Pension Fund, Hymans Robertson, is engaged to provide the Pension Fund with expert advice about the assumptions to be applied. Further information about the key assumptions used to calculate the actuarial present value of promised retirement benefits and the effect on the pensions liability of changes in individual assumptions are shown in section 6.15.
- **Provision for doubtful debt:** In 2015/16 a provision for doubtful debt was made of £52,865. The provision was created for all invoiced debt at 31 March 2016 of £379,958. The provision is based on the County Council's Income Collection and Debt Management Policy for providing for doubtful debt as follows:

Age of debt at 31 March 2016	Provision created
0 – 274 days	0%
275 – 456 days	35%
457 – 639 days	50%
Over 639 days	100%

## 6. Notes to the Accounts

### 6.1 Contributions Receivable

2014/15			2015/16	
£000s	£000s		£000s	£000s
32,545	32,994	<u>Members</u>	33,471	33,834
449		Normal	363	
		Additional		
		<b>Total members</b>		
		<u>Employers</u>		
94,764	123,538	Normal	98,344	127,914
27,865		Deficit funding	27,769	
909		Augmentation and early retirement strain costs	1,801	
		<b>Total employers</b>		
	<b>156,532</b>	<b>Total contributions receivable</b>		<b>161,748</b>

Members' additional contributions represent contributions from members to purchase additional years of membership or pension in the Scheme.

Employers' normal contributions represent the ongoing contributions paid into the Pension Fund by employers in accordance with the Rates and Adjustments Certificate, issued by the Pension Fund Actuary. These reflect the cost of benefits accrued by current members over the year.

Employers' deficit funding includes:

- £25,691,215 (£25,376,714 in 2014/15) past service adjustment which represents the additional contributions required from employers towards the deficit where an employer's funding level is less than 100%, as per the Rates and Adjustments Certificate. The deficit recovery period varies depending on the individual circumstances of each employer. For statutory bodies, the Pension Fund normally targets the recovery of any deficit over a period not exceeding 20 years. For Transferee Admission Bodies the deficit recovery period would be the shorter of the end of the employer's service contract or the expected future working lifetime of the remaining Scheme members. Further information can be found in the Pension Fund's Funding Strategy Statement on page 68 and accessible from [www.yourpension.org.uk/agencies/HCC/](http://www.yourpension.org.uk/agencies/HCC/).
- £2,077,893 (£2,467,874 in 2014/15) paid by employers in excess of the minimum contribution levels required by the Pension Fund Actuary in the Rates and Adjustments Certificate.
- £nil (£20,000 in 2014/15) termination payments where an employer had ceased to be a participating employer in the Pension Fund.

Contributions received are further analysed in the table below by type of employer.

2014/15			2015/16	
Members	Employer		Members	Employer
£000s	£000s		£000s	£000s
13,799	50,085	Administering Authority	14,640	53,918
16,066	60,520	Other Scheduled Bodies	16,299	63,044
3,129	12,933	Admitted Bodies	2,895	10,952
<b>32,994</b>	<b>123,538</b>	<b>Total contributions receivable</b>	<b>33,834</b>	<b>127,914</b>

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### 6.2 Transfers In from Other Schemes

The Pension Fund received £3,646,542 (£6,897,332 in 2014/15) in relation to individual members' transfers of benefits into the Pension Fund. No amounts were received during the year for group transfers from other schemes.

Transfers are shown on a cash basis, in accordance with the accounting policy.

### 6.3 Benefits Payable

2014/15 £000s		2015/16 £000s
58,535	Administering Authority	62,412
63,366	Other Scheduled Bodies	65,223
12,944	Admitted Bodies	14,109
<b>134,845</b>	<b>Total benefits payable</b>	<b>141,744</b>

### 6.4 Transfers Out to Other Schemes

2014/15 £000s		2015/16 £000s
7,931	Individual transfers	5,289
39,022	Bulk transfers	4,136
<b>46,953</b>	<b>Total Transfers out to other schemes</b>	<b>9,425</b>

### 6.5 Management Expenses

The Pension Fund's Investment Managers are remunerated on the basis of fees calculated as a percentage of assets under management or as a fixed annual fee. Some Investment Managers also have a performance related fee, payable where performance exceeds the performance target, set out in Appendix C to the Statement of Investment Principles.

Investment management expenses include transaction costs associated with the acquisition, issue or disposal of Pension Fund assets and associated financial instruments. In addition to these costs, indirect costs are incurred through the bid-offer spread on investments sales and purchases. These are reflected in the cost of investment acquisitions and in the proceeds from the sales of investments set out in note 6.7.

The Pension Fund's assets are held in custody by an independent custodian. The Custodian is responsible for the safekeeping of the Pension Fund's financial assets, the settlement of transactions, income collection, tax reclamation and other administrative actions in relation to the Pension Fund's investments.

The Pension Fund's performance measurement service is provided by BNY Mellon. An analysis of the Pension Fund's performance is shown in the Investment Performance section on pages 59-63.

2014/15 £000s		2015/16 £000s
12,281	Management fees	11,790
1,505	Transaction costs	1,504
205	Custody fees	235
<b>13,991</b>	<b>Total investment management expenses</b>	<b>13,529</b>

## Financial Statements

### 6.6 Investment Income

#### a) Analysis of investment income

2014/15 £000s		2015/16 £000s
	<u>Income from fixed interest securities</u>	
(3)	Public Sector	(1)
	<u>Dividends from equities</u>	
20,126	UK	22,866
15,893	Overseas	12,898
	<u>Income from pooled investment vehicles</u>	
12,024	Property	10,590
2,736	Other managed funds	1,833
238	Interest on cash deposits	313
	<u>Other investment income</u>	
259	Securities lending	370
117	Class action proceeds	180
12	Underwriting commission	58
<b>51,402</b>	<b>Total investment income</b>	<b>49,107</b>

An analysis of investment income accrued during 2014/15 and 2015/16 is shown in the following table.

2014/15					2015/16			
UK £000s	Overseas £000s	Global £000s	Total £000s		UK £000s	Overseas £000s	Global £000s	Total £000s
20,146	15,893	0	36,039	Equities	22,866	12,898	0	35,764
(2)	(1)	0	(3)	Bonds	0	(1)	0	(1)
8,872	3,348	2,520	14,740	Alternatives	7,073	2,382	2,968	12,423
238	0	0	238	Cash and cash equivalents	302	11	0	313
100	288	0	388	Other	368	240	0	608
<b>29,354</b>	<b>19,528</b>	<b>2,520</b>	<b>51,402</b>	<b>Total investment income</b>	<b>30,609</b>	<b>15,530</b>	<b>2,968</b>	<b>49,107</b>

#### b) Securities lending

The Pension Fund has an arrangement with its Custodian to lend securities from within its portfolio of stocks to third parties in return for collateral. Collateralised lending generated income of £369,603 for 2015/16 (£259,462 for 2014/15). This is included within investment income in the Fund Account.

The Pension Fund obtains collateral at 102% of the market value of securities loaned for collateral denominated in the same currency as that of the loans, or 105% in the case of cross-currency collateral. The market value of securities on loan and collateral held at 31 March 2016 and 2015 is shown in the following table, analysed by collateral type.

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2014/15			2015/16	
Market value of securities on loan £000s	Collateral held £000s		Market value of securities on loan £000s	Collateral held £000s
70,109	75,209	Government debt and Supranationals	1,425	1,502
1,369	1,437	UK Equity DBV	0	0
470	495	G10 debt	45,835	49,025
<b>71,948</b>	<b>77,141</b>	<b>Total</b>	<b>47,260</b>	<b>50,527</b>

### 6.7 Profit and Losses on the Disposal of Investments and Changes in the Value of Investments

An analysis of profit and losses on disposal of investments and changes in the value of investments is shown in the following tables giving the value at 31 March 2016 compared to the value at 31 March 2015.

Value at 31 March 2014  £000s		Purchases at cost and derivative payments  £000s	Sale proceeds and derivative receipts  £000s	Profits and losses on disposals and change in value of investments  £000s	Value at 31 March 2015  £000s
15	<u>Fixed interest securities</u> Public Sector	0	(15)	0	0
706,244	<u>Equities</u> UK	87,117	(177,578)	38,907	654,690
726,995	Overseas	417,948	(538,706)	113,607	719,844
202,546	<u>Pooled investment vehicles</u> Property	24,776	(7,346)	28,318	248,294
1,036,505	Unit trusts	183,153	(37,367)	168,750	1,351,041
412,911	Other managed funds	34,176	(41,252)	41,551	447,386
29	<u>Derivatives</u> Net forward foreign exchange*	7,692	(6,654)	(654)	413
199,939	Cash deposits	0	(65,471)	686	135,154
<b>3,285,184</b>	<b>Subtotal</b>	<b>754,862</b>	<b>(874,389)</b>	<b>391,165</b>	<b>3,556,822</b>
<b>(127,646)</b>	<b>Net other investment balances**</b>				<b>3,362</b>
<b>3,157,538</b>	<b>Total investments assets / (liabilities)</b>				<b>3,560,184</b>

\* Net forward foreign exchange assets/liabilities (see note 6.8a)

\*\* Net other investment balances assets/liabilities (see note 6.8a)



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Value at 31 March 2015  £000s		Purchases at cost and derivative payments  £000s	Sale proceeds and derivative receipts  £000s	Profits and losses on disposals and change in value of investments  £000s	Value at 31 March 2016  £000s
	<u>Equities</u>				
654,690	UK	116,261	(106,423)	(29,498)	635,030
719,844	Overseas	250,798	(476,059)	(37,696)	456,887
	<u>Pooled investment vehicles</u>				
248,294	Property	134,681	(140,598)	27,315	269,692
1,351,041	Unit trusts	299,809	(6,964)	(4,862)	1,639,024
447,386	Other managed funds	88,710	(45,433)	8,939	499,602
	<u>Derivatives</u>				
413	Net forward foreign exchange*	13,032	(8,892)	(4,429)	124
135,154	Cash deposits	0	(77,872)	(640)	56,642
<b>3,556,822</b>	<b>Subtotal</b>	<b>903,291</b>	<b>(862,241)</b>	<b>(40,871)</b>	<b>3,557,001</b>
<b>3,362</b>	<b>Net other investment balances**</b>				<b>9,929</b>
<b>3,560,184</b>	<b>Total investments assets / (liabilities)</b>				<b>3,566,930</b>

\* Net forward foreign exchange assets/liabilities (see note 6.8a)

\*\* Net other investment balances assets/liabilities (see note 6.8a)

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at year end and profits and losses realised on the sale of investments during the year. Derivative receipts and payments correspond to the sterling equivalent amount of forward foreign exchange settled during the year. The sale proceeds for cash deposits represent the net movement in cash held by the Investment Managers during the year. The change in market value of cash results from gains and losses on foreign currency cash transactions.

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### 6.8 Investment Analysis

#### a) Analysis of investment assets at market value

2014/15			2015/16	
£000s	£000s		£000s	£000s
		<b>Investment assets</b>		
		<u>Equities</u>		
654,690		UK quoted	635,030	
719,844		Overseas quoted	456,887	
	<b>1,374,534</b>	<b>Total equities</b>		<b>1,091,917</b>
		<u>Pooled investment vehicles</u>		
158,265		UK property	152,746	
2,794		Overseas property	757	
87,235		Global property	116,189	
<b>248,294</b>		<b>Property</b>	<b>269,692</b>	
104,357		UK equity unit trusts	118,507	
377,973		Overseas equity unit trusts	585,156	
376,890		UK Index Linked Gilts Fund	397,756	
330,579		Global Core Plus Bond Fund	358,743	
161,242		Global Absolute Return Bond Fund	178,862	
<b>1,351,041</b>		<b>Unit trusts</b>	<b>1,639,024</b>	
68		UK private equity	0	
13,987		UK other managed funds	13,826	
117,864		Overseas private equity	115,942	
315,451		Global Alternatives Fund	369,817	
16		Overseas other managed funds	17	
<b>447,386</b>		<b>Other managed funds</b>	<b>499,602</b>	
	<b>2,046,721</b>	<b>Total pooled investment vehicles</b>		<b>2,408,318</b>
		<u>Derivatives</u>		
472		Forward foreign exchange	858	
	<b>472</b>	<b>Total derivatives</b>		<b>858</b>
		<u>Cash</u>		
135,154		Cash deposits	56,642	
	<b>135,154</b>	<b>Total Cash</b>		<b>56,642</b>
		<u>Other investment balances</u>		
6,657		Amounts receivable from the sale of investments	6,573	
4,392		Investment income due	4,502	
	<b>11,049</b>	<b>Total other investment balances</b>		<b>11,075</b>
	<b>3,567,930</b>	<b>Total investment assets</b>		<b>3,568,810</b>

Table continues overleaf

## Financial Statements

2014/15			2015/16	
£000s	£000s		£000s	£000s
		<b>Investment liabilities</b>		
		<u>Derivative contracts</u>		
(59)		Forward foreign exchange contracts	(734)	
	(59)	<b>Total derivatives contracts</b>		(734)
		<u>Other investment balances</u>		
(7,429)		Amounts payable for the purchase of investments	(925)	
(258)		Non recoverable tax payable	(221)	
	(7,687)	<b>Total other investment balances</b>		(1,146)
	(7,746)	<b>Total investment liabilities</b>		(1,880)
	<b>3,560,184</b>	<b>Total investment assets and liabilities at market value</b>		<b>3,566,930</b>

Five pooled holdings exceeded 5% of the total investment assets and liabilities available to fund benefits and 5% of their asset class at 31 March 2016. These were the Legal & General Over 5 yr Index Linked Gilts Fund, Royal London Core Plus Bond Fund, Legal & General North America Equity Index Fund, LGT Capital Crown Phoenix Alternatives Fund and the Henderson Absolute Return Bond Fund.

Cash deposits (including cash and cash instruments) and other investment balances (including accrued dividend entitlements) are accounted for as investment assets as these form part of the net assets available for investment within the investment portfolio.

Investment assets and liabilities at the Net Asset date are further analysed by asset class in the following table.

2014/15					2015/16			
UK £000s	Overseas £000s	Global £000s	Total £000s		UK £000s	Overseas £000s	Global £000s	Total £000s
773,034	1,097,833	0	1,870,867	Equities	767,363	1,042,060	0	1,809,423
376,890	0	491,821	868,711	Bonds	397,756	0	537,605	935,361
158,333	120,658	402,686	681,677	Alternatives	152,746	116,699	486,006	755,451
121,729	13,428	(3)	135,154	Cash and cash equivalents	43,807	12,842	(7)	56,642
1,520	1,842	413	3,775	Other	7,585	2,344	124	10,053
<b>1,431,506</b>	<b>1,233,761</b>	<b>894,917</b>	<b>3,560,184</b>	<b>Total assets and liabilities</b>	<b>1,369,257</b>	<b>1,173,945</b>	<b>1,023,728</b>	<b>3,566,930</b>

## Financial Statements

### b) Analysis by Investment Manager

The value of investments held by each Investment Manager on 31 March 2016 are shown in the following table with a comparison to 2015.

31 March 2015			31 March 2016	
£000s	%		£000s	%
361,060	10.1	Allianz Global Investors Europe GmbH	362,313	10.2
341,221	9.6	Baillie Gifford & Co.	328,740	9.2
265,111	7.5	CBRE Global Collective Investors (UK) Ltd.	297,688	8.3
276,721	7.8	Global Thematic Partners, LLC	384	0.0
90,722	2.5	HarbourVest Partners, LLC	84,386	2.4
161,242	4.5	Henderson Global Investors Ltd.	178,862	5.0
148,317	4.2	JP Morgan Asset Management (UK) Ltd.	143,701	4.0
305,406	8.6	Jupiter Asset Management Ltd.	305,065	8.5
852,059	23.9	Legal & General Assurance (Pensions Management) Limited	1,094,728	30.7
383,451	10.8	LGT Capital Partners (Ireland) Ltd	369,817	10.4
624	0	Pantheon Ventures	2,887	0.1
1,347	0	Permira Advisers LLP	677	0.0
330,580	9.3	Royal London Asset Management Ltd.	358,744	10.1
42,123	1.2	Standard Life Investments Ltd.	38,919	1.1
59	0	TTP Venture Managers Ltd.	0	0.0
141	0	Residual funds from previous portfolios	19	0.0
<b>3,560,184</b>	<b>100</b>	<b>Funds externally managed</b>	<b>3,566,930</b>	<b>100</b>
<b>20,855</b>		<b>Funds held at Hertfordshire County Council and non-investment balances</b>	<b>17,320</b>	
<b>3,581,039</b>		<b>Net Assets of the Scheme</b>	<b>3,584,250</b>	

The market values in table 6.8(b) include the value of investments, cash and net current assets held by each Investment Manager at 31 March. The funds held by Hertfordshire County Council include net current assets, long term assets and cash required to manage the cash flow associated with the payment of benefits and collection of contributions.

Residual funds from previous portfolios represent residual cash and investment income still due to the portfolios previously run by outgoing Investment Managers following the review of the Pension Fund's Investment Strategy.

### c) Encumbrance of Assets

The Custodian has a lien over the Pension Fund's assets in order to recover any outstanding debts. This is held for the protection of the Custodian and has never been invoked.

## 6.9 Derivatives

The Pension Fund uses derivative financial instruments to manage its exposure to specific risks arising from its investment activities. The Pension Fund does not hold derivatives for speculative purposes.

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### Forward foreign exchange contracts

Forward foreign exchange contracts are over the counter contracts with non-exchange counterparties and are used to hedge against foreign currency movements. Forward foreign exchange contracts are disclosed in the accounts at fair value which is the gain or loss that would arise from closing out the contract at the balance sheet date by entering into an equal and opposite contract at that date.

The counterparties at 31 March 2015 and 31 March 2016 were UK and overseas investment banks and the contracts held with these investment banks are analysed in the following table by duration.

2014/15				Duration	2015/16			
Currency Payable £000s	Currency Receivable £000s	Fair Value			Currency Payable £'000	Currency Receivable £000s	Fair Value	
		Asset	Liability				Asset	Liability
		£000s	£000s				£000s	£000s
(280)	280	0	0	Within 1 month	0	0	0	0
(79,679)	80,092	472	(59)	3-6 months	(101,465)	101,589	858	(734)
(79,959)	80,372	472	(59)	Total	(101,465)	101,589	858	(734)

### 6.10 Long Term Financial Assets

Long term assets of £2,956,000 in the Net Assets Statement relates to the bulk transfer of Magistrates Court staff to the civil service pension scheme in 2005 in accordance with the terms of transfer agreement. In 2014/15 long term assets of £3,727,084 included £3,695,000 in respect of the bulk transfer of Magistrates Court staff and £32,084 for early retirement strain costs.

### 6.11 Current Assets

2014/15 £000s		2015/16 £000s
13,541	Contributions due from employers	13,438
8,662	Cash and cash equivalents	4,428
42	VAT due from HMRC	539
606	Other debtors and prepayments	479
(72)	Provision for doubtful debt	(53)
<b>22,779</b>	<b>Total current assets</b>	<b>18,831</b>

Cash and cash equivalents represent investments in money market funds and call accounts where funds are repayable without penalty and on notice of not more than 24 hours.

Current assets are further analysed by type of debtor organisation.

2014/15			2015/16	
£000s	£000s		£000s	£000s
45	14,189	Central government bodies	1,909	14,456
7,892		Other local authorities	8,092	
7		NHS bodies	3	
6,245		Other entities and individuals	4,452	
		<b>Total debtors</b>		
(72)		Provision for doubtful debt	(53)	
8,662		Cash and cash equivalents	4,428	
	<b>8,590</b>	<b>Total cash balances</b>		<b>4,375</b>
	<b>22,779</b>	<b>Total current assets</b>		<b>18,831</b>

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### 6.12 Current Liabilities

2014/15 £000s		2015/16 £000s
1,196	Tax payable to HMRC	1,292
1,557	Investment management fees	1,285
444	Other creditors	324
2,362	Unpaid benefits	1,053
92	Cash and cash equivalents	513
<b>5,651</b>	<b>Total current liabilities</b>	<b>4,467</b>

Cash balances in the table above include cash balances less cash in transit in the form of unrepresented cheques and payments committed by BACs at the net asset date.

Current liabilities are further analysed by type of creditor organisation.

2014/15 £000s		2015/16 £000s
1,196	Central government bodies	1,295
0	Other local authorities	12
4,363	Other entities and individuals	2,647
92	Cash and cash equivalents	513
<b>5,651</b>	<b>Total current liabilities</b>	<b>4,467</b>

### 6.13 Financial Instruments

#### a) 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 of financial assets and liabilities by category and Net Assets Statement heading.

The 2014/15 figures have been restated from those reported in the 2014/15 Annual Report and Accounts to reflect the re-categorisation of the Global Alternatives Fund reported within "Managed Funds". For consistency with the Net Asset Statement, the Global Alternatives Fund has been reported on a whole fund rather than a segregated basis. The following table shows the restated figures for "Managed Funds".

All financial instruments are carried in the balance sheet at their fair value. The Pension Fund has not entered into any financial guarantees that are required to be accounted for as financial instruments.

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31 March 2015				31 March 2016		
RESTATED						
Fair value through profit and loss £000s	Loans and receivables £000s	Financial liabilities at amortised cost £000s		Fair value through profit and loss £000s	Loans and receivables £000s	Financial liabilities at amortised cost £000s
1,374,534	0	0	Equities	1,091,917	0	0
248,294	0	0	Property	269,692	0	0
1,351,041	0	0	Unit trusts	1,639,024	0	0
447,386	0	0	Managed funds	499,602	0	0
472	0	0	Derivatives	858	0	0
0	135,154	0	Cash deposits	0	56,642	0
11,049	0	0	Other investment balances	11,075	0	0
0	3,727	0	Long term assets	0	2,956	0
0	22,779	0	Current assets	0	18,831	0
3,432,776	161,660	0	Total financial assets	3,512,168	78,429	0
(59)	0	0	Derivatives	(734)	0	0
(7,687)	0	0	Other investment balances	(1,146)	0	0
0	0	(5,651)	Current liabilities	0	0	(4,467)
(7,746)	0	(5,651)	Total financial liabilities	(1,880)	0	(4,467)
3,425,030	161,660	(5,651)	Total	3,510,288	78,429	(4,467)

### b) Net gains and losses on financial instruments

2014/15 £000s		2015/16 £000s
390,479	Fair value through profit and loss	(40,231)
686	Loans and receivables	(640)
<b>391,165</b>	<b>Total gains and losses</b>	<b>(40,871)</b>

### c) Valuation of financial instruments carried at fair value

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

**Level 1:** Financial instruments 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 interest securities, quoted index linked securities and unit trusts. Listed securities 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 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 where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data.

## Financial Statements

The following tables provides an analysis of the financial assets and liabilities of the Pension Fund analysed across levels 1 to 3, based on the level at which the fair value is observable, along with comparative figures for 2015. The figures as at 31 March, 2015 have been restated from those reported in the 2014/15 Annual Report and Accounts to reflect the re-classification of financial assets and liabilities following confirmation of valuation levels from the Pension Fund's Investment Managers.

	31 March 2016			
	Level 1	Level 2	Level 3	Total
	£000s	£000s	£000s	£000s
<u>Financial assets</u>				
Fair value through profit and loss	2,541,135	563,990	407,043	3,512,168
Loans and receivables	78,429	0	0	78,429
<u>Financial liabilities</u>				
Fair value through profit and loss	(1,146)	(734)	0	(1,880)
Financial liabilities at amortised cost	(4,467)	0	0	(4,467)
<b>Net financial assets</b>	<b>2,613,951</b>	<b>563,256</b>	<b>407,043</b>	<b>3,584,250</b>

	31 March 2015			
	RESTATED			
	Level 1	Level 2	Level 3	Total
	£000s	£000s	£000s	£000s
<u>Financial assets</u>				
Fair value through profit and loss	2,558,742	498,654	375,380	3,432, 776
Loans and receivables	161,660	0	0	161,660
<u>Financial liabilities</u>				
Fair value through profit and loss	(7,687)	(59)	0	(7,746)
Financial liabilities at amortised cost	(5,651)	0	0	(5,651)
<b>Net financial assets</b>	<b>2,707,064</b>	<b>498,595</b>	<b>375,380</b>	<b>3,581,039</b>

### 6.14 Nature and Extent of Risks Arising from Financial Instruments

The Pension Fund maintains positions in a variety of financial instruments including bank deposits, equity instruments, fixed interest securities and derivatives. This exposes it to a variety of financial risks including credit and counterparty risk, liquidity risk, market risk and exchange rate risk.

#### a) Overall procedures for managing risk

The principle powers to invest are contained in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) and require an administering authority to invest any pension fund money that is not needed immediately to make payments from the pension fund. These regulations require the Pension Fund to formulate a policy for the investment of its Fund money.

The Administering Authority's overall risk management procedures focus on the unpredictability of financial markets and implementing restrictions to minimise these risks.

The Pension Fund has prepared a Statement of Investment Principles which is provided at page 49 and sets out the Pension Fund's policy on matters such as the type of investments to be held, balance between types of investments, investment restrictions and the way risk is managed.



## Financial Statements

Pension Fund cash held by the Administering Authority is invested in accordance with the Pension Fund's treasury management strategy and lending policy ("Treasury Management Strategy"), prepared in accordance with the CIPFA Prudential Code, CIPFA Treasury Management in the Public Services Code of Practice and the legal framework and investment guidance set out and issued through the Local Government Act 2003. The Treasury Management Strategy sets out the criteria for investing and selecting investment counterparties and details the approach to managing risk for the Pension Fund's financial instrument exposure.

Investment performance by external Investment Managers and the Administering Authority is reported to the Pensions Committee and Board quarterly. Performance of Pension Fund investments managed by external Investment Managers is compared to benchmark returns. For Pension Fund cash held by the Administering Authority, performance of the treasury function is assessed against treasury management performance measures modelled on the CIPFA Treasury Management Code of Practice which has been adopted by the County Council.

### b) Credit risk and counterparty risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Pension Fund. The market value of investments generally reflects an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Pension Fund's financial assets and liabilities. Therefore credit risk on investments is reflected in the market risk, in the other price risk figures given in section d) Market Risk.

In addition, the Pension Fund reviews its exposure to credit and counterparty risk on its investments through its external Investment Managers by the review of the Investment Managers' annual internal control reports. This is to ensure that Investment Managers exercise reasonable care and due diligence in their activities for the Pension Fund, such as in the selection and use of brokers. The Investment Management Agreements for the Pension Fund's bond managers prescribes the investment restrictions on the securities they can invest in, including the minimum acceptance criteria for investments.

Credit risk also arises through the Pension Fund's deposits with banks and financial instruments. For cash managed by the Administering Authority, the Pension Fund's Treasury Management Strategy for 2015/16 sets out the type and minimum acceptable criteria for investments by reference to credit ratings from Fitch, Moody's and Standard & Poor's and outlines the process to be followed for credit rating downgrades.

The credit ratings and amounts held in money market funds, call accounts and cash/current accounts at 31 March 2015 and 2016 are shown in the table below.

2014/15			2015/16	
£000s	Credit rating		£000s	Credit rating
		<b>Cash managed by Administering Authority</b>		
(84) <sup>1</sup>	A	Bank current account	(505) <sup>1</sup>	A-
3,984	A to AA-	Call accounts	1,925	A-
4,670	AAA	Money market funds	2,495	AAA
		<b>Cash managed by Custodian and Investment Managers</b>		
68,587	A to AA-	Bank current account	1,149	A+ to AA-
69,447	AAA	Money Market Funds	55,551	AAA
<b>146,604</b>		<b>Total cash and cash equivalents</b>	<b>60,615</b>	

<sup>1</sup> Cash balances include cash balances less cash in transit in the form of unpresented cheques and payments committed by BACs at the Net Asset date.

### c) Liquidity risk

Liquidity risk is the risk that the Pension Fund will not be able to meet its financial obligations when they fall due.

The main risk for the Pension Fund is not having the funds available to meet its commitments to make pension payments to its members. To manage this, the Pension Fund has a cashflow management system that seeks to ensure that cash is available when needed. The Pension Fund also manages its liquidity risk by having access to money market funds and call accounts where funds are repayable without penalty and on notice of not more than 24 hours. At 31 March 2016 £3,915,444 (100%) of the cash and cash equivalents held by the Administering Authority was held in money market funds, call accounts and bank current accounts.

The Pension Fund has set a cap of £20 million (£35 million from 1 April 2016) on the amount of cash held by the Administering Authority to balance the need for the Pension Fund to be as fully invested as possible whilst maintaining liquidity to avoid the need to sell assets at inopportune times. Where there are surplus funds in excess of the cap, these funds are distributed to Investment Managers, after taking advice from the Pension Fund's Investment Consultant.

External Investment Managers have substantial discretionary powers over their individual portfolios and the management of their cash positions. The Pension Fund's investments are largely made up of listed securities on major stock exchanges and are therefore considered readily realisable. The Pension Fund defines liquid assets as assets which can be converted into sterling cash within three months. At 31 March 2016 the value of illiquid assets was £430,038,358 (12.1% of total fund assets).

### d) Market risk

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The Pension Fund is exposed to the risk of financial loss from a change in the value of its investments and the risk that the Pension Fund's assets fail to deliver returns in line with the anticipated returns underpinning the valuation of its liabilities over the long term. The change in the market value of its investments during the year was -£40,870,990

In order to manage market value risk, the Pension Fund has set restrictions on the type of investments it can hold, subject to investment limits, in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended). Details of these can be found in the Pension Fund's Statement of Investment Principles on pages 49-56.

The Pension Fund has adopted a specific benchmark and the weightings of the various asset classes within the benchmark form the basis for asset allocation within the Pension Fund. This allocation is designed to diversify the risk and minimise the impact of poor performance in a particular asset class. It seeks to achieve a spread of investments across both the main asset classes (quoted equities, bonds, private equity and property) and geographic regions within each class.

Market risk is also managed by constructing a diversified portfolio across multiple Investment Managers and regularly reviewing the Investment Strategy and performance of the Pension Fund. On a daily basis, Investment Managers will manage risk in line with policies and procedures put in place in the Investment Manager Agreement and ensure that the agreed limit on maximum exposure to any one issuer or class of asset is not breached.

For cash managed by the Administering Authority, the Pension Fund has set institution and group limits to diversify the Pension Fund's investment across a range of individual holdings, sectors and countries.

#### 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 these changes are caused by factors specific to the individual instrument or issuer or factors affecting all such instruments in the market.

The Pension Fund is exposed to changes in equity and bond prices, as the future price is uncertain. All securities investments present a risk of loss of capital. This risk is mitigated using diversification and policies on selecting investments as discussed above.

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The one year expected volatility in market prices are shown in the following table, along with the changes in the value of the Pension Fund's investment assets and liabilities if the market price of investments increase or decrease in line with these movements. The total fund volatility takes into account the expected interactions between the different asset classes, based on the underlying volatilities and correlations of the assets in line with mean variance portfolio theory.

Asset Class	Value as at 31 March 2016	Change	Value on Increase	Value on Decrease
	£000s	%	£000s	£000s
UK Equities, Unit Trusts and Pooled Funds	767,363	17.1	898,583	636,144
Global equities, Unit Trusts and Pooled Funds (ex UK)	1,049,581	19.6	1,255,299	843,863
Property	277,214	14.7	317,964	236,464
Corporate Bonds (medium term)	358,743	9.5	392,824	324,662
Index-Linked gilts (medium term)	397,756	9.6	435,941	359,571
Private Equity	160,347	28.7	206,367	114,327
Commodities	17,348	20.0	20,818	13,878
High yield debt/convertible bonds/insurance linked securities	95,043	7.5	102,171	87,915
Emerging Market Debt	40,348	12.7	45,472	35,224
Infrastructure equity	4,455	20.3	5,359	3,551
Absolute Return Bonds	178,862	10.1	196,927	160,797
Absolute return/Diversified Growth	162,699	12.6	183,199	142,199
Cash, other investment balances and forward foreign exchange contracts	57,171	0.6	57,514	56,828
Total Fund	3,566,930	10.8	3,952,158	3,181,701

Asset Class	Value as at 31 March 2015	Change	Value on Increase	Value on Decrease
	£000s	%	£000s	£000s
UK Equities, Unit Trusts and Pooled Funds	777,896	17.0	910,138	645,654
Global equities, Unit Trusts and Pooled Funds (ex UK)	1,092,972	20.1	1,312,659	873,284
Property	248,294	14.7	284,793	211,795
Corporate Bonds (short term)	161,242	7.1	172,690	149,794
Corporate Bonds (medium term)	367,798	9.5	402,739	332,857
Index-Linked gilts (medium term)	376,890	8.6	409,302	344,477
Private Equity	144,321	28.6	185,597	103,045
Commodities	14,728	13.8	16,761	12,696
High yield debt/convertible bonds/insurance linked securities	83,059	13.4	94,189	71,929
Overseas Real Estate Investment Trusts	11,069	13.3	12,541	9,597
Infrastructure	3,742	15.9	4,337	3,147
Absolute return/Diversified Growth	142,774	12.0	159,907	125,641
Cash, other investment balances and forward foreign exchange contracts	135,399	0.6	136,211	134,587
Total Fund	3,560,184	11.2	3,958,925	3,161,443

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### Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Pension Fund recognises that interest rates can vary and can affect both income to the Pension Fund and the value of the net assets available to pay benefits. A 100 basis point (BPS) movement in interest rates has been advised by the Pension Fund Actuary, as a sensible level to indicate interest rate sensitivity.

The analysis in the following table assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits, of a +/- 100 BPS change in interest rates. Movement in bond values have been calculated to include the impact of modified duration. Modified duration expresses the measurable change in the value of a security in response to a change in interest rates.

Value at 31 March 2015	Potential change +/- 100 BPS	Value on increase	Value on decrease	Asset class exposed to interest rate risk	Value at 31 March 2016	Potential change +/- 100 BPS	Value on increase	Value on decrease
£000s	£000s	£000s	£000s		£000s	£000s	£000s	£000s
138,034	0	138,034	138,034	Cash at Custodian and Investment Managers	56,700	0	56,700	56,700
8,570	0	8,570	8,570	Cash held by Administering Authority	3,915	0	3,915	3,915
950,958	119,384	831,574	1,070,342	Bond (pooled funds)	1,020,962	131,563	889,399	1,152,525
<b>1,097,562</b>	<b>119,384</b>	<b>978,178</b>	<b>1,216,946</b>	<b>Total</b>	<b>1,081,577</b>	<b>131,563</b>	<b>950,014</b>	<b>1,213,140</b>

Value at 31 March 2015	Potential change +/- 100 BPS	Value on increase	Value on decrease	Income source exposed to interest rate risk	Value at 31 March 2016	Potential change +/- 100 BPS	Value on increase	Value on decrease
£000s	£000s	£000s	£000s		£000s	£000s	£000s	£000s
179	2	181	177	Cash at Custodian and Investment Managers	264	2	266	262
59	1	60	58	Cash held by Administering Authority	49	1	50	48
<b>238</b>	<b>3</b>	<b>241</b>	<b>235</b>	<b>Total</b>	<b>313</b>	<b>3</b>	<b>316</b>	<b>310</b>

This analysis demonstrates that a 1% increase in interest rates will not affect the interest received on fixed interest assets but will reduce their fair value and vice versa. Changes in interest rates do not impact on the value of cash but they will affect the interest income received on those balances. Changes to both the fair value of assets and the income received from investments impact on the net assets available to pay benefits.

The Pension Fund's bond holdings are held in accumulation funds where income is retained and automatically reinvested rather than being distributed to the Pension Fund. Income earned from these funds are therefore excluded from the analysis above.

### Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Pension Fund holds a number of financial assets and liabilities in overseas financial markets and is therefore exposed to the risk of loss arising from exchange rate movements of foreign currencies. At 31 March 2016, the Pension Fund had overseas investments (excluding forward foreign exchange contracts) of £1,893,836,788 and £12,842,041 cash denominated in currencies other than sterling.

The Pension Fund Actuary has advised that the one year expected standard deviation for an individual currency at the 31 March 2016 is 10% (13% at 31 March 2015). This assumes no diversification, and in particular, that interest rates remain constant. An analysis of the impact this would have on the Pension Fund is given in the following table together with the prior year comparator.

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Asset Class	Value as at 31 March 2016	Potential market movement +/-10%	Value on increase	Value of decrease
	£000s	£000s	£000s	£000s
Overseas Equity	456,887	45,689	502,576	411,198
Overseas property	107,651	10,765	118,416	96,886
Overseas unit trusts	843,523	84,352	927,875	759,171
Overseas managed funds	485,776	48,578	534,354	437,198
Foreign currencies	12,842	1,284	14,126	11,558
<b>Total</b>	<b>1,906,679</b>	<b>190,668</b>	<b>2,097,347</b>	<b>1,716,011</b>

Asset Class	Value as at 31 March 2015	Potential market movement +/-13%	Value on increase	Value on decrease
	£000s	£000s	£000s	£000s
Overseas Equity	719,844	93,580	813,424	626,264
Overseas property	84,359	10,967	95,326	73,392
Overseas unit trusts	500,860	65,112	565,972	435,748
Overseas managed funds	433,331	56,333	489,664	376,998
Foreign currencies	14,895	1,936	16,831	12,959
<b>Total</b>	<b>1,753,289</b>	<b>227,928</b>	<b>1,981,217</b>	<b>1,525,361</b>

External Investment Managers manage this risk through the use of forward foreign exchange contracts and futures, to hedge currency exposures back to the base currency. See section 6.9 for further information.

The Treasury Management Strategy does not permit the Administering Authority to invest in foreign currency denominated deposits.

### 6.15 Actuarial Present Value of Promised Retirement Benefits

The actuarial present value of promised retirement benefits of the Pension Fund at 31 March 2016 and 31 March 2015 are set out in the following table. This is the underlying commitment of the Pension Fund in the long term to pay retirement benefits to its active (employee members), deferred and pensioner members.

31 March 2015 £m		31 March 2016 £m
5,047	Present value of promised retirement benefits	4,733

Liabilities have been projected using a roll forward approximation from the latest formal valuation as at 31 March 2013 and therefore do not take account of any changes in membership since the valuation date. The liability at 31 March 2016 is estimated to comprise of £2,292 million with respect to employee members, £906 million with respect to deferred members and £1,535 million with respect to pensioners. The principal assumptions used by the Pension Fund Actuary were:

31 March 2015		31 March 2016
	<b>Financial assumptions</b>	
2.4% per annum	Inflation/pension increase rate	2.2% per annum
3.8% per annum	Salary increase rate	3.7% per annum
3.2% per annum	Discount rate	3.5% per annum
	<b>Mortality assumptions</b>	
	Longevity at 65 for current pensioners:	
22.3	• Men	22.3
24.5	• Women	24.5
	Longevity at 65 for future pensioners:	
24.3	• Men	24.3
26.7	• Women	26.7

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Allowance has been made for future pensioners to elect to exchange 50% of the maximum additional tax free cash up to HMRC limits for pre-April 2008 service and 75% of the maximum tax-free cash for post April 2008 service.

The actuarial present value of promised retirement benefits is sensitive to changes in actuarial assumptions. The significant changes and their impact on the value of the Pension Fund's liabilities between 31 March 2015 and 31 March 2016 were:

Change in assumptions for the year ended 31 March 2016	£m	%
0.5% decrease in discount rate	482	10
1 year increase in member life expectancy	142	3
0.5% increase in salary increase rate	147	3
0.5% increase in pensions increase rate	328	7
<b>Total increase in liabilities due to changes in assumptions</b>	<b>1,099</b>	<b>23</b>

The assumptions used by the Pension Fund Actuary to calculate the present value of promised retirement benefits are those required by the Code of Practice on Local Authority Accounting 2015/16. The liability set out in the table above is used for statutory accounting purposes and should not be compared against the value of liabilities calculated on a funding basis, which is used to determine contribution rates payable by employers in the Pension Fund. Further information on the Pension Fund's policy for funding its liabilities is set out in section 6.16.

### 6.16 Funding Policy

The Pension Fund's approach to funding its liabilities is set out in its Funding Strategy Statement. The statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions and prudence in the funding basis.

The Pension Fund Actuary is required to report on the "solvency" of the Pension Fund at least every three years. The last actuarial valuation of the Pension Fund was carried out as at 31 March 2013 to determine contribution rates for the financial years 2014/15 to 2016/17, with the new rates effective from 1 April 2014. A copy of the 2013 Valuation Report is accessible from the Pension Fund website: [www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx](http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx)

The market value of the Pension Fund's assets at the valuation date was £2,908 million and represented 82.5% of the Pension Fund's accrued liabilities, allowing for future pay increases.

In accordance with the Scheme regulations, employer contribution rates were set to meet 100% of the Pension Fund's existing and prospective liabilities. The contribution rates were calculated using the projected unit actuarial method (or the attained age method for employers closed to new entrants) and the main actuarial assumptions were as follows:

Discount rate	4.8%
Salary increases	3.8%
Price inflation/pension increases	2.5%

Further information can be found in the Funding Strategy Statement on page 68 and the Actuarial Valuation report on page 17.

### 6.17 Additional Voluntary Contributions (AVCs)

Scheme members have the option to make AVCs to enhance their pension benefits. These contributions are invested separately from the Pension Fund's assets, with either the Standard Life Assurance Company or the Equitable Life Assurance Society.

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2014/15							2015/16					
Standard Life		Equitable Life		Total AVCs			Standard Life		Equitable Life		Total AVCs	
£000s	£000s	£000s	£000s	£000s	£000s		£000s	£000s	£000s	£000s	£000s	£000s
	5,059		1,550		6,609	Value at 1 April		5,161		1,552		6,713
						<u>Income</u>						
226		4		230		Contributions received	229		7		236	
0		0		0		Transfer values received	3		0		3	
	226		4		230	Total Income		232		7		239
						<u>Expenditure</u>						
(612)		(83)		(695)		Retirement benefits	(390)		(167)		(557)	
(4)		(1)		(5)		Transfer values paid	(11)		(46)		(57)	
(2)		0		(2)		Lump sum death benefit	0		(4)		(4)	
	(618)		(84)		(702)	Total Expenditure		(401)		(217)		(618)
	494		82		576	Change in market value		(31)		24		(7)
	5,161		1,552		6,713	Value at 31 March		4,961		1,366		6,327

### 6.18 Related Parties

#### a) Hertfordshire County Council

The County Council incurred costs of £426,901 in relation to the management of the Pension Fund and was subsequently reimbursed by the Pension Fund for these expenses. The County Council also contributed £53,917,610 to the Pension Fund in 2015/16.

#### b) Pensions Committee

Five members of the County Council Pensions Committee were councillor members of the Hertfordshire Local Government Pension Scheme during 2015/16. Each member of the Pensions Committee is required to declare their interests at each meeting.

#### c) Key Management Personnel

The Administering Authority disclosure of senior officer remuneration includes the S151 Officer who has responsibility for the proper financial administration of the Pension Fund under the Local Government Act 1972. During 2015/16 this included the Director of Resources, Deputy Chief Executive and Assistant Director Finance.

These Officers were employed by the Administering Authority and spent a proportion of time on the financial management of the Pension Fund. These costs comprise an element of the remuneration from the Pension Fund to the County Council in 2015/16 of £426,901.

The remuneration paid by Hertfordshire County Council to key management personnel of the Pension Fund, apportioned for the proportion of time on the financial management of the Pension Fund, were:

Position	Year	Apportioned salary	Apportioned pension contributions	Total apportioned remuneration
		£	£	£
Director of Resources	2015/16	338	62	400 <sup>1</sup>
	2014/15	0	0	0
Deputy Chief Executive	2015/16	5,533	1,015	6,548 <sup>2</sup>
	2014/15	12,160	2,505	14,665
Assistant Director Finance	2015/16	3,817	705	4,522 <sup>3</sup>
	2014/15	0	0	0

<sup>1</sup> S151 Officer from 22 – 31 March 2016

<sup>2</sup> S151 Officer from 1 April – 31 August 2015

<sup>3</sup> S151 Officer from 1 September 2015 – 22 March 2016

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### 6.19 Contingent Liabilities and Contractual Commitments

The Pension Fund had no contingent liabilities.

At 31 March 2016, the Pension Fund had a contractual commitment of a further £111.1 million (£118.3 million at 31 March 2015) to private equity limited partnerships and private equity funds within the Global Alternatives Fund, based on exchange rates applicable at the balance sheet date.

### 6.20 Contingent Assets

#### a) Withholding tax reclaims

The Pension Fund has entered into a process to reclaim withholding tax made by other European Union (EU) countries, based on precedent cases in some EU countries that tax has been withheld unfairly under EU law. Claims have been submitted in France and Germany.

The Pension Fund's claims are set out in the following table in both euros and sterling (calculated using exchange rates as at 31 March 2016). The claims are subject to legal processes but based on precedent and legal advice, the Pension Fund expects to be successful in these claims. Therefore the amounts below are contingent assets for the Pension Fund.

Country	Euro Value at 31 March 2016	Sterling Value at 31 March 2016
	€ 000s	£ 000s
Germany	148	118
France	191	151
<b>Total</b>	<b>339</b>	<b>269</b>

#### b) Bonds

34 admitted bodies in the Pension Fund held bonds as surety to guard against the possibility of being unable to meet their pension obligations. These bonds are drawn in favour of the Pension Fund and payment will only be triggered in the event of employer default.

### 6.21 Statement of Investment Principles

Regulation 12.1 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) requires the Pension Fund to publish a Statement of Investment Principles. This is set out on pages 49-56



### 1. Investment Management

#### Powers of Investment

The principal powers to invest are contained in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) and require an administering authority to invest any pension fund money that is not needed immediately to make payments from the Pension Fund.

These regulations permit a range of investments, subject to specific restrictions. Investments may be made:

- in any security on any recognised stock exchange (no single holding to exceed 10% of the value of all investments);
- in unlisted securities (subject to a maximum of 10% of the total value of investments);
- in Unit Trusts and other Managed Funds subject to a maximum of 25% of the total value of investments with any one Investment Manager;
- by deposit with any bank (subject to a maximum of 10% of the value of all investments to any one bank, excepting National Savings Bank) or local authority (the total of such deposits not to exceed 10% of the total value of all investments).

The regulations require that the administering authority's investment policy must be formulated with a view to:

- the advisability of investing pension fund money in a wide variety of investments;
- the suitability of particular investments and types of investments;
- obtaining proper advice at reasonable intervals about their investments.

A local authority may elect to impose its own restrictions in addition to the legal restraints laid down in the regulations. The additional limits which have been determined by the County Council are set out in the Pension Fund's Statement of Investment Principles on pages 49-56.

#### Responsibility for Investing the Pension Fund's Assets

The Pensions Committee of the County Council is responsible for setting the overall investment strategy of the Pension Fund and monitoring investment performance.

The majority of the Pension Fund's investments are managed by external Investment Managers, who have substantial discretionary powers regarding their individual portfolios. The split of the Pension Fund between these managers at 31 March 2016 is shown in the following table.

Investment Manager	Pension Fund %
Allianz Global Investors Europe GmbH	10.2
Baillie Gifford & Co.	9.2
CBRE Global Collective Investors (UK) Ltd	8.3
Henderson Global Investors Ltd	5.0
Jupiter Asset Management Ltd	8.5
JPMorgan Asset Management (UK) Ltd	4.0
Legal & General Assurance (Pensions Management) Limited	30.7
LGT Capital Partners (Ireland) Ltd	10.4
Royal London Asset management Ltd	10.1
Private Equity	3.6

An amount of cash is held by the County Council in order to manage the payment of members' pension benefits and the collection of contributions. This is invested in accordance with the Pension Fund's Treasury Management Strategy which is reviewed and approved annually by the Pensions Committee. The 2015/16 Treasury Management Strategy was approved by the Pensions Committee on 27 February 2015.

The Statement of Investment Principles details the extent to which the Administering Authority complies with principles of good governance and investment practice, set out in the Myners review of Institutional Investment in the UK.

## **2. Statement of Investment Principles 2016**

### **1. Introduction**

- 1.1 The County Council is responsible for the administration of the Pension Fund. The County Council has a statutory duty to ensure that any funds not immediately required to pay pension benefits, are suitably invested.
- 1.2 As required by statute, the County Council has approved a Statement of Investment Principles ("Statement") which is applied to the management of the Pension Fund's investments. The latest Statement will be presented for approval by the Pensions Committee on 9 September 2016.
- 1.3 In accordance with government guidelines, the extent to which the Pension Fund complies with the statutory guidance "Investment decision making and disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles" is set out at Appendix A to this Statement.

### **2. Who Makes the Investment Decisions?**

- 2.1 The strategic management of the assets is the responsibility of the Pensions Committee. The committee determines the strategic management of the assets based upon the professional advice it receives and the investment objectives as set out in section 6. The Pensions Committee is responsible for monitoring the performance of the Investment Managers and the investments made, reviewing asset allocation decisions and the performance objectives for the Pension Fund. In addition the Pensions Committee can appoint (and, when necessary, dismiss) Investment Managers.
- 2.2 Day to day operational decisions are delegated to the County Council's Chief Finance Officer, the Director of Resources.
- 2.3 The Pension Fund's governance arrangements are set out in full in the Governance Compliance Statement which is accessible from the Pension Fund website [www.yourpension.org.uk/agencies/HCC/](http://www.yourpension.org.uk/agencies/HCC/)

### **3. What are the Investment Objectives of the Pension Fund?**

- 3.1 To comply with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended), specifically to ensure that all:
  - funds are suitably invested;
  - investments are diversified;
  - relevant investment limits are not exceeded;
  - investments and investment arrangements are regularly monitored and reviewed.
- 3.2 To ensure that the Pension Fund has sufficient assets to pay Scheme benefits.
- 3.3 To achieve a long term rate of return on the invested funds (both capital gains and income) which assists in controlling the level of employers' contributions to the Pension Fund and also the cost of the pensions to the local taxpayers where appropriate by:
  - i) as a minimum, matching the Pension Fund Actuary's rate of return assumptions made when assessing the Pension Fund's level of funding; and
  - ii) exceeding the Pension Fund's benchmark by 1% measured over three year rolling periods.

- 3.4 The Statement of Investment Principles is linked to the Funding Strategy Statement, which sets out the Pension Fund's strategy for meeting employers' pension liabilities. The aim of the funding strategy is to ensure the long-term solvency of the Pension Fund while not unnecessarily restraining the investment strategy set out in this document. The two strategies set out the common objective of the Pension Fund to maximise returns on investments to control the level of employers' contributions.

#### **4. Achieving the Investment Objectives**

- 4.1 The Pension Fund sets a long-term investment strategy (the mix of asset types) to have regard to the Pension Fund's liability structure and its investment objectives. This strategy is reviewed at a minimum every three years after each actuarial valuation but is monitored on an ongoing basis to assess any necessary changes.
- 4.2 The Pensions Committee having taken appropriate professional advice, has made the arrangements set out below to reduce the risk that one or more of the investment objectives for the Pension Fund are not achieved over the long term.

##### **1. Suitable Investments**

The Pensions Committee considers that the following types of investments, within specific limits, are suitable for the purposes of the Pension Fund:

- cash, bank deposits and other short term money market investments;
- quoted fixed interest securities, individual securities and pooled investment vehicles;
- quoted equity investments, individual securities and pooled investment vehicles;
- property unit trusts;
- derivative instruments, but not to be used for speculative purposes;
- alternative asset classes including commodities and absolute return strategies;
- unquoted equity investments and private equity pooled vehicles.

##### **2. Pension Fund Benchmark and Asset Allocation**

The Pension Fund has adopted a specific benchmark which has been approved by the Pensions Committee, following appropriate professional advice from the Investment Consultant, Investment Managers and the performance measurement consultant. The composition of the Pension Fund benchmark is set out at Appendix B to this Statement.

The weightings of the various asset classes within the benchmark form the basis for asset allocation within the Pension Fund. The asset allocation set out in the benchmark is designed to spread the risk and minimise the impact of poor performance in a particular asset class. It seeks to achieve a spread of investments across both the main asset classes (quoted equities, bonds, private equity and property) and geographic regions within each class.

##### **3. Investment Management Choice**

The main choices when selecting a fund management style are:

- Active or passive – making independent decisions when buying or selling investments (“active”) or buying stocks to replicate a specific index (“passive”).
- Multi-asset or specialist – investing across a broad range of asset classes (“multi-asset”) or in a narrow, specific asset class (“specialist”).

The Pension Fund currently uses “active, specialist”, “active, multi-asset” and “passive, specialist” Investment Managers only on the advice of the Investment Consultant to increase the potential return of the Pension Fund.

The number of Investment Managers and the share of the Pension Fund by type as at 31 March 2016 are shown in the following table, along with comparative figures for 31 March 2015.

## Investment Report

Share of Total Pension Fund 31 March 2015			Share of Total Pension Fund 31 March 2016	
%	Number of Investment Managers		%	Number of Investment Managers
61.6	8	External, active, specialist	55.3	7
10.8	1	External, active, multi-asset	10.4	1
23.9	1	External, passive, multi-asset	30.7	1
3.7	5	Private Equity	3.6	4

The percentages in the table above are calculated using the value of investments, cash and net current assets held by each Investment Manager at 31 March. During 2015/16, the Fund moved funds out of its active global equity mandate with Global Thematic Partners to the passive multi-asset mandate managed by Legal & General Assurance (Pensions Management) Limited.

Full details of the Investment Managers, their mandates and fee basis are shown at Appendix C.

All the Investment Managers need the approval of the Chief Finance Officer, the Director of Resources, to acquire shares in any securities that are not listed on a recognised stock exchange.

#### 4. Responsible Ownership including Social, Environmental and Ethical Considerations

Investment Managers are expected to apply their professional expertise to maintain suitably diversified portfolios for a pension fund. When making investment decisions, Investment Managers are expected to take account of what they reasonably believe are all relevant considerations.

The Pension Fund routinely votes on all matters raised by the largest 350 listed UK companies where it owns shares. The Pension Fund's voting policy is to vote in accordance with the current principles of corporate governance best practice, as advised by the ISS Governance, except when the advice of Investment Managers indicates such action would not be in the best financial interests of the Pension Fund.

Equity managers who are regulated by appropriate UK (or other relevant) authorities are expected to report on their adherence to the UK Stewardship Code on at least an annual basis.

The Pension Fund is a member of the Local Authority Pension Fund Forum (LAPFF) which acts on behalf of local authority pension funds in engaging on Environmental, Social and Corporate Governance ("ESG") issues. Additionally, in monitoring the Pension Fund's Investment Managers, the Pensions Committee receives updates from the Investment Consultant on their research ratings, which include a rating for ESG issues. These ratings reflect the Investment Consultant's views on the extent to which ESG and active ownership practices (voting and engagement) are integrated into the Investment Manager's strategy.

#### 5. Investment Restrictions

The following investment restrictions apply to the funds under management:

- i) all limits determined under the Local Government Pension Scheme Investment and Management of Funds) Regulations 2009 (as amended); and
- ii) additional limits which have been determined by the County Council:
 

Private Equity	-	Total investments are not to exceed a maximum of 7.5% of the value of the Pension Fund. In general the Pensions Committee expects private equity to be no more than 5%. The 2.5% headroom allows for fluctuations in the value of other assets.
Options, futures and contracts for differences	-	A maximum of 25% of UK equity portfolio. Only to be used to protect against possible adverse fluctuations in the values of other investments or cash in the portfolio.
Insurance contracts	-	Any single insurance contracts are not to exceed a maximum of 35% of the value of the Pension Fund.
Individual equity holdings	-	The total holding in a single company is not to exceed 5% of the issued share capital.

Any breaches of the restrictions above are reported to the next available meeting of the Pensions Committee.

### **6. Investment Performance Management**

The investment performance of Investment Managers is measured by an independent organisation. This service is provided by the Pension Fund's Custodian, BNY Mellon Asset Servicing B.V. Quarterly reports are provided to the Chief Finance Officer, the Director of Resources and to the Pensions Committee and Pensions Board.

### **7. Monitoring of Investment Managers**

The Pensions Committee meets quarterly to review the performance of the Pension Fund's Investment Managers.

### **8. Actuarial Valuation**

The Pension Fund is subject to triennial valuations by an independent actuary. Employers' contributions are determined by the Pension Fund Actuary to ensure that in the long term the Pension Fund's assets will match its liabilities. The framework for this is set out in the Funding Strategy Statement.

### **9. Stock Lending**

The Pension Fund operates a stock lending programme through its custodian bank. The Pension Fund limits the lending to 20% of the total of its portfolios and ensures that the collateral is in cash or bonds and is valued on a daily basis to be on average 105% of the value of the stock which has been lent.

### **10. Custody Arrangements**

The Pension Fund's assets are held in custody by an independent custodian, where reasonable controls have been certified by an appropriate auditor.

## **5. Compliance with this Statement**

- 5.1 The Pension Fund will monitor compliance with this Statement in particular, it will ensure its investment decisions are exercised with a view to giving effect to the principles contained in this Statement, so far as is reasonably practicable.

## **6. Compliance with Myners Principles**

- 6.1 The Myners principles cover the arrangements for effective investment management decision making, setting and monitoring clear investment objectives, focus on asset allocation, arrangements to receive appropriate expert advice, explicit manager mandates shareholder activism, use of appropriate investment benchmarks, measurement of performance, transparency in investment management arrangements and regular reporting.
- 6.2 The Pension Fund supports the principles and complies with the principles as set out in appendix A to this Statement.

## **7. Review of this Statement**

- 7.1 This Statement will be reviewed to respond to any material changes to any aspects of the Pension Fund, its liabilities, finances and its attitude to risk which it judges to have a bearing on the stated investment policy.

Appendix A to the Statement of Investment Principles 2016

Compliance with Myners Principles	
Principle	Current Position
<b>1. Effective Decision Making</b> <i>Administering authorities should ensure that:</i> <ul style="list-style-type: none"> <li><i>decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation;</i></li> <li><i>and</i></li> <li><i>those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.</i></li> </ul>	<p>Day to day operational decisions are delegated to the County Council's Chief Finance Officer, the Director of Resources, who, with relevant members of staff, regularly attends seminars and briefing sessions and accesses professional and other publications to maintain a high level of skills and knowledge in investment matters.</p> <p>Members of the Pensions Committee act in the role of trustees for the Pension Fund. An annual training plan is approved setting out training sessions which include quarterly workshops on investments and pension related issues.</p> <p>Both Members and Officers involved with making investment decisions take advice from appropriately qualified professionals where appropriate.</p> <p>The CIPFA Knowledge and Skills framework and Pensions Regulator toolkit are available to all Members and Officers as a learning tool for the development of knowledge of pension investments and the regulatory background.</p> <p>A medium term business plan for the Pension Fund is prepared annually and incorporated within Hertfordshire County Councils integrated plan.</p>
<b>2. Clear Objectives</b> <i>An overall investment objective(s) should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisors and investment managers.</i>	<p>The Pension Fund's main investment objective, as set out in this Statement of Investment Principles, acknowledges the need to meet the Pension Fund's liabilities and states that the aim is to ensure the impact on local taxpayers is minimised.</p> <p>The Statement of Investment Principles is circulated to the Pension Fund's advisors and Investment Managers and is published on the Pension Fund website.</p> <p>The following investment objectives for the Pension Fund were agreed in 2011, following a comprehensive investment strategy review:</p> <ul style="list-style-type: none"> <li>- <b>Return objective:</b> To achieve 100% funding on an ongoing basis over a 20 year period from 2011 (i.e. by 2031), with a probability of 67%.</li> <li>- <b>Risk objective:</b> Limiting the likelihood of a fall in funding level to below 65% at the 2016 Actuarial Valuation to a one in ten probability.</li> </ul>
<b>3. Risk and Liabilities</b> <i>In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities. These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.</i>	<p>The Pension Fund's main investment objective, as set out in this Statement of Investment Principles, acknowledges the need to meet the Pension Fund's liabilities and states that the aim is to ensure the impact on local taxpayers is minimised.</p> <p>The Pension Fund's Risk Register sets out the key risks to the Pension Fund along with controls in place to manage those risks. Risks are monitored on a regular basis and a quarterly report presented to the Pensions Committee</p> <p>The Pension Fund carries out employer risk monitoring exercises, including an annual employer covenant check. This facilitates early detection of issues that may impact on an employer's ability to meet their liabilities to the Pension Fund.</p>

Appendix A to the Statement of Investment Principles 2016 (continued)

Principle	Current Position
<b>4. Performance Assessment</b>	
<p><i>Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.</i></p> <p><i>Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision making body and report on this to scheme members.</i></p>	<p>The Pensions Committee formally measures performance of Investment Managers and investments on a quarterly basis. Performance is also reported to the Pensions Board on a quarterly basis.</p> <p>Performance measurement services are provided by BNY Mellon, which includes daily exception reporting on Investment Manager compliance with their Investment Manager Agreements.</p> <p><b>Development Areas</b></p> <ul style="list-style-type: none"> <li>Develop a framework to formally measure the performance of the Pension Fund's advisors.</li> </ul>
<b>5. Responsible ownership</b>	
<p><i>Administering authorities should:</i></p> <ul style="list-style-type: none"> <li><i>adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents</i></li> <li><i>include a statement of their policy on responsible ownership in the statement of investment principles</i></li> <li><i>report periodically to scheme members on the discharge of such responsibilities.</i></li> </ul>	<p>The Pension Fund's Investment Managers have adopted the Institutional Shareholders' Committee Statement of Principles.</p> <p>A statement regarding responsible ownership is included in the Statement of Investment Principles, which is part of the Annual Report published on the Pension Fund website for all Scheme members to access.</p>
<b>6. Transparency and reporting</b>	
<p><i>Administering authorities should:</i></p> <ul style="list-style-type: none"> <li><i>act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives</i></li> <li><i>provide regular communication to scheme members in the form they consider most appropriate.</i></li> </ul>	<p>In addition to this Statement, the Pension Fund communicates with its stakeholders through the publication of the following documents which are all accessible from the Pension Fund website:</p> <ul style="list-style-type: none"> <li>Governance Compliance Statement</li> <li>Annual report</li> <li>Communication Statement</li> </ul> <p>In addition a monthly newsletter is published and accessible from the Pension Fund website and an annual meeting is held for all employers.</p> <p>Communication with Scheme members is through the website, periodic mailings and through the Pension Fund employers.</p>

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## Investment Report

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### Appendix B to the Statement of Investment Principles 2016

Asset Class	Allocation %	Benchmark
UK Equity	10.0	FTSE All-Share Index
UK Equity smaller cap	6.0	FTSE All-Share Index ex-top 20 stocks
Overseas Equity	20.2	Composite of FTSE indices
Global Equity	14.0	MSCI AC World Index (NDR)
Absolute Return Bonds	5.0	3 month sterling LIBOR
Sterling Corporate Bonds	10.0	50% iBoxx Non Gilt All Maturities Index/50% FTSE A All Maturities Gilts Index
Index-Linked Gilts	10.0	FTA A Over 5 Year Index-Linked Gilts Index
Property	8.0	IPD UK All Balanced Funds Index IPD Adjusted Global Index
Alternatives	10.8	3 month sterling LIBOR
Private Equity	5.0	FTSE All-Share Index
Cash	1.0	7 Day Sterling LIBID
<b>Total</b>	<b>100.0</b>	



## Investment Report

### Appendix C to the Statement of Investment Principles 2016

Pension Fund Investment Managers at 31 March 2016				
Investment Manager	Value of Portfolio at 31/03/2016 £m	Type of Mandate	Performance Target % above benchmark	Fee Type
Allianz Global Investors Europe GmbH	362.3	Active, Specialist, Global Equities	3% - 4%	Ad valorem
Baillie Gifford & Co.	328.7	Active, Specialist, UK Equities	1.25%	Fixed fee
CBRE Global Collective Investors (UK) Ltd.	297.7	Active, Specialist Property	1.0%	Performance related
Global Thematic Partners, LLC	0.4	Active, Specialist, Global Equities	3% - 5%	Ad valorem
HarbourVest Partners, LLC	84.4	Active, Specialist, Private Equity	Not applicable	Performance related
Henderson Global Investors Ltd.	178.9	Active, Specialist, Bonds	3%	Ad valorem
JP Morgan Asset Management (UK) Ltd.	143.7	Active, Specialist, Global Equities	3%	Performance related
Jupiter Asset Management Ltd.	305.1	Active, Specialist, UK Equities	2%	Performance related
Legal & General Assurance (Pensions Management) Ltd.	1,094.7	Active, Specialist, Multi-Asset Equities/Bonds	0%	Ad valorem
LGT Capital Partners (Ireland) Ltd.	369.8	Active, Multi-Asset Alternatives	4%	Ad valorem
Pantheon Ventures (UK) LLP	2.9	Active, Specialist, Private Equity	Not applicable	Performance related
Permira Advisers, LLP	0.7	Active, Specialist, Private Equity	Not applicable	Performance related
Royal London Asset Management Ltd.	358.7	Active, Specialist, Bonds	1.75%	Ad valorem
Standard Life Investments Ltd.	38.9	Active, Specialist, Private Equity	Not applicable	Performance related

**Fee types:**

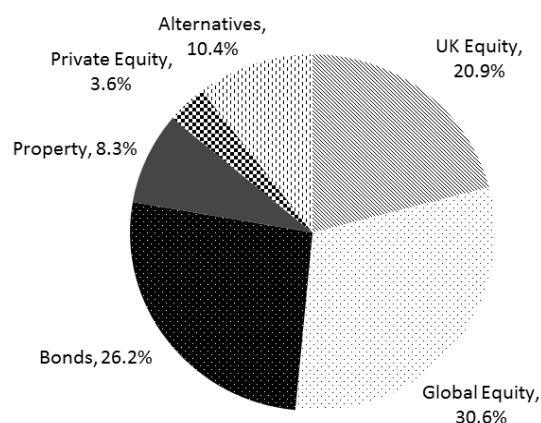
- Fixed fee** - fee is fixed amount, indexed by RPI annually
- Ad valorem** - based only on the value of the portfolio
- Performance related** - additional fees payable where performance exceeds the target

## 3. Investment Policy

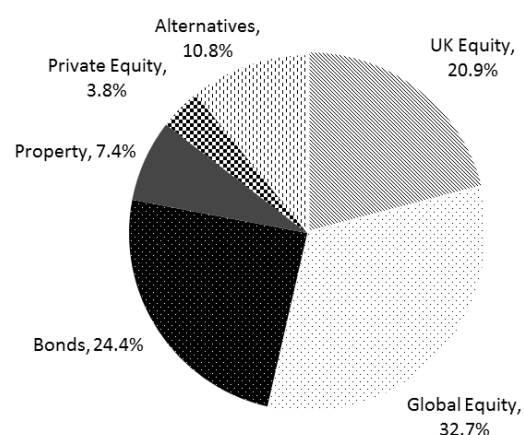
Appendix B of the Statement of Investment Principles on page 55 sets out the target asset allocation of the Pension Fund for 2015/16, in comparison with the Pension Fund's specific benchmark allocation.

The actual distribution of the Pension Fund's assets across the main asset classes as at 31 March 2016 (and as at 31 March 2015 for comparison) are shown below:

**Distribution of Pension Fund at 31 March 2016**



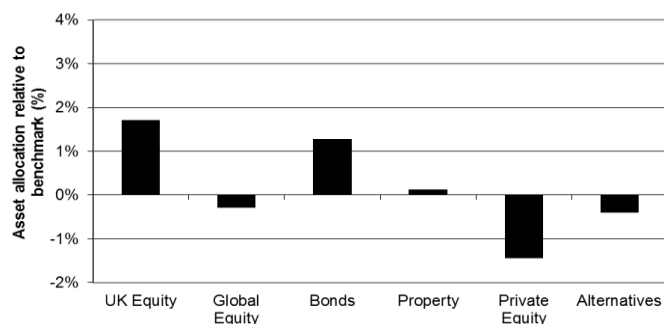
**Distribution of Pension Fund at 31 March 2015**



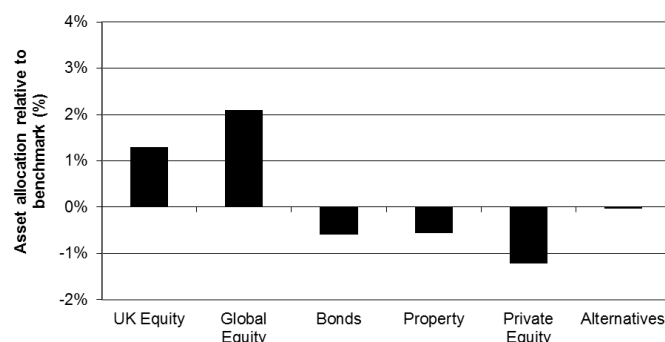
The change in the asset distribution over the period reflects a gradual switching out of equities and into lower risk asset classes.

The actual asset allocation of the Pension Fund's relative to the benchmark allocation is outlined below at 31 March 2016 (with 31 March 2015 also shown for comparison):

**Actual asset allocation relative to benchmark allocation as at 31 March 2016**



**Actual asset allocation relative to benchmark allocation as at 31 March 2015**

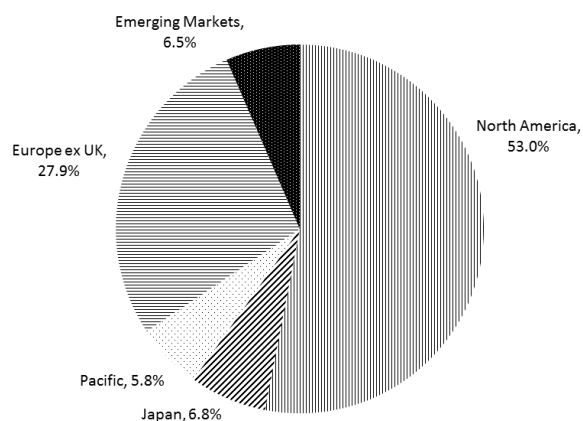


As at 31 March 2016, the Pension Fund's allocation to UK equities, Bonds and Property were modestly overweight relative to the benchmark allocation, with other allocations modestly underweight, particularly Private Equity.

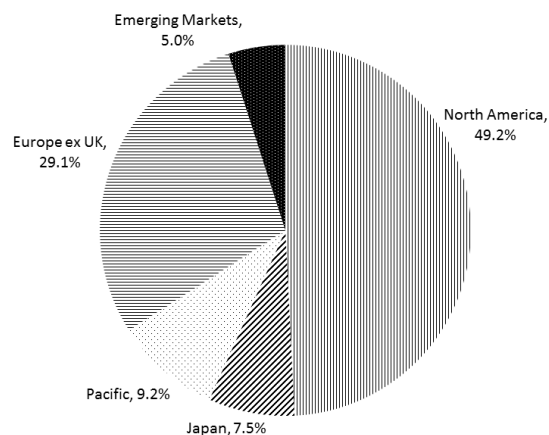
## Investment Report

The regional distribution of the Pension Fund's overseas equity investments as at 31 March 2016 (and as at 31 March 2015 for comparison) is shown below:

**Distribution of Pension Fund's overseas equity investments at 31 March 2016**



**Distribution of Pension Fund's overseas equity investments at 31 March 2015**



The top ten largest equity holdings of the Pension Fund as at 31 March 2016 (and as at 31 March 2015 for comparison) are shown in the following tables.

Ten Largest Equity Holdings at 31 March 2016	Market Value £m	% of Total Investments
Legal & General Group	19.4	0.54
Relx	17.3	0.49
Bunzl	17.1	0.48
Microsoft	15.8	0.44
British American Tobacco	15.3	0.43
WPP	13.5	0.38
Ashtead Group	13.4	0.38
United Health Group	12.4	0.35
Prudential	12.1	0.34
St James's Place	11.5	0.32

Ten Largest Equity Holdings at 31 March 2015	Market Value £m	% of Total Investments
Legal & General Group	23.0	0.65
Bunzl	17.3	0.49
Reed Elsevier	16.7	0.47
Ashtead Group	15.1	0.43
Roche	15.0	0.42
Microsoft	13.6	0.38
Rolls-Royce	13.6	0.38
Adidas	13.6	0.38
Prudential	13.5	0.38
Citigroup	13.1	0.37

#### **4. Review of World Markets (courtesy of Royal London Asset Management)**

The twelve months under review exhibited contrasting features of growth, decline, stability and uncertainty, and demonstrated divergence between regional economies. Although signs of economic expansion emanated from many key countries, markets remained very sensitive to events and sharp bouts of volatility meant that, across the period as a whole, most regional equity markets ended the year lower (in sterling terms), with the notable exception being the US. Corporate and high-yield bond markets also suffered on account of haphazard risk aversion. Accordingly, as investors flitted sporadically into 'safe haven' assets, core government bond yields fell even further over the year, with many dipping into negative territory by the end of March 2016.

Led by oil, commodity prices continued their downward spiral, putting pressure on exporting countries and their currencies, and also on high yield bond markets (which are dominated by issuance from commodity-related companies). Worries over Chinese demand also played a prominent role in depressing prices of raw materials. In February 2016, however, the oil price resumed an upward trajectory, providing some respite and boosting investor sentiment as it continued to gather pace towards the end of the first quarter.

The fortunes of China continued to wield considerable influence over global equity markets, prompting two significant plunges over the year. The first was in the summer of 2015, where the Chinese government took the world by surprise and lowered its currency. Markets subsequently recovered, and data from China was better than expected, but in early January 2016 investors once again fled to 'safe havens' as concerns over Chinese stability rattled Asian stock markets and overflowed into a more widespread exodus from riskier asset classes. Emerging markets bore the brunt of these market dynamics, and were the weakest region in performance terms over the review period.

After much anticipation, the US Federal Reserve (Fed) decided to raise interest rates for the first time in nearly a decade at the end of 2015. In spite of expectations that the Bank of England (BoE) would follow suit, UK interest rates remained at their now habitual low levels. The European Central Bank (ECB) and the Bank of Japan (BOJ) expanded their loose monetary policies, which provided some support for markets in the first quarter of 2016.

In the UK, data pointed to economic expansion, albeit at a slower rate than predicted. A clear victory in the 2015 General Election aided stability, and loose monetary policy continued to support growth. Nevertheless, by the first quarter of 2016, the current account deficit had reached record levels, and signs of hesitation and a slowdown ahead of the 'Brexit' vote emerged towards the end of the review period. In the Eurozone, Greece intermittently resumed centre-stage for dramas surrounding bail-out agreements, but the region as a whole continued to grow as confidence in many peripheral economies, as well as in their core peers, quietly gained traction. Inflation remained low, however, and a number of countries, and indeed companies, issued ultra-long bonds to take advantage of low borrowing costs and inflation expectations.

In the US, domestic demand, increases in employment and disposable income growth have supported recovery, and regardless of weakness in commodity-related industries, business investment in other sectors has been rising. Despite the Fed's show of confidence in December 2015, however, concerns over the broader state of the global economy were strong enough to hinder further rate increases in the US. Uncertainties regarding China, the broader banking system, Greece and the UK referendum on EU membership remain brittle threads in the overall fabric of market confidence.

#### **5. Investment Performance**

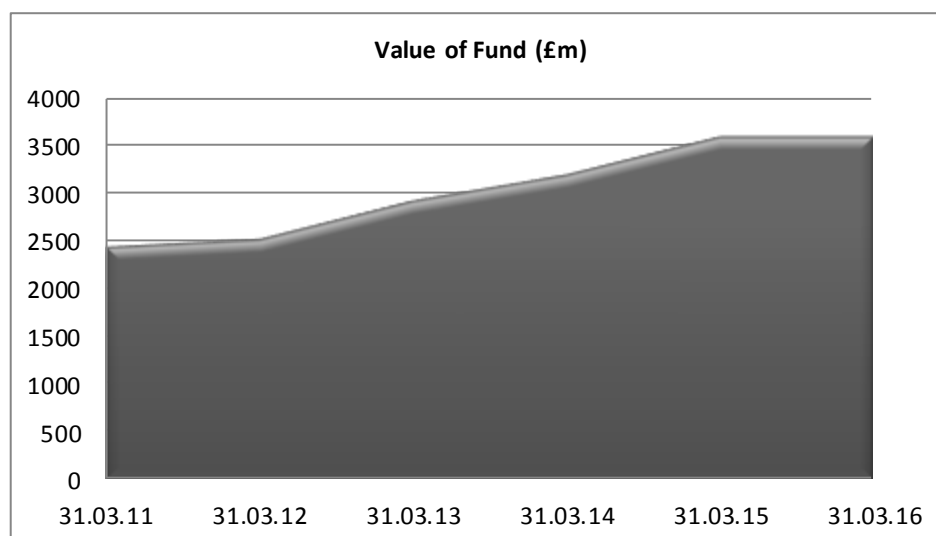
In order to monitor the performance of the investment managers, the Pension Fund participates in performance measurement services. In 2015/16 these services were provided by BNY Mellon Asset Servicing B.V. and Mercer. The performance of the investment managers is reported to the Pensions Committee on a quarterly basis.

Over the twelve months to 31 March 2016 the Pension Fund return was -0.2% (net of fees). The performance of the Pension Fund against benchmark is shown in the table below, along with comparative figures for the previous year.

	<b>Fund return %</b>	<b>Benchmark return %</b>	<b>Relative return %</b>
2014/15	13.5	12.4	1.1
2015/16	-0.2	-0.1	-0.1

## Change in the Pension Fund's Total Assets

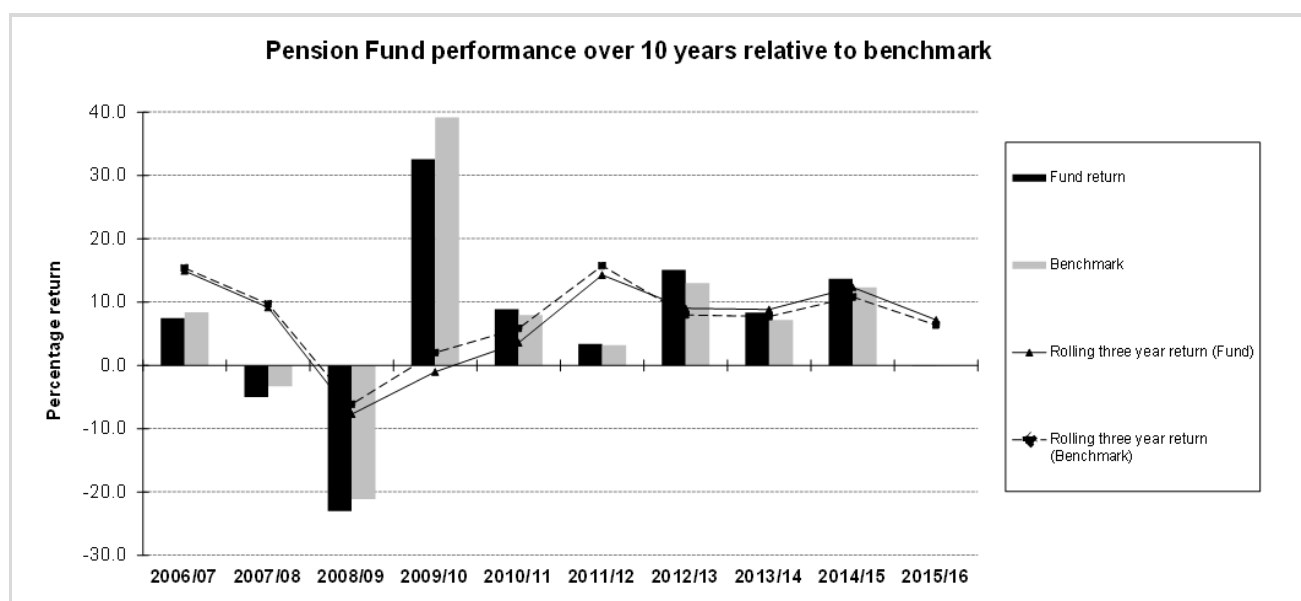
The change in the value of the Pension Fund's invested assets over the five years to 2015/16 is shown below.



## Comparison with the Pension Fund's Benchmark

The Pension Fund's performance is analysed against a customised benchmark, as set out in the Statement of Investment Principles on pages 49-56. The graph below shows the annual investment returns of the Pension Fund compared to the benchmark over the last ten years. This shows that the Pension Fund has performed above benchmark in four years out of the last five.

Overlaid on the chart is a rolling three year annualised return on the Fund's assets compared with the equivalent figures for the benchmark.



## Investment Report

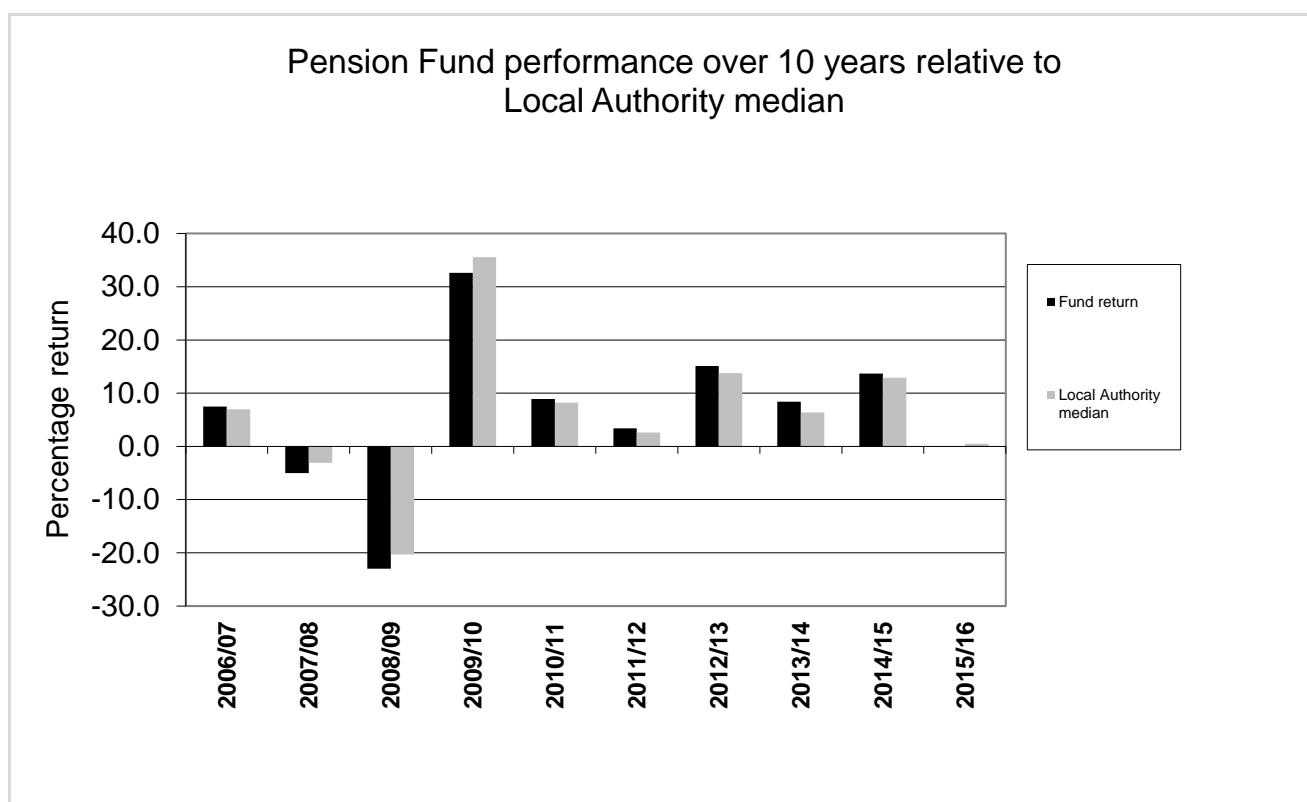
The table below shows the long term performance of the Pension Fund against the benchmark.

	Pension Fund	Benchmark	Relative Performance
3 year % per annum	7.2	6.4	0.8
5 year % per annum	7.9	7.2	0.7
10 year % per annum	5.2	5.7	(0.5)

### Performance Comparisons

The following graph shows the performance of the Pension Fund over the last ten financial years relative to the median (or middle) fund in the local authority list.

It should however be noted that each local authority pension scheme has their own objectives, relating to their specific liability profiles (the nature and term of the pensions due to be paid out) and the asset classes held by their Fund. Whilst the following analysis highlights the performance of the Fund relative to other local authorities, each pension scheme will have their own methods to analyse performance and have different requirements on the returns they are expecting to achieve in practice.

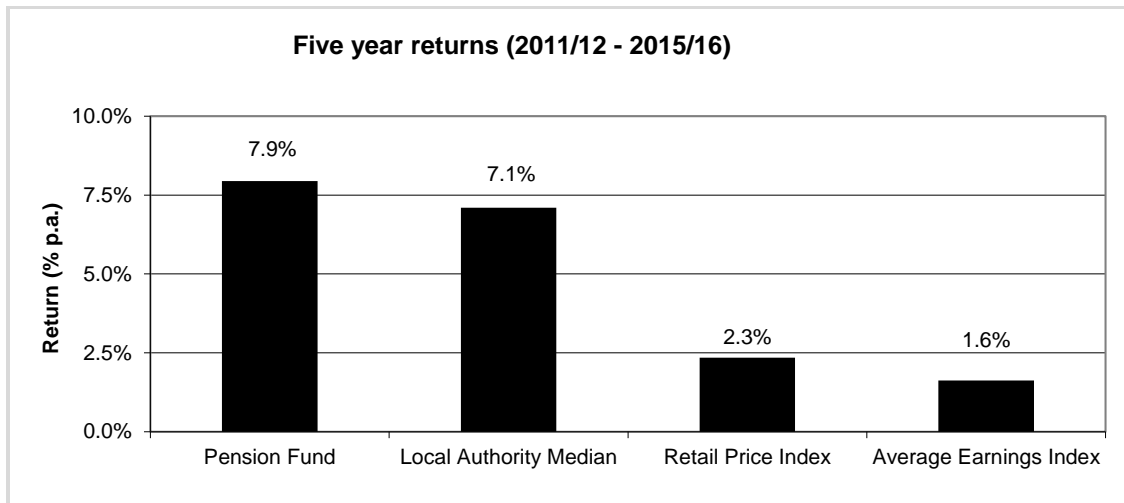


The following table shows the long term performance of the Pension Fund against the local authority median.

	Pension Fund	Local Authority median	Relative Performance
3 year % per annum	7.2	6.5	0.7
5 year % per annum	7.9	7.1	0.8

### Long Term Returns

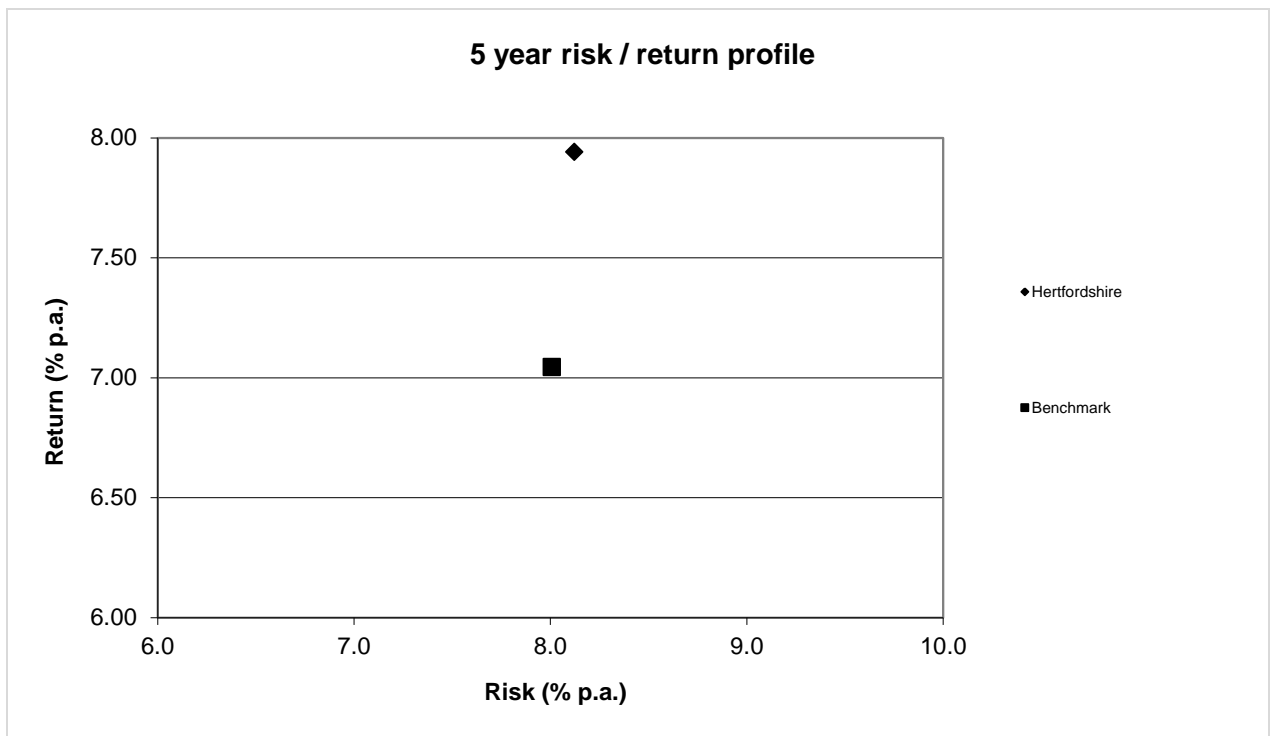
The five year returns from 2011/12 to 2015/16 are shown in the following chart below:



The chart above shows that over the last five financial years, the Pension Fund's performance outperformed retail price inflation and the rate of growth in average earnings.

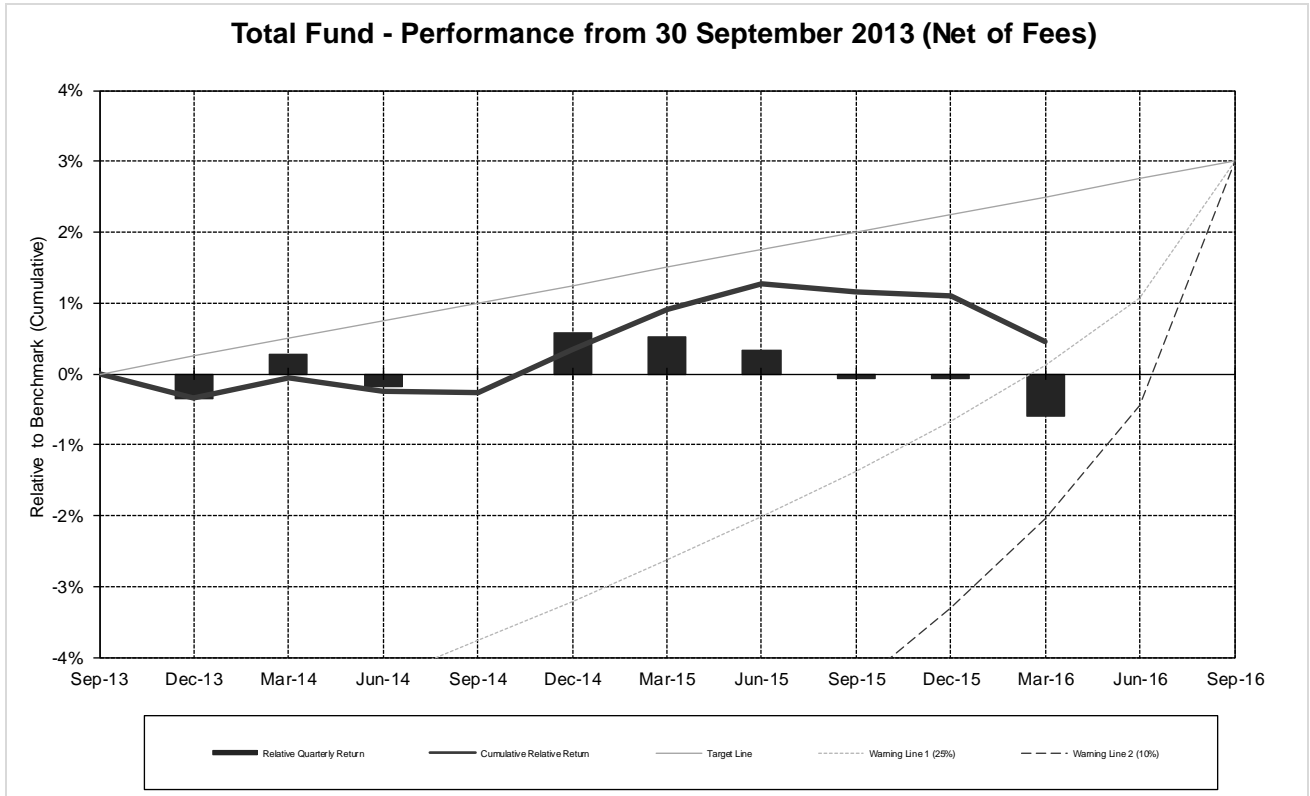
### Risk Comparisons

The chart below highlights the risk and return profile of Pension Fund relative to its benchmark over the last five years. Risk is defined as the volatility or annualised standard deviation of quarterly returns. This highlights that the Pension Fund's returns have been marginally more volatile than the Pension Fund's benchmark. The Pension Fund did however generate higher returns than the benchmark over this period.



The control chart on the following page highlights the performance of the Pension Fund over time against its targets to put into perspective any significant deviation from the target.

The chart spans three years as this is the time period over which the majority of the managers are expected to meet their target.



The lines on the charts are as follows:

#### The Benchmark Return

This is the horizontal line, at point 0%, representing the benchmark return. If a manager's performance were exactly in line with the benchmark return, the performance line (see below) would follow this horizontal line exactly.

#### Relative Quarterly Return

The bars represent the difference between the Fund's investment returns from those of the benchmark over each quarterly period. A positive bar (above zero) represents positive performance, a negative bar (below zero) represents negative performance.

#### Cumulative Relative Return

This solid line represents the cumulative performance achieved relative to the benchmark return. Because active investment management produces uneven returns, the performance is not expected to exactly follow the target line. Instead the performance will fluctuate with the objective that the performance line will meet or exceed the target line by the end of the period.

#### The Target Line

This is a simplistic representation of cumulative added value over the period. If, for example, a manager has a target to achieve a return of 0.5% p.a. in excess of the benchmark return, the graph will show the target of 1.5% added value by the end of the three year period. This is shown as a thin black line.

#### The Warning Line 1 (25%)

Investment managers operate with different styles and the degree of volatility experienced during their progress towards the target will vary between managers. In order to give an indication of an "acceptable" level of volatility we have included a warning line (25%). This line is drawn in such a way that we would expect variations in cumulative performance not to bring the performance line below the warning line under normal circumstances.

The warning line is plotted such that at any point above the line there is a better than a one in four chance (this level of chance is thought to be appropriate) of the target being reached within the time frame, while below the line the chance is less than one in four.

#### The Warning Line 2 (10%)

The warning line (10%) is similar to the warning line (25%) but the chance of meeting the original target at this level is much lower – one in ten.



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**Appendix 1: List of Employing Bodies**

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**ACTIVE EMPLOYERS**

**Scheduled Bodies**

**Councils and other bodies whose employees have a statutory right to be in the Scheme**

Hertfordshire County Council (including schools)	Welwyn Hatfield District Council
Broxbourne Borough Council	Hertford Regional College
Dacorum Borough Council	North Hertfordshire College
East Hertfordshire District Council	Oakland's College
Hertsmere Borough Council	Police Constabulary
North Herts District Council	Police and Crime Commissioner
St Albans District Council	University of Hertfordshire
Stevenage Borough Council	West Herts College
Three Rivers District Council	West Hertfordshire Crematorium Joint Committee
Watford Borough Council	

**Academies, Free Schools, Studio Schools and Technical Schools**

Alban City Free School	Hitchin Girls School
Applecroft Primary School	John Henry Newman School
Ascot Road Community Free School	John Warner School
Beaumont School	Jupiter Community Free School
Birchwood High School	Kings Langley School
Bishop Hatfield Girls School	Knights Templar School
Bovingdon Primary Academy	Knightsfield
Broxbourne Academy	Lanchester Community Free School
Bushey Academy	Leventhorpe School
Bushey Meads School	Links ESC
Chaulden Junior School	Little Reddings JMI
Chauncy School	Longdean School
Christchurch CofE School	Loretto College
Countess Anne Academy	Mandeville Primary School
Crabtree Infants School	Marlborough School
Crabtree Junior School	Meridian School
Da Vinci Studio School	Monkswalk School
Dame Alice Owen's School	Mount Grace School
Elstree UTC	Nicholas Breakspear School
Fair Field Junior	Northgate Primary School
Flamstead End Academy	Onslow St Audrey's School
Fleetville Infants	Our Lady Catholic School
Fleetville Juniors	Parmiters School
Francis Combe Academy	Pinewood School
Freman College	Presdales School
Garden City Academy (GCA)	Queens' School
Goffs School	Ralph Sadleir School
Greneway School	Reach Free School
Grove Academy	Richard Hale School
Hailey Hall School	Rickmansworth School
Haileybury Turnford School	Roundwood Park School
Hammond Academy	Roysia Middle School
Hatfield Community Free School	Samuel Ryder Academy
Herts & Essex Academy	Sandringham School
Hertswood Lower School	Sele School
Hitchin Boys School	Simon Balle

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**Academies, Free Schools, Studio Schools and Technical Schools continued**

Sir John Lawes School	Thomas Alleyne
St. Albans Girls' School	Tring School
St. Catherine of Siena	Verulam School
St. Clement Danes School	Watford Boys
St. George's School	Watford Girls
St. Joan of Arc Catholic School	Watford UTC
St. John's Catholic Primary	West Herts Community Free School
St Mary's Primary Free School	Westfield CTC
St. Mary's CofE High School	Wilshire Dacre Junior Academy
St. Mary's RC Primary	Windhill21
St. Michael's Catholic High School	Woolgrove School
St Thomas More	Wroxham School
Stanborough School	Yavneh College
Summercroft Primary School	

**Employers who can designate their employees to be in the Scheme**

Abbots Langley Parish Council	Markyate Parish Council
Aldenham Parish Council	Nash Mills Parish Council
Ashwell Parish Council	North Mymms Parish Council
Berkhamsted Town Council	Redbourn Parish Council
Bishops Stortford Town Council	Royston Town Council
Buntingford Town Council	Sandridge Parish Council
Chorleywood Parish Council	Sawbridgeworth Town
Codicote Parish Council	St Stephens Parish Council
Colney Heath Parish Council	Stanstead Abbots Parish Council
Croxley Green Parish Council	Stanstead St Margarets Parish Council
E2BN	Tring Town Council
Elstree and Borehamwood Town Council	Universitybus Ltd
Harpenden Town Council	Walkern Parish Council
Hatfield Town Council	Ware Town Council
Hertford Town Council	Watford Rural Parish Council
Kimpton Parish Council	Welwyn Parish Council
Kings Langley Parish Council	Wheathampstead Parish Council
Knebworth Parish Council	Woolmer Green Parish Council
London Colney Parish Council	

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**Admitted Bodies (employers who participate by virtue of an admission agreement)**

ABM Catering Ltd	Highfield Park Trust
Age UK	Hitchin Markets Ltd
Amey Services	John O'Conner (Grounds Maintenance) Ltd
B3 Living	Letchworth Garden City Heritage Foundation
Capita	Mears Building Contractors Ltd
Care By Us*	North Herts Homes
Churchill Contract Services *	Northgate Information Solutions UK *
Citizens Advice Bureau in Hertsmere	NSL Limited
Citizens Advice Service in Three Rivers	Opus (UK) Ltd
Cofely	Pre School Learning Alliance *
Compass Contract Services Ltd	Quantum Care Ltd
CP Plus	Radlett Centre Trust
Crime Reduction Initiative	Ringway Infrastructure Service
Cucina *	Securitas Security Services
Dacorum Sports Trust	Serco *
Edwards and Blake Limited *	Sports and Leisure Management Ltd *
Elstree Film Studios	St Mary's CE Academy Cheshunt Trading Limited*
Evergreen, The Cleaning Company Limited	Steria Services Ltd
Exemplas	Stevenage Leisure *
Fusion Lifestyle	The Fairway Public House Limited
Geoffrey Osborne Ltd	Three Rivers West Trust
Goldsborough Home Care	Thrive Homes
Haywards Services *	Udata Infrastructure UK Ltd
Herts Catering Ltd *	Veolia ES (UK) PLC *
Hertfordshire Action on Disability	Watford and District YMCA
Hertfordshire Association of Parish and Town Councils	Watford Community Housing Trust
Hertfordshire Community Meals *	Welwyn and Hatfield Community Housing Trust
Herts for Learning	Welwyn Hatfield Leisure Limited
Hertfordshire Partnership NHS Foundation Trust	Welwyn Hatfield Sports Centre Trust Limited
Hertsmere Leisure Trust *	YMCA

\* Employer with more than one admission agreement relative to the service contracts they have with Scheduled Bodies

## **CEASED EMPLOYERS**

**Employers with no active members but with some outstanding liabilities whose pensioners are or will be paid from the Pension Fund**

### **Scheduled Bodies**

Hertfordshire Magistrates Courts Committee

Letchworth Garden City Council

Shenley Parish Council

### **Admitted Bodies**

Action for Children

Affinity Sutton

Aldenham Renaissance Ltd

Apcoa Parking Services UK Ltd

ARP Trading Ltd

Art Café

Aspire Leisure Trust

Association of Charity Officers

Carers in Hertfordshire

Caterplus

Chauncy Housing Association

Colesseum Theatre

Colne Valley Water Company

Commission for the New Towns

Dacorum Council for Voluntary Service

DC Leisure Management Ltd

Department of Transport

Digica FMS

East Herts Citizens Advice Bureau

East of England IDB Limited

Elior

Europa Services Ltd

Group for the Rootless of Watford

Hemel Hempstead Day Centre Limited

Hertford Museum Trust

Hertfordshire Care Trust

Hertfordshire Careers Service

Herts E-Learning Partnership

Hertfordshire Training & Enterprise Council

Hertfordshire Family Mediation Service

Kameleon 4 Ltd (formerly Dorchester Solutions)

Lee Valley Water Company

Leonard Cheshire

Mace

Mitie Property Services

National Car Parks Limited

North Herts Hospice Care Association

Office and General Environmental Services Limited

Offley Place Ltd

Principle Cleaning

Pro-Action Herts

Rhodes Museum Foundation

Rickmansworth and Uxbridge Valley Water Co

Riversmead Housing Association

Shenley Park Trust

Society of Education Officers

St Albans Citizens Advice Bureau

St Albans Diocesan Board for Social Responsibility

St Albans Society for the Deaf

Stevenage Homes

Superclean Services Wolthorpe Ltd

Thames Water Authority

Town & County Markets

TSG Mechanical Ltd

Watford & Three Rivers Trust

Watford Sheltered Workshop

Watford Town Centre Partnership Ltd

Wellfield Trust

West Hertfordshire Computer Consortium

Weston Voluntary Nursery

Woman's Royal Voluntary Society

## **1 Introduction**

This is the Funding Strategy Statement (FSS) of the Hertfordshire Pension Fund ("the Pension Fund"), which is administered by Hertfordshire County Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Pension Fund Actuary, Hymans Robertson LLP, and after consultation with the Pension Fund's employers and investment adviser. This revised version replaces the previous FSS and is effective from 31 March 2014.

### **1.1 Navigation around this document**

Section 2 describes the purpose and regulatory framework for the FSS and outlines how it operates in Hertfordshire.

Section 3 provides a brief introduction to some of the main principles behind funding and the application of these.

Section 4 provides an overview of the different types of employers in the Pension Fund and a general outline about managing contribution levels.

Section 5 outlines issues affecting specific types of employers in the Pension Fund.

Section 6 shows how the FSS is linked with the Pension Fund's Investment Strategy.

The Appendices provide further details on the following matters:

- A. The responsibilities of key parties
- B. Actuarial assumptions adopted
- C. Key risks and controls
- D. Glossary of key terms

## **2 Funding Strategy Statement**

### **2.1 Regulatory framework**

The requirement to maintain and publish a FSS is contained in Local Government Pension Scheme Regulations ("the LGPS Regulations") which are updated from time to time. The LGPS Regulations state that in publishing the FSS the Administering Authority must have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2012) and to its Statement of Investment Principles.

The FSS is not an exhaustive statement of policy on all issues and forms part of a framework which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the three years) which is appended to the formal valuation report issued after each Triennial Valuation;
- the Pension Fund's policies on admissions and cessations;
- The Pension Fund's Governance Policy and Compliance Statement and Communication Strategy Statement;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Pension Fund's Statement of Investment Principles (see Section 6).

This is the framework within which the Pension Fund Actuary carries out triennial valuations to set employers' contributions, provides recommendations to the Administering Authority when other funding decisions are required, for example, when employers join or leave the Pension Fund. The FSS applies to all employers participating in the Pension Fund and the roles and responsibilities of the key parties involved in the management of the Pension Fund are summarised in Appendix A.

Further details on the Pension Fund's policies and strategies can be found on the Pension Fund website at <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>.

## **2.2 Purpose of the FSS**

The Department for Communities and Local Government (DCLG) has stated that the purpose of the FSS is:

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

The FSS sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities.

Local Government Pension Scheme (the “Scheme”) members' benefits are guaranteed by the Local Government Pension Scheme (Benefits, Membership and Contribution) Regulations 2007 (as amended), and do not change as a result of changes in the market value of investments or employer contributions. Scheme members' contributions are also fixed in the LGPS Regulations, at a level which covers only part of the cost of the benefits.

Investment returns will help pay for only some of the benefits. Therefore employers pay the balance of the cost of delivering the benefits to members and their dependants.

## **2.3 Objectives of the FSS**

The FSS sets out the Pension Fund's objectives:

- to ensure the long-term solvency of the Pension Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/ dependants' benefits as they fall due for payment;
- not to restrain unnecessarily the Investment Strategy of the Pension Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Pension Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return. This will also minimise the costs to be borne by Council taxpayers;
- to reflect the different characteristics of different employers in determining contribution rates. This requires that the Pension Fund has a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council taxpayer from an employer defaulting on its pension obligations.

## **2.4 Consultation and review**

The Pension Fund reviews the FSS in detail at least every three years as part of the Triennial Valuation. The Administering Authority will consult with all employers and relevant interested parties when preparing and publishing its FSS, in accordance with the LGPS Regulations and CIPFA guidance.

This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next Valuation in 2016.

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The FSS may be amended before the next Valuation to reflect any regulatory changes, or alterations to the way the Pension Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be notified to all employers in the monthly Pension Fund Newsletter;
- amendments affecting only one class of employer would be consulted on with specific employers affected by the amendment;
- other more significant amendments would be subject to full consultation with all employers and relevant interested parties.

Any amendments to the FSS are approved by the Pensions Committee and would be reported at the next Committee meeting for consideration and approval.

If you have any other queries on the FSS please contact Patrick Towey in the first instance at e-mail address [pensions.team@hertfordshire.gov.uk](mailto:pensions.team@hertfordshire.gov.uk).

### 3 General Funding Principles

This section provides an introduction to the main principles behind funding and how contribution rates are calculated. These calculations involve actuarial assumptions about future experience which are described in more detail in Appendix B.

#### 3.1 Calculation of contribution rates

Employer contributions are normally made up of two elements:

- a) the estimated cost of future benefits being built up from year to year, referred to as the “**future service rate**”; plus
- b) an adjustment for the difference between the assets built up to date and the value of past service benefits, referred to as the “**past service adjustment**”. If there is a deficit then the past service adjustment will increase the employer's total contribution; if there is a surplus then there may be a reduction in the employer's total contribution. Any past service adjustment will aim to return the employer to full funding over an appropriate period (the “deficit recovery period”).

The Pension Fund Actuary is required by the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) to report the **Common Contribution Rate**, for all employers collectively at each Triennial Valuation, combining items 3.1 (a) and (b) above. This is based on actuarial assumptions about the likelihood, size and timing of benefit payments to be made from the Pension Fund in the future, as outlined in Appendix B.

The Pension Fund Actuary is also required to adjust the **Common Contribution Rate** for circumstances specific to each individual employer. It is this adjusted contribution rate which the employer is required to pay. The rates for all employers are shown in the Pension Fund's Rates and Adjustments Certificate which is published with the formal valuation report after each Triennial Valuation.

In effect, the **Common Contribution Rate** is a notional quantity, as it is unlikely that any employer will pay that exact rate. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific circumstances.

Details of the outcome of the Triennial Valuation as at 31 March 2013 can be found in the formal valuation report, including an analysis at Pension Fund Level of the **Common Contribution Rate**. The formal valuation report also includes details of individual employer contribution rates. The formal report is accessible from <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>.

#### 3.2 Calculation of the future service rate

The future service element of the employer contribution rate is calculated aiming to ensure that the contributions will meet benefits accrued by members in the future in the Pension Fund. This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

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The future service rate is calculated separately for all the employers other than those employers within a Pool. A Pool is a group of employers that have common characteristics who are grouped together largely for risk sharing (see section 3.10 for further details). Employers within a Pool will pay the contribution rate applicable to the Pool as a whole.

The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only admission bodies and designating employers that may have the power not to automatically admit all eligible new staff to the Pension Fund, depending on the terms of their Admission Agreements and employment contracts. The definition of different types of employers is provided in section 4.

**a) Employers which admit new entrants**

These rates will be derived using the "Projected Unit Method" of Valuation with a one year period, i.e. only considering the cost of the next year's benefit accrual and contribution income. If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment, or outsourcing decisions) the rate would rise over time.

**b) Employers which do not admit new entrants**

To give more long term stability to such employers' contributions, the "Attained Age" funding method is normally adopted. This measures benefit accrual and contribution income over the whole future anticipated working lifetimes of current active employee members.

Both approaches include expenses of administration to the extent that they are borne by the Pension Fund, and include allowances for benefits payable on death in service and ill health retirement.

### 3.3 Calculation of the deficit or surplus

The Pension Fund Actuary is required to report on the "solvency" of the whole Pension Fund in a Valuation. As part of this Valuation, the Actuary will calculate the solvency position of each employer.

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see section 3.4),  
to;
- the value placed by the Actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Pension Fund Actuary agrees with the Administering Authority the assumptions to be used in calculating this value. These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer's current and former employees, based on pensionable service to the Valuation date only (i.e. ignoring further benefits to be built up in the future).

The amount of deficit or shortfall is the difference between the asset value and the liabilities value. If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit. If it is more than 100% then the employer is said to be in surplus.

A larger deficit will give rise to higher employer contributions. If a deficit is spread over a longer period then the annual employer contribution will be lower than if it was spread over a shorter period. However, deferring payment over a longer period will lead to higher contributions in the long term as a lower annual cost will incur a greater amount of interest on the deficit as the employer will lose out on investment returns generated by the Pension Fund assets.

The Pension Fund generally operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis. For more mature employers or those closed to new entrants the Pension Fund may target a funding level on a more prudent basis.

### 3.4 Calculation of each employer's asset share and liabilities

The Administering Authority does not account for each employer's assets separately. Instead, at each Triennial Valuation, the Pension Fund Actuary is required to apportion the assets of the whole Pension Fund between the employers.



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This apportionment uses the income and expenditure figures provided for certain cashflows for each employer. This process adjusts for transfers of liabilities between employers participating in the Pension Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as “analysis of surplus”.

The Pension Fund Actuary does not allow for certain relatively minor events, including but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Pension Fund.

The asset apportionment is capable of verification but not to audit standard. The Administering Authority recognises the limitations in the process, but it considers that the Pension Fund Actuary’s approach addresses the risks of employer cross-subsidisation to an acceptable degree.

#### 3.5 Calculating contributions for individual employers

Over the period between each Triennial Valuation, the results of the calculations for setting contribution rates for a given individual employer will be affected by:

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
- the effect of any differences in the valuation basis on the value placed on the employer’s liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made.

Actual investment returns achieved on the Pension Fund between each Valuation are applied proportionately across all employers, to the extent that employers, in effect, share the same Investment Strategy. Transfers of liabilities between employers within the Pension Fund occur automatically within this process, with a sum broadly equivalent to the value of the pension reserve in respect of the transferring member(s), being exchanged between the two employers.

Employer covenant, and likely term of membership will also affect the contribution rate. If an employer is approaching the end of its participation in the Pension Fund then its contributions may be amended appropriately, so that the assets meet (as closely as possible) the value of its liabilities in the Pension Fund when its participation ends.

#### 3.6 Methods for setting contribution rates

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Pension Fund. With this in mind, there are a number of methods which the Administering Authority may permit, to improve the stability of employer contributions. Where circumstances permit these include:

- capping of employer contribution rate changes within a pre-determined range (“stabilisation”);
- the use of extended deficit recovery periods;

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- the phasing in of contribution rises or reductions;
- the pooling of contributions amongst employers with similar characteristics; and
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

The above issues are discussed in more detail in sections 3.7 to 3.11.

Section 3.12 to 3.17 provides details of other factors that could have an impact on an employer's contribution rate and funding position.

Employers that are permitted to use one or more of the above methods will often be paying, for a time, contributions less than the theoretical contribution rate. Such employers should appreciate that:

- their true long term liability (i.e., the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the method adopted;
- lower contributions in the short term will incur a greater loss of investment returns on the deficit. Thus, deferring a certain amount of contribution will lead to higher contributions in the long-term; and
- it will take longer to reach full funding, all other things being equal.

The Administering Authority recognises that there may be particular circumstances affecting individual employers that are not easily managed within the conditions and policies set out in the FSS. Therefore the Administering Authority may direct the actuary to adopt alternative funding approaches but this will be at its sole discretion and on a case by case basis.

#### 3.7 Stabilisation

Stabilisation is a mechanism where year on year variations in the employer contribution rate are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. The Administering Authority, on the advice of the Pension Fund Actuary, believes that the stabilised contributions can be viewed as a prudent long term approach.

It is at the Administering Authority's discretion whether to allow an employer in the Pension Fund to stabilise their Contribution rate. In general, stabilisation has only been appropriate for those employers with tax raising powers. In particular, stabilisation would only be considered for an employer when the employer is open to new entrants, have a long term time horizon in the Pension Fund, and be deemed to have a strong covenant to protect the Pension Fund and the other employers in the Fund against the risk of the employer defaulting in relation to its liabilities. The Administering Authority also has the discretion to stop any contribution stabilisation if they become concerned about the security and covenant of a stabilised employer. In this instance, a revised contribution rate plan would be calculated and paid by the Employer.

#### 3.8 Deficit recovery periods and payments

When calculating contributions, the Administering Authority instructs the actuary to adopt specific deficit recovery periods for all employers. The deficit recovery period starts at the commencement of the revised contribution rate and for the 2013 Triennial Valuation this is 1 April 2014. The Administering Authority would normally expect the same approach to be used at successive Triennial Valuations, but reserves the right to propose alternative spreading periods.

For the 2013 Valuation, the following alternative spreading periods are in operation and further arrangements will be considered:

- where an employer has no new entrants to the Scheme then the deficit would be recovered by a fixed monetary amount over a period to be agreed with the employing body or its successor, not to exceed 10 years;
- where stabilisation applies, the resulting employer contribution rate will be amended to comply with the stabilisation mechanism;
- where stabilisation does not apply, the deficit recovery payments for each employer covering the three year period until the next Valuation will sometimes be set as a percentage of salaries. However, the Administering

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Authority reserves the right to amend these rates between Valuations and/or to require these payments in monetary terms instead, for instance where:

- the employer is relatively mature, i.e. has a large deficit recovery contribution rate where its payroll is a smaller proportion of its deficit than is the case for most other employers, or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed the Scheme to new entrants.

The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table below:

Type of employer <sup>1</sup>	Maximum length of deficit recovery	Payment method
Local Authorities	20 years	% of payroll or monetary amount
Other Public Bodies e.g. Police, Fire, Colleges	20 years	% of payroll or monetary amount
Maintained schools and Academies	20 years	% of payroll
Community Admission Bodies and Designating employers <b>open</b> to new entrants	Future working lifetime of the remaining scheme members allowing for expected leavers, to a maximum 20 years	% of payroll or monetary amount
Community Admission Bodies and Designating employers <b>closed</b> to new entrants	Future working lifetime of the remaining scheme members allowing for expected leavers	Monetary amount
Transferee Admission Bodies	Outstanding contract term	% of payroll or monetary amount

<sup>1</sup> See Section 4 for a definition and characteristics of types of employers.

### 3.9 Phasing in of contribution changes

All phasing is subject to the Administering Authority being satisfied about the strength of the employer's covenant. For employers where stabilisation does not apply, phasing will not be permitted over periods greater than three years.

Transferee Admission Bodies and employers which have no active members at this valuation will not be allowed to phase in contribution changes.

### 3.10 Pooled contributions

From time to time the Administering Authority may set up pools for employers with similar characteristics as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service. This will always be in line with its broader funding strategy.

The exceptions are Transferee Admission Bodies and Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants.

Employers, who participate in a pool, will be required to comply with the conditions and requirements set out in the pooling policy applicable to that Pool. These employers will not normally be advised of their individual contribution rate unless agreed by the Administering Authority and where the employer agrees to pay the additional actuarial fees for calculation of an individual contribution rate.

The following pooling arrangements are in operation for the 2013 Valuation:

- Hertfordshire maintained schools, academies, free schools, university technical colleges and studio schools; and
- Town and Parish Councils.

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

### **3.11 Additional flexibility in return for added security**

At its discretion, the Administering Authority may permit greater flexibility when setting the employer's contributions if the employer provides added security. Such flexibility includes a reduced rate of contribution, an extended deficit recovery period, or permission to join a Pool with another body.

Suitable security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan;
- whether the admission agreement is likely to be open or closed to new entrants.

### **3.12 Non ill health early retirement costs**

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). Following the benefit regulation changes from April 2008 and April 2014, the relevant age may be different for different periods of service.

Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. Effective from 1 April 2013 employers have been required to pay any new early retirement strains in the year of retirement. Arrangements to pay for previously incurred early retirements over a phased period have been agreed on a case by case basis.

The Pension Fund Actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

### **3.13 Ill health early retirement costs**

Employers in the Pension Fund will usually have an 'ill health allowance' which is an assumed level of ill health retirements within a financial year. The Pension Fund monitors each employer's ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance determined at the previous Valuation, the employer will be charged additional contributions on the same basis as applies for non ill-health cases.

### **3.14 Ill health insurance**

If an employer provides satisfactory evidence to the Administering Authority of a current insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Pension Fund each year is reduced by the amount equivalent to the value of that year's insurance premium, so that the total contribution is unchanged, and
- monitoring of allowances will not be required.

The employer must confirm each year that they have renewed the policy and must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

### **3.15 Employers with no remaining active members**

Under the LGPS Regulations, once an employer has no active members then this would trigger a cessation valuation to determine the employer's funding position. Where the employer is in a deficit funding position, then the employer will either be required to make an immediate payment of any deficit calculated, or an alternative payment plan will be agreed at the sole discretion of the Administering Authority (see Section 4 for more detail). On payment of the cessation amount, this would extinguish the employer's obligations to the Pension Fund.

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Once a cessation payment has been made, this may give rise to the following situations:

- the employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the liability will fall to all Pension Fund employers and will be taken into consideration at successive formal Valuations. The Pension Fund Actuary will apportion the remaining liabilities to all employers on a pro-rata basis when calculating review contribution rates;
- the last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the Pension Fund's actuary will apportion the remaining assets to all employers on a pro-rata basis when calculating revised contribution rates at successive formal Valuations.

In exceptional circumstances the Pension Fund may permit an employer with no remaining active members to continue contributing to the Pension Fund rather than carrying out a cessation valuation. The Administering Authority may need to seek legal advice in such cases. Any agreed arrangement would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Pension Fund would reserve the right to invoke the cessation requirements in the future.

#### 3.16 Policies on bulk transfers

The Pension Fund will consider bulk transfers on a case by case basis, but in general the Pension Fund:

- will not pay bulk transfers that exceed the lesser of (a) the asset share of the transferring employer in the Pension Fund, and (b) the value of the past service liabilities of the transferring members;
- will not grant added benefits to members bringing in entitlements from another Pension Fund unless the asset transfer is sufficient to meet the added liabilities;
- may permit shortfalls to arise on bulk transfers if the Pension Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's contributions to increase between Valuations.

#### 3.17 Review of contribution rates

The Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between Valuations.

Such reviews may be triggered by significant events including but not limited to:

- a substantial reduction in payroll;
- pay awards in excess of the assumptions used in the last Valuation;
- altered employer circumstances;
- Government restructuring affecting the employer's business;
- contract terminating;
- failure to pay contributions;
- failure to arrange appropriate security as required by the Administering Authority.

The outcome of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

## 4 Employer Bodies and Contributions

This section provides an overview of the different types of employers in the Pension Fund and a general outline about managing contribution levels. This should be read in conjunction with the general principles outlined in Section 3 and Section 5 which discusses specific issues for the different groups of employing bodies.

### 4.1 Types of employers participating in the Pension Fund

Historically the Scheme was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate. There has been a large increase in the number of employers in the Pension Fund which is largely the

result of schools transferring to academy status and services being outsourced from scheme employers such as Councils.

In essence, participation in the Scheme is open to public sector employers providing some form of service to the local community. The majority of members will be employees of local authority employers (and ex-employees) and the majority of participating employers are those providing services in place of (or alongside) local authority services.

The LGPS Regulations define various types of employer as follows:

#### **Scheduled bodies**

This category includes Councils, and other specified employers such as academies and further education establishments. These must provide access to the Scheme for their employees who are not eligible to join another public sector scheme (such as the Teachers Pensions Scheme). These employers are specified in a schedule to the LGPS Regulations.

It is now possible for Local Authority maintained schools to convert to academy status, and for other forms of school (such as free schools) to be established under the academies legislation. All such academies, as employers of non-teaching staff, become separate new employers in the Pension Fund. As academies are defined in the LGPS Regulations as “Scheduled Bodies”, the Administering Authority has no discretion over their admission to the Pension Fund, and the academy has no discretion over allowing its non-teaching staff to join the Pension Fund.

#### **Designating employers**

Employers such as Town and Parish Councils are able to participate in the Scheme by passing a resolution at their management meeting and the Pension Fund cannot refuse them entry where the resolution is passed. These employers can designate which of their employees are eligible to join the Scheme.

#### **Community and transferee admission bodies**

Other employers are able to participate in the Pension Fund via an admission agreement, and are referred to as ‘admission bodies’. These employers are generally those with a “community of interest” with another scheme employer called a **community admission bodies** (“CAB”) or those providing a service on behalf of a scheme employer called a **transferee admission bodies** (“TAB”). CABs will include housing associations and charities and TABs will generally be contractors. The Pension Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Pension Fund’s admissions and indemnity policy are not met.

### **4.2 Balancing the cost of contributions**

The Administering Authority and the Pension Fund Actuary acknowledge that higher contributions required to be paid to the Pension Fund will mean less cash available for the employer to spend on the provision of services. However, this is balanced against the following considerations:

- The Pension Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Pension Fund must have the assets available to meet retirement and death benefits, which in turn means that the various employers must each make appropriate contributions. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer’s ultimate obligation to the Pension Fund for its current and former employees;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Pension Fund;
- The Pension Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible;
- The Pension Fund wishes to avoid the situation where an employer falls so far behind managing its funding shortfall that its deficit becomes unmanageable in practice. Such a situation may lead to employer insolvency and the resulting deficit falling to other employers of the Pension Fund. In that situation, those employers’ services would in turn suffer as a result;

- Councils' contributions to the Pension Fund should be at a suitable level, to protect the interests of different generations of Council taxpayers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; a Council will wish to minimise the extent to which Council taxpayers in one period are in effect benefiting at the expense of those paying in a different period.

Overall there is clearly a balance to be struck between the Pension Fund's need for maintaining prudent funding levels, and employers' need to allocate their resources appropriately. The Pension Fund achieves this through various techniques which affect contribution increases to various degrees, as discussed in Section 3. In deciding which of these techniques to apply to any given employer, the Pension Fund will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc. This helps the Pension Fund establish a picture of the financial standing or covenant of the employer, i.e. its ability to meet its long term Pension Fund commitments. To ensure that the information is kept up-to-date, Pension Fund employers are required to complete an annual declaration form to confirm the accuracy of information held on the database.

Where an employer is considered relatively low risk then the Pension Fund will permit greater flexibility (such as stabilisation or a longer deficit recovery period relative to other employers). This may temporarily produce lower contribution levels than would otherwise have applied. This is permitted on the expectation that the employer will still be able to meet its obligations for many years to come.

An employer whose risk assessment indicates a less strong covenant or whose participation in the Scheme is limited, will generally be required to pay higher contributions. This is because there is a higher probability that at some point it will fail or be unable to meet its pension contributions resulting in its deficit in the Pension Fund then falling to other Pension Fund employers, or because the employer has less time to meet its obligations to the Pension Fund.

## **5. Specific Issues for Individual Employer Bodies**

This section outlines issues affecting specific groups of employers in the Pension Fund and should be read in conjunction with Sections 3 and 4 above.

### **5.1 Scheduled bodies**

#### **5.1.1 Stabilisation**

Stabilisation is a mechanism where the employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Pension Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" may, therefore, be paying less than their theoretical contribution rate and should be aware of the risks of this approach. Employers should consider making additional payments to the Pension Fund to improve their funding position.

The stabilisation mechanism allows short term investment market volatility to be managed so that this does not cause volatility in employer contribution rates. This is on the basis that a long term view can be taken on net cash inflow, investment returns and strength of the employer covenant since Scheduled Bodies are expected to be in the Scheme for the long term.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority (see Section 3.7) and;
- there are no material events which cause the employer to become ineligible, e.g. significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer, perhaps due to Government restructuring.

On the basis of extensive modelling carried out for the 2013 Valuation exercise, the stabilisation parameters have been set taking into account each employer's individual characteristics and membership profile while considering employer security and other factors. The stabilisation parameters have been set allowing for annual increases of around 1-3% of pay. These parameters and the approach will be reviewed at the 31 March 2016 valuation, to take effect from 1 April 2017.

### **5.1.2 New academy employers**

At the effective date of this FSS, the Pension Fund's policies on academies' funding issues are as follows:

- a) A new academy will be regarded as a separate employer in its own right and will have the option to either join the Schools and Academies Pool or remain as a separate employer. For further information please see the Pension Fund's "Schools and Academies Pooling Arrangement Policy" at <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>.
- b) Where an academy is part of a Multi Academy Trust (MAT) the academy's figures will be calculated as outlined in Sections c – e below, but can be combined with those of the other academies in the MAT;
- c) The new academies past service liabilities on conversion will be calculated based on its active Pension Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those active members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status which remain with the ceding council;
- d) The new academy will be allocated an initial asset share from the ceding Council's assets in the Pension Fund. This asset share will be calculated using the estimated funding position of the ceding Council at the date of academy conversion. The share will be based on the active members' funding level, having first allocated assets in the Council's share to fully fund any ex-employees of the school that have deferred and pensioner status. The asset allocation will be based on market conditions and the academy's active Pension Fund membership on the day prior to conversion;
- e) The new academy's initial contribution rate will be calculated using market conditions, the Council funding position and, membership data, all as at the day prior to conversion.

The Pension Fund's current pooling arrangement for academies is subject to change in light of any amendments to DCLG guidance or any other regulations affecting academies. Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS. In particular, policies (c), (d) and (e) above will be reconsidered at each Valuation.

### **5.1.3 Treatment of surplus**

For employers where stabilisation applies, any funding surplus will be covered by the stabilisation arrangement. Where stabilisation does not apply, the Administering Authority's preferred approach is for contributions to be kept at the future service rate, although reductions may be permitted by the Administering Authority.

### **5.1.4 Cessation**

Since scheduled bodies are legally obliged to participate in the LGPS, scheduled bodies may not choose to cease participation in the Scheme. In the rare event of a cessation occurring, for example due to government changes, the Administering Authority will instruct the Pension Fund Actuary to carry out a cessation valuation to determine the funding position of the scheduled body. Where there is a deficit, payment of this amount in full would normally be sought from the scheduled body; where there is a surplus current legislation does not permit a refund payment to the scheduled body.

To the extent reasonably practicable, the actuary will adopt an approach which protects the other employers from the likelihood of any material loss emerging in the future. This will include the following methods:

- a) Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in Appendix B;
- b) Alternatively, it may be possible to simply transfer the former scheduled body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee;
- c) Where a guarantor does not exist then the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment out-performance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation liabilities.



Under (a) and (c), any shortfall would usually be levied on the departing scheduled body as a single lump sum payment. If this is not possible then the Pension Fund would drawdown on any guarantee in place for the employer.

In the event that the Pension Fund is not able to recover the required payment in full either from the scheduled body or guarantor, then the unpaid amounts will be shared amongst all of the other employers in the Pension Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Pension Fund, or alternatively, this will be reflected in the contribution rates set at the next formal Valuation following the cessation date.

Further details can be found in the Pension Fund's Cessation Policy, accessible from <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>.

#### **5.1.5 Outsourcing Services**

Scheduled bodies that have outsourced services to a contractor will be liable for any unpaid deficit of the contractor on cessation. Additionally, scheduled bodies will be liable for any future deficits and contributions arising after cessation relating to the contractor's participation in the Pension Fund.

### **5.2 Community admission bodies and designating employers**

#### **5.2.1 New community admission bodies**

With effect from 1 October 2012, the Local Government Pension Scheme Miscellaneous Regulations 2012 introduced mandatory new requirements for all admission bodies admitted to the Pension Fund. Under these regulations, all new admission bodies will be required to provide some form of security, such as a guarantee from the outsourcing employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Pension Fund;
- the current deficit.

Any security must be to the satisfaction of the Administering Authority and will be reassessed on an annual basis.

The Administering Authority will only consider requests from CABs (or other similar bodies, such as section 75 NHS partnerships) to join the Pension Fund if they are sponsored by a scheduled body with tax raising powers, guaranteeing their liabilities and supplemented by the provision of a form of security as above.

The above approaches reduce the risk to other employers in the Pension Fund, sharing any shortfall for admission bodies ceasing with unpaid liabilities.

#### **5.2.2 Basis for community admitted bodies and designating employers open to new entrants**

In the circumstances where:

- the employer is a CAB or designating employer, and
- the employer is open to new entrants, and

the Administering Authority will normally target a funding level of 100% of accrued liabilities over the future working lifetime of the remaining scheme members, valued on an ongoing basis.

The Administering Authority reserves the right to vary the discount rate used to set the employer contribution rate to protect other employers in the Pension Fund; in particular where the designating employers and admission bodies has no guarantor or where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease.

**5.2.3 Basis for community admitted bodies and designating employers closed to new entrants**

In the circumstances where:

- the employer is a CAB or designating employer, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may vary the discount rate used to set the employer contribution rate in order to protect other employers in the Pension Fund. In particular, contributions may be set on a more prudent basis for an employer to achieve full funding by the time the agreement terminates or the last active member leaves (e.g. using a discount rate set equal to gilt yields). This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

**5.2.4 Treatment of surplus**

The Administering Authority's preferred approach is for contributions to be kept at the future service rate, although reductions may be permitted by the Administering Authority.

**5.2.5 Cessation**

Notwithstanding the provisions of the admission agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- last active member ceasing participation in the Pension Fund;
- the insolvency, winding up or liquidation of the CAB or designating employer;
- any breach by the admission body of any of its obligations under the agreement that they have failed to remedy to the satisfaction of the Pension Fund;
- a failure by the admission body to pay any sums due to the Pension Fund within the period required; or
- the failure by the admission body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Pension Fund.

On cessation of a CAB or designating employer, the Administering Authority will instruct the Pension Fund Actuary to carry out a cessation valuation to determine the funding level on cessation. Where there is a deficit, payment of this amount in full would normally be sought from the employer; where there is a surplus it should be noted that current legislation does not permit a refund payment to the employer.

For an employer whose participation is voluntarily ended either by themselves or the Pension Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The Actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in the future. This will include the following methods:

- a) Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in Appendix B;
- b) Alternatively, it may be possible to simply transfer the former admission body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee;
- c) Where a guarantor does not exist then, in order to protect other employers in the Pension Fund, the cessation liabilities and final deficit will normally be calculated using a "gilt's cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment out-performance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation liabilities.

Under (a) and (c), any shortfall would usually be levied on the departing admission body as a single lump sum payment. If this is not possible then the Pension Fund would look to any bond, indemnity or guarantee in place for the employer.

In the event that the Pension Fund is not able to recover the required payment in full either from the admission body or guarantor, then the unpaid amounts will be shared amongst all of the other employers in the Pension Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Pension Fund, or alternatively will be reflected in the contribution rates set at the next formal Valuation following the cessation date.

As an alternative, where the ceasing admission body is continuing in business, the Pension Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing admission body. Under this agreement the Pension Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each Triennial Valuation. The Pension Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the admission body would have no contributing members.

Further details can be found in the Pension Fund's cessation policy, accessible from <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>.

### **5.3 Transferee admission bodies**

#### **5.3.1 New transferee admission bodies**

A new TAB usually joins the Pension Fund as a result of the outsourcing of some services from an existing employer (normally a scheduled body such as a Council, school or academy) to another organisation (a "contractor"). This normally involves the TUPE transfer of some staff from the outsourcing employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Pension Fund to enable TUPE transferred employees to continue to have access to the Scheme. At the end of the contract the employees revert to the outsourcing employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Pension Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees' Pension Fund benefits i.e. the TAB will be set up on a 'Fully Funded' basis. The expectation is that the contractor will then be fully funded at the end of the contract.

Employers which "outsource" have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. There are three routes that such employers may wish to adopt but it must be appreciated that the risk ultimately resides with the employer letting the contract. Any arrangement will have to be agreed between the outsourcing employer and the contractor. The options are:

##### **a) Pooling**

Under this option the contractor is pooled with the outsourcing employer and will pay the same rate as the outsourcing employer, which may be under the stabilisation approach.

##### **b) Outsourcing employer retains pre-contract risks**

Under this option the outsourcing employer would retain responsibility for assets and liabilities for service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue after the contract commencement date for transferred staff. The contractor's contribution rate could vary from one Valuation to the next and the contractor would be liable for any deficit at the end of the contract term for assets and liabilities attributable to service accrued during the contract term.

##### **c) Fixed contribution rate agreed**

Under this option the contractor pays a fixed contribution rate during the term of the contract and doesn't pay any cessation deficit.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions as it is unfair to burden the outsourcing employer with that risk. For example the contractor should typically be responsible for pension costs that arise from;

- above average pay increases, including the effect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (b) above;
- redundancy and early retirement decisions.

**d) Theoretical contribution rate**

Under this option the Pension Fund Actuary will calculate the theoretical contribution rate for the contractor based on the finalised transferring membership and market conditions as at the date the contractor joins the Pension Fund. This rate will then be payable until the next formal Valuation when it will be reassessed and adjusted. The contractor would be liable for any deficit at the end of the contract term attributable to service accrued before the transfer and during the contract term.

**5.3.2 Indemnity**

With effect from 1 October 2012, the Local Government Pension Scheme Miscellaneous Regulations 2012 introduced mandatory new requirements for all admission bodies admitted to the Pension Fund. Under these regulations, all new admission bodies are required to provide some form of security, such as a guarantee from the outsourcing employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Pension Fund;
- the current deficit.

For all new TABs, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis.

These approaches reduce the risk to other employers in the Pension Fund sharing any shortfall for admission bodies ceasing with an unpaid liabilities.

**5.3.3 Treatment of surplus**

Where a TAB is found to be in surplus at the valuation, contributions may be reduced by spreading the surplus over the remaining contract term.

**5.3.4 Transferee admission bodies ceasing**

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- last active member ceasing participation in the Pension Fund;
- the insolvency, winding up or liquidation of the Admission Body;
- any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Pension Fund;
- a failure by the Admission Body to pay any sums due to the Fund within the period required by the Pension Fund; or
- the failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Pension Fund.

Participation is assumed to expire at the end of the contract.

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On cessation, the Administering Authority will instruct the Pension Fund Actuary to carry out a cessation valuation to determine the funding level on cessation. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it is noted that current legislation does not permit a refund payment to the Admission Body.

Where a contract has ceased, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The Actuary will therefore adopt an approach which is appropriate to the circumstances of cessation and to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future.

- a) Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in Appendix B;
- b) Alternatively, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee;
- c) Where a guarantor does not exist then, in order to protect other employers in the Pension Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment out-performance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation liabilities.

Under (a) and (c), any shortfall would usually be levied on the ceasing admission body as a single lump sum payment. If this is not possible then the Pension Fund would drawdown on any bond, indemnity or guarantee in place for the employer.

If the Pension Fund is not able to recover the required payment in full either from the admission body or guarantor, then the unpaid amounts will be shared amongst all of the other employers in the Pension Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Pension Fund, or alternatively will be reflected in the contribution rates set at the next formal Valuation following the cessation date.

As an alternative, where the ceasing admission body is continuing in business, in exceptional circumstances, the Pension Fund reserves the right to enter into an agreement with the ceasing Admission Body. Under such an agreement the Pension Fund would accept an appropriate alternative security to be held against any liabilities, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation liability. This approach would be monitored and reviewed at each Triennial Valuation. The Pension Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the admission body would have no contributing members.

Further details can be found in the Pension Fund's Cessation Policy, accessible from <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>.

## 6 Funding Strategy and Links to the Investment Strategy

### 6.1 The Pension Fund's Investment Strategy

The Pension Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, and this is done through the Pension Fund's Investment Strategy.

The Investment Strategy is set by the Administering Authority, after taking investment advice from the Pension Fund's investment consultant, Mercers. The precise mix, investment manager make up and target returns are set out in the Statement of Investment Principles (SIP), which is accessible from the Pension Fund website <http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx>.

A full review of the Investment Strategy is carried out after each Triennial Valuation, and the Investment Strategy is kept under review on an annual basis to ensure that it remains appropriate to the Pension Fund's liability profile. The Investment Strategy is applied to all employers.

**6.2 Link between the Funding Strategy Statement and the Investment Strategy**

The Pension Fund must be able to meet all benefit payments when they fall due. These payments will be met by contributions (resulting from the FSS) or asset returns and income (resulting from the Investment Strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers. The funding and investment strategies are, therefore, inextricably linked.

**6.3 Compatibility of the Pension Fund's Funding Strategy Statement and Investment Strategy**

In the opinion of the Pension Fund Actuary, the current FSS is consistent with the current Investment Strategy of the Pension Fund. The asset out-performance assumption contained in the discount rate (see Section 3 of Appendix B) is within a range that is considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government. However, in the short term, such as the formal Triennial Valuations, there is scope for volatility and there is a material chance that in the short term and medium term, asset returns will fall short of this target. The stability measures described in Section 3 will mitigate, but not remove, the effect on employers' contributions.

The Pension Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

**6.4 Impact of the strategies on the stabilisation mechanism**

The Actuary has developed four key measures which capture the essence of the Pension Fund's funding and investment strategies:

- **Prudence** – the Pension Fund should have a reasonable expectation of being fully funded in the long term;
- **Affordability** – how much can employers afford;
- **Stewardship** – actuarial assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position;
- **Stability** – employers should not see significant changes in their contribution rates from one year to the next to help to provide a more stable budgeting environment.

The key issue is that the main objectives often conflict. For example, minimising the long term cost of the Scheme (i.e. keeping employer rates affordable) is best achieved by investing in higher returning assets e.g. equities. However, the yield on equities are very volatile, which conflicts with the objective to have stable contribution rates.

Therefore a balance needs to be maintained between risk and reward which has been considered by the use of Asset Liability Modelling. This is a set of calculation techniques applied by the Pension Fund Actuary, to model the range of potential future solvency levels and contribution rates.

The Actuary modelled the impact of these four key areas, for the purpose of setting a stabilisation approach (see Section 5.1.1). The modelling demonstrated that retaining the present Investment Strategy, coupled with constraining employer contribution rate changes as described in 5.1.1, struck an appropriate balance between the objectives above. In particular the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Pension Fund.

The current stabilisation mechanism is to remain in place until 2017 and will be reviewed as part of the 2016 Valuation.

**6.5 Monitoring of the Pension Fund's overall funding position**

The Administering Authority monitors the relative funding position of the overall fund, i.e. changes in the relationship between asset values and the liabilities value, on a quarterly basis and reports this to the Pension Committee.

## **Appendix A: Responsibilities of Key Parties**

The efficient and effective operation of the Pension Fund needs various parties to each play their part.

### **A1 The Administering Authority should:**

- operate the Pension Fund in accordance with the relevant LGPS Regulations;
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Pension Fund employer;
- collect employer and employee contributions, investment income and other amounts due to the Pension Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Pension Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income that are not immediately required to pay benefits) in accordance with the Pension Fund's Statement of Investment Principles (SIP) and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Pension Fund;
- take appropriate measures to safeguard the Pension Fund against the consequences of employer default;
- manage the Triennial Valuation process in consultation with the Pension Fund Actuary;
- prepare and maintain a Funding Strategy Statement (FSS) and a SIP, after consultation;
- notify the Pension Fund Actuary of material changes that could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the Pension Fund's performance and funding and amend the FSS and SIP as appropriate.

### **A2 The individual employer should:**

- deduct contributions from employees' salary correctly;
- pay all contributions promptly by the due date and as determined by the Actuary;
- establish and exercise a discretions policy within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

### **A3 The Pension Fund Actuary should:**

- prepare Triennial Valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
- provide advice relating to new employers in the Pension Fund, including the level and type of bonds or other forms of security and the monitoring of these;
- prepare advice and calculations in connection with bulk transfers and individual benefit related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal Triennial Valuations, where circumstances suggest this may be necessary;
- advise on the termination of admission bodies' participation in the Pension Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

**A4 Other parties:**

- investment advisers (either internal or external) should ensure the Pension Fund's SIP remains appropriate and consistent with this FSS;
- investment managers, custodians and bankers should ensure effective investment (and dis-investment) of Pension Fund assets, in line with the SIP;
- auditors should comply with their auditing standards, ensure the Pension Fund's compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Pension Fund;
- legal advisers (either internal or external) should ensure the Pension Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures.



## **Appendix B: Actuarial Assumptions**

### **B1 What are the actuarial assumptions?**

These are expectations of future experience used to place a value on future benefit payments (“the liabilities”). Assumptions are made about the amount of benefit payable to members (“the financial assumptions”) and the likelihood or timing of payments (“the demographic assumptions”). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants’ benefits.

Changes in assumptions will affect the measured value of future service accrual and past service liabilities, and hence the measured value of the past service deficit. However, different assumptions only impact on the pace of funding and will not of course affect the actual benefits payable by the Pension Fund in future.

The combination of all assumptions is described as the “basis”. A more optimistic basis might involve higher assumed investment returns (“the discount rate”), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower liability values and lower employer costs. A more prudent basis will give higher liability values and higher employer costs.

### **B2 What basis is used by the Pension Fund?**

The Pension Fund’s standard funding basis is described as the “ongoing basis”, which applies to most employers in most circumstances. This is described in more detail in B3 below. It anticipates employers remaining in the Pension Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Pension Fund long term, a more prudent basis applies: see section 5.2.2 and 5.3.4.

### **B3 What assumptions are made in the ongoing basis?**

#### **a) Investment return / discount rate**

The key financial assumption is the anticipated return on the Pension Fund’s investments. This is known as the discount rate and this assumption makes allowance for an anticipated out-performance of Pension Fund returns relative to long term yields on UK Government bonds (“gilts”). There is, however, no guarantee that Pension Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial Valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the Triennial Valuation at 31 March 2013 and setting contribution rates effective from 1 April 2014, the Pension Fund Actuary has assumed that future investment returns earned by the Pension Fund over the long term will be 1.8% per annum greater than gilt yields at the time of the Valuation. In the opinion of the Pension Fund Actuary, based on the current Investment Strategy, this asset out-performance assumption is within a prudent range that would be considered acceptable for the purposes of the funding valuation.

#### **b) Salary growth**

Pay for public sector employees is currently subject to restriction by the UK Government until 2016. Although this “pay freeze” does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards. Based on long term historical analysis of the membership in LGPS funds, the salary increase assumption at the 2013 valuation has been set to 0.5% above the retail prices index (RPI) per annum. This is a change from the previous valuation, which assumed a two year restriction at 1% per annum followed by longer term growth at RPI plus 1.5% per annum.

**c) Pension increases**

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. This change was allowed for in the Valuation calculations as at 31 March 2010. The basis of such increases is set by the Government, and is not under the control of the Pension Fund or any employers.

As at the previous Valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the “formula effect” of the difference between RPI and CPI. At the 2013 Valuation, we propose a reduction of 0.8% per annum. This is a larger reduction than at 2010, which will serve to reduce the value placed on the Pension Fund’s liabilities (all other things being equal).

**d) Life expectancy**

The demographic assumptions are intended to be best estimates of future experience in the Pension Fund. These are based on past experience of LGPS funds which participate in Club Vita which is the longevity analytics service used by the Pension Fund, and endorsed by the Actuary.

The longevity assumptions adopted at this Valuation are a bespoke set of “VitaCurves”, produced by the Club Vita’s detailed analysis, which are specifically tailored to fit the membership profile of the Pension Fund. These curves are based on the data provided by the Pension Fund for the purposes of this Valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with a 1.25% per annum minimum underpin to future reductions in mortality rates. This is a higher allowance for future improvements than was made in the 2010 Valuation.

The combined effect of the above changes from the 2010 Valuation approach is to deduct around one year of life expectancy on average. The approach taken is considered reasonable in light of the long term nature of the Pension Fund and the assumed level of security underpinning members’ benefits.

**e) General**

The same financial assumptions are adopted for all employers, in deriving the past service deficit and the future service rate: as described in Sections 3.5 to 3.10 and Section 5, these calculated figures are translated in different ways into employer contributions, depending on the employer’s circumstances.

The demographic assumptions, in particular the life expectancy assumption, vary by type of member and so reflect the different membership profiles of employers.

## Appendix C: Key Risks and Controls

### C1 Types of risk

The Administering Authority has an active risk management programme in place. Key risks are incorporated in the Pension Fund's Risk Register and this is monitored on an ongoing basis and performance is reported to the Pensions Committee on a quarterly basis.

Risk	Summary of Control Mechanisms
<b>The Pension Fund Investment Strategy does not deliver the long term projected investments returns and/or does not comply with legislation</b>	Ensure the strategy complies with the Local Government Pension Scheme regulations, Statement of Investment Principles and Investment Management Agreements.
	Set the Investment Strategy in light of the risk and return objectives of the Pension Fund and review at regular intervals to ensure the Strategy is still appropriate
	Diversify investment across asset classes and markets to reduce the impact of financial market volatility including setting a limit for the proportion of the Pension Fund's assets held in illiquid asset classes such as private equity and property.
	Monitor and provide a quarterly report to the Pensions Committee on Investment Managers' performance against benchmark.
	Monitor Investment Managers' compliance with the investment restrictions and limits laid out in the Pension Fund's Statement of Investment Principles and Investment Managers' Agreements and report any cases of non-compliance
<b>The funding level of the Pension Fund deteriorates</b>	Set investment out-performance targets at the triennial valuation with reference to the Pension Fund's current Investment Strategy and on a relatively prudent basis to reduce the risk of under-performance against anticipated returns. At the same time, review and agree the other actuarial assumptions such as salary increases, discount rates, longevity etc.
	Provide the Pensions Committee with quarterly actuarial reports that monitor the funding position of the Pension Fund and the sensitivity of this to changes in general market conditions.
	Undertake annual data validation checks to identify any discrepancies or errors in the data with the Pension Fund's third party pension's administration service.
	Monitor and ensure scheme employers pay the extra capital/strain cost of non ill-health retirements following each individual decision and in the year the decision is made.
	Monitor each scheme employer's ill-health experience on an ongoing basis against the "ill health budget" set for each employer at the triennial valuation and require them to make additional contributions to the Pension Fund where budgets are exceeded.
	Monitor cash flows at a whole Pension Fund level and an individual scheme employer level and certify cash deficit contributions for those with reducing payrolls as identified at the triennial valuation.
	At each triennial valuation, assign any liabilities relating to ceased transferee admission bodies to the original ceding scheme employer.
	Monitor the 'characteristics' and individual funding position of pool members to ensure pooling is still appropriate. Require members of the Schools or Parish and Town Councils Pools to sign a pooling agreement which sets certain conditions and requirements for scheme employers' participation in the pool.
	Set deficit recovery plans after taking into account the particular characteristics of each type of scheme employer and the future working lifetime of its employees. Use shorter deficit recovery periods for organisations with a limited "life" in the Pension Fund or without statutory tax raising powers.
	Monitor the covenant of scheme employers and review their ability to meet ongoing liabilities,

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Risk	Summary of Control Mechanisms
<b>Scheme employers default on meeting their obligations to the Pension Fund and LGPS</b>	Develop further data quality controls with the Pension Fund's third party pension's administration service to monitor membership data submitted by scheme employers to ensure it is accurate and up to date.
	Develop a risk evaluation approach to identify covenant risk, categorising scheme employers as low, medium or high. Establish a set of risk criteria and monitor scheme employers against this. Engage with scheme employers at an early stage to address funding issues.
	Monitor contributions to ensure that scheme employers are paying the correct employer contribution rate.
	Do not allow unsupported employers to be admitted to the Pension Fund. Require all community admission bodies and transferee admission bodies to obtain a bond or guarantor from a scheme employer. Revalue bonds every three years to ensure the risk cover is still appropriate.
	Carry out regular financial checks on participating scheme employers, especially non-tax raising bodies.
	Carry out an annual employer survey to identify any changes in funding stream for scheme employers.
	Pool the contributions for scheme employers with similar characteristics to allow sharing of risk amongst scheme employers.
	Carry out cessation valuations on a more prudent gilts basis to ensure the payment calculated when a scheme employer's liabilities are crystallised is sufficient to meet the future payment of benefits made by the Pension Fund.
<b>The Pension Fund and its third party providers do not comply with regulations, statute or procedure</b>	Review the Custodian's and Investment Managers' internal control reports to identify any concerns over controls and processes in place
	Ensure the Custodian undertakes monthly reconciliations with the Pension Fund's Investment Managers to ensure all assets are correctly accounted for and holdings are agreed.
	Require all large employers in the Pension Fund to provide an Annual Assurance Certification that payroll systems are compliant and have been tested by the scheme employers' internal auditors
	Engage internal and external audit reports to regularly test that appropriate controls are in place over the payment of benefits and expenses and collection of contributions and that they are working effectively. Implement any recommendations resulting from both these audits.
	Work in conjunction with the Strategic Procurement Group to ensure all procurements are carried out in accordance with HCC contract and EU regulations.
	Review the Pension Fund SORP in preparing the Statement of Accounts to ensure compliance and engage external audit to review the Pension Fund accounts each year.
	Manage performance of the Pension Fund's third party pension's administration service through a service level agreement and monitor against Key Performance Indicators.
	Work closely with the Pension Fund's third party pension's administration service to ensure it complies with current regulations and is alert to and can implement any changes to scheme benefits.
	Ensure the Pension Fund's third party pension's administration service has a robust programme in place to test controls on the membership benefit system and that they are fully compliant and up to date.

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**Appendix D: Glossary**

Actuarial assumptions/ Basis	The combined set of assumptions made by the Pension Fund Actuary, about the future, to calculate the value of liabilities. The main assumptions will relate to the discount rate, salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value.
Administering Authority	The County Council has a statutory responsibility for running the Pension Fund and is, in effect, the Pension Fund's "trustees" who are Members of Hertfordshire County Council.
Admission Bodies	Employers which voluntarily participate in the Pension Fund, so that their employees and ex-employees are Scheme members. There will be an admission agreement setting out the employer's obligations. For more details see Section 4.1.
Common contribution rate	The Pension Fund-wide future service rate plus past service adjustment. It should be noted that this will differ from the actual contributions payable by individual employers.
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Deficit	The shortfall between the assets value and the liabilities value. This relates to assets and liabilities built up to date, and ignores the future build-up of pension which, in effect, is assumed to be met by future contributions).
Deficit repair/ recovery period	The target length of time over which the current deficit is intended to be paid off. A shorter period will give rise to a higher annual past service adjustment (deficit repair contribution), and vice versa.
Designating Employer	Employers such as Town and Parish Councils that are able to participate in the Scheme via a resolution passed by their Board. These employers can designate which of their employees are eligible to join the Scheme.
Discount rate	The annual rate at which future assumed cashflows (in and out of the Pension Fund) are discounted to the present day. This is necessary to provide a liabilities value which is consistent with the present day value of the assets, to calculate the deficit. A lower discount rate gives a higher liabilities value, and vice versa. It is similarly used in the calculation of the future service rate and the common contribution rate.
Employer	An individual participating body in the Pension Fund, which employs (or used to employ) members of the Pension Fund. Normally the assets and liabilities values for each employer are individually tracked, together with its future service rate at each Valuation.
Funding level	The ratio of assets value to liabilities value: for further details see Section 3.3.
Future service rate	The actuarially calculated cost of each year's build-up of pension by the current active members, excluding members' contributions but including Pension Fund administrative expenses. This is calculated using a chosen set of actuarial assumptions.
Gilt	A UK Government bond, i.e. a promise by the Government to pay interest and capital according to the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Pension Fund, but their main use in funding is as an objective measure of solvency.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Pension Fund can consider the employer's covenant to be as strong as its guarantor's.
Outsourcing employer	An employer which has outsourced or transferred a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the Scheme benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the outsourcing employer. An outsourcing employer will usually be a Council or other scheduled body, including academies.
Liabilities	The actuarially calculated present value of all pension entitlements of all members of the Pension Fund, built up to date. This is compared with the present market value of Pension Fund's assets to derive the deficit. It is calculated on a chosen set of actuarial assumptions.

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Maturity	A general term to describe a Pension Fund (or an employer's position within a Pension Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for Investment Strategy and, consequently, the Funding Strategy.
Members	The individuals who have built up (and may still be building up) entitlement in the Pension Fund. They are divided into actives (current employee members), deferred (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).
Past service adjustment	The part of the employer's annual contribution which relates to past service deficit repair.
Pooling	Employers may be grouped together for the purpose of calculating contribution rates. Their combined membership and asset shares are used to calculate a single contribution rate applicable to all employers in the pool. A pool may still require each individual employer to ultimately pay for its own share of deficit, or (if formally agreed) it may allow deficits to be passed from one employer to another. For further details of the Pension Fund's current pooling policy see Section 3.10.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's members, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs. their salary levels, etc. A membership (or liability) profile might be measured for its maturity also.
Rates and Adjustments Certificate	A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal Valuation. This is completed by the Actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Pension Fund for the three year period until the next valuation is completed. The Rates and Adjustments Certificate is appended to the formal Valuation Report issued following each Triennial Valuation.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Pension Fund. These include Councils, colleges, universities, academies, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).
Scheme	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. The LGPS Regulations also dictate eligibility (particularly for scheduled bodies), members' contribution rates, benefit calculations and certain governance requirements. The Scheme is divided into 101 Pension Funds throughout the UK. Each pension fund is autonomous to the extent not dictated by the LGPS Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Solvency	In a funding context, this usually refers to a 100% funding level, i.e. where the assets value equals the liabilities value.
Stabilisation	Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large, stable and long term employers in the Pension Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these.
Theoretical contribution rate	The employer's contribution rate, including both future service rate and past service adjustment, which would be calculated on the standard actuarial basis, before any allowance for stabilisation or other agreed adjustment.
Valuation	An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Pension Fund, and usually individual employers. This is normally carried out in full every three years, but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date.

## Glossary to the Annual Report and Accounts

Actuary	An independent qualified consultant who advises on the financial position of the Pension Fund. Every three years the Actuary reviews the assets and liabilities of the Pension Fund and produces the actuarial valuation which recommends the employer contribution rates.
Administering Authority	A local authority required to maintain a pension fund under the Local Government Pension Scheme regulations. Within the geographical boundary of Hertfordshire, the Administering Authority is Hertfordshire County Council.
Admission agreement	A contract between an administering authority, admitted body and if applicable, the outsourcing Scheme employer.
Augmentation	Additional membership awarded to a member by their employer, to a maximum of ten years.
Benchmark	A notional fund which is developed to provide a standard against which an Investment Manager's performance is measured.
Bonds	A certificate of debt issued by a company, government or other institution. A bondholder is a creditor of the issuer and usually receives interest at a fixed rate. Also referred to as fixed interest securities.
Career Average Revalued Earnings (CARE) scheme	<p>A scheme that are a type of defined benefit pension scheme where the benefits at retirement are based on average pensionable earnings and the length of membership of the scheme.</p> <p>From 1 April 2014, the Scheme moved from a final salary scheme to a career average revalued earnings (CARE) scheme details of which are accessible from the Pension Fund website at <a href="http://www.yourpension.org.uk/agencies/HCC/">www.yourpension.org.uk/agencies/HCC/</a>.</p>
Chief Finance Officer	An officer of that has delegated responsibility to manage the financial arrangements for an organisation. Hertfordshire County Council delegates these responsibilities to the post of the Director of Resources.
Communication Policy Statement	A statement of policy on communications with members and employers including the provision of information about the Scheme, the format, frequency and method of distributing such information and the promotion of the Scheme to prospective members.
Custody/Custodian	The safe-keeping of securities by a financial institution. The Custodian is responsible for maintaining investment records, the settlement of transactions, income collection, tax reclamation and other administrative actions in relation to the Pension Fund's investments.
Deferred members	Members who leave their employment or opt out of the Scheme and have their benefits deferred until retirement or until they request a transfer to another pension scheme.
Defined benefit final salary scheme	A pension scheme where the scheme rules define the benefits independently of the contributions paid by the members and employer. Members' benefits are a specified fraction of a scheme member's final pay.
Equities	Shares in UK and overseas companies.
Ex-officio	A member of a body (a board, committee, council, etc.) who is part of it by virtue of holding another office.
Final pensionable pay	The figure used to calculate a member's pension benefits and is normally a members pay in the last year before they retire. A member's benefits could also be calculated on one of the previous two years pay if that amount is higher, or the average of any three consecutive years in the last ten years if the member has had a downgrade in the last ten years or pay has been restricted in that period.
Fixed interest securities	Investments which guarantee a fixed rate of interest. The securities represent loans which are repayable at a future date but which can be traded on a recognised stock exchange until this time. Also known as bonds.
Forward foreign exchange contract	An agreement between two parties to exchange one currency for another at a forward or future date.
Funded scheme	A pension scheme that has available assets to cover all liabilities, including the obligation of future payments to retirees.
Funding Strategy Statement	A statement of the Pension Fund's strategy for meeting employers' pension liabilities.
Futures	Contracts to buy or sell specific quantities of a commodity or financial instrument at a specified price with delivery set at a specified time in the future.
Governance Policy and Compliance Statement	A statement of the governance arrangements of the Pension Fund including the delegation of responsibility, terms of reference, representation and compliance with statutory guidelines.

## Glossary to the Annual Report and Accounts

Hertfordshire Local Government Association	A voluntary organisation, acting on behalf of the local government sector in Hertfordshire.
Index linked	Bonds on which the interest and ultimate capital repayment are recalculated on the basis of changes in inflation.
Investment Consultant	A professionally qualified individual or company who provides objective, impartial investment advice to the Pension Fund.
Investment Manager	An organisation that specialises in the investment of a portfolio of securities on behalf of an organisation subject to the guidelines and directions of the investor.
Lien	A form of security interest granted over an asset to secure the payment of a debt or performance of some other obligation.
Mandate	A set of instructions given to an investment manager as to how a fund is to be managed. Targets for performance against a benchmark or limits on investing in certain stocks or sectors may be set. This is formalised within an investment manager agreement between a pension fund and investment manager.
Pooled investment vehicles	An investment which allows investors' money to be pooled and used by investment managers to buy a variety of securities, thereby giving investors a stake in a diversified portfolio of securities.
Private equity	An asset class consisting of equity securities in operating companies that are not publicly traded on a stock exchange.
Quoted securities	Shares with prices quoted on a recognised stock exchange.
Rates and Adjustments Certificate	A certificate issued by the Pension Fund Actuary setting out the contribution rates payable by participating employers
Scheme	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. The LGPS Regulations also dictate eligibility (particularly for scheduled bodies), members' contribution rates, benefit calculations and certain governance requirements. The Scheme is divided into 101 Pension Funds throughout the UK. Each pension fund is autonomous to the extent not dictated by the LGPS Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Scheme Administrator	An organisation responsible for the administration of the benefits of the Pension Fund, including the payment of benefits and maintenance of membership records. This is contracted to The London Pensions Fund Authority.
Spot market exchange rate	A spot exchange rate refers to the current exchange rate.
Statement of Investment Principles	A formal policy on how a pension fund will invest its assets including the types in investments to be held, the balance between different types of investments and risk.
Transfer values	A capital value transferred to or from a pension scheme in respect of a contributor's previous periods of pensionable employment.
Transferee admission bodies	An external body contracted to provide services or assets in connection with the exercise of a function of the local authority.
Unit Trust	A pooled fund in which investors can buy or sell units on an ongoing basis.
Unquoted securities	Shares which are dealt in the investment market but which are not listed on a recognised stock exchange.
VitaCurves	Bespoke analysis of the longevity of the Pension Fund's members.
Whole time equivalent salary	The pay a part-time member would receive if they worked full time.