



# Pension Fund

## Annual Report and Accounts For the year ended 31<sup>st</sup> March 2009

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# Annual Report

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Welcome to the Annual Report and Accounts for the Durham County Council Pension Fund for the financial year ended 31<sup>st</sup> March 2009.

These are the key issues;

- Contributing members increased by 0.28% to 19,303
- Market value of the Fund's assets decreased from £1,428m to £1,245m (12.8%)

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

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

**Stuart D Crowe, C.P.F.A.**  
***Corporate Director - Resources***

## MANAGEMENT STRUCTURE (AS AT 31<sup>ST</sup> MARCH 2009)

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<b>ADMINISTERING AUTHORITY:</b>	Durham County Council	County Hall, Durham DH1 5UE
<b>PENSION FUND COMMITTEE:</b>	Durham County Council Members:	Councillor Andrew Turner (Chairman) Councillor Nigel Martin (Vice Chairman) Councillor Colin Carr Councillor Jean Chaplow Councillor Amanda Hopgood Councillor John Lethbridge Councillor Peter May Councillor Dennis Morgan Councillor Reg Ord Councillor Robin Todd Councillor Brian Wilson
	Darlington Borough Council Members:	Councillor S J Harker Councillor I. G. Haszeldine
	District Council Members Nominated by the Durham County District Councils' Association:	Councillor D. Jackson (Durham City Council) Councillor P Ward (Easington District Council) Councillor G. K. Robinson (Teesdale District Council) Councillor V Perkins (Wear Valley District Council)
<b>COUNTY COUNCIL OFFICERS:</b>	G Garlick L. A. Davies, LLB  S. D. Crowe, CPFA	Chief Executive Acting Director of Corporate Services Corporate Director - Resources
<b>STAFF OBSERVERS:</b>	N. Hancock	UNISON GMB

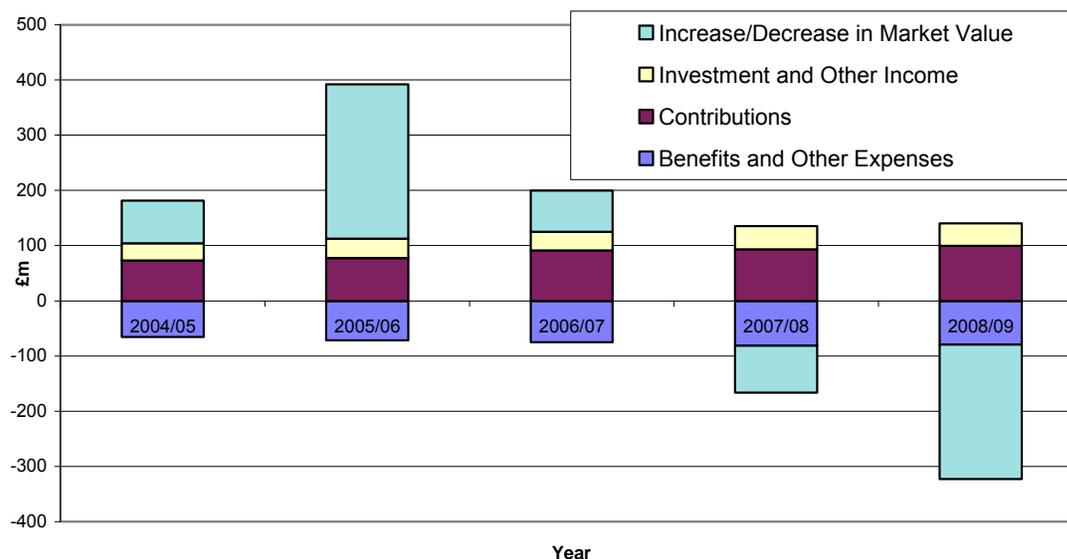
## MANAGEMENT STRUCTURE (AS AT 31<sup>ST</sup> MARCH 2009)

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<b>INVESTMENT MANAGERS:</b>	AllianceBernstein Limited	Mayfair Place, London
	Baring Asset Management	Bishopsgate, London.
	BlackRock Investment Management (UK) Limited	King William Street, London
	CB Richard Ellis Collective Investors Limited	North Row, London
	Edinburgh Partners Limited	Charlotte Square, Edinburgh
	Royal London Asset Management Limited	Gracechurch Street, London
<b>GLOBAL CUSTODIAN</b>	J P Morgan Europe Limited	Embankment, London
<b>INDEPENDENT ADVISERS:</b>	P. J. Williams	AllenbridgeEPIC, London.
	PSolve Asset Solutions	Jermyn Street, London
<b>ACTUARY TO THE FUND:</b>	Hewitts	40 Queen Square Bristol BS1 4QP
<b>AUDITORS TO THE FUND:</b>	Audit Commission	Nickalls House Metro Centre Gateshead, NE11 9NH

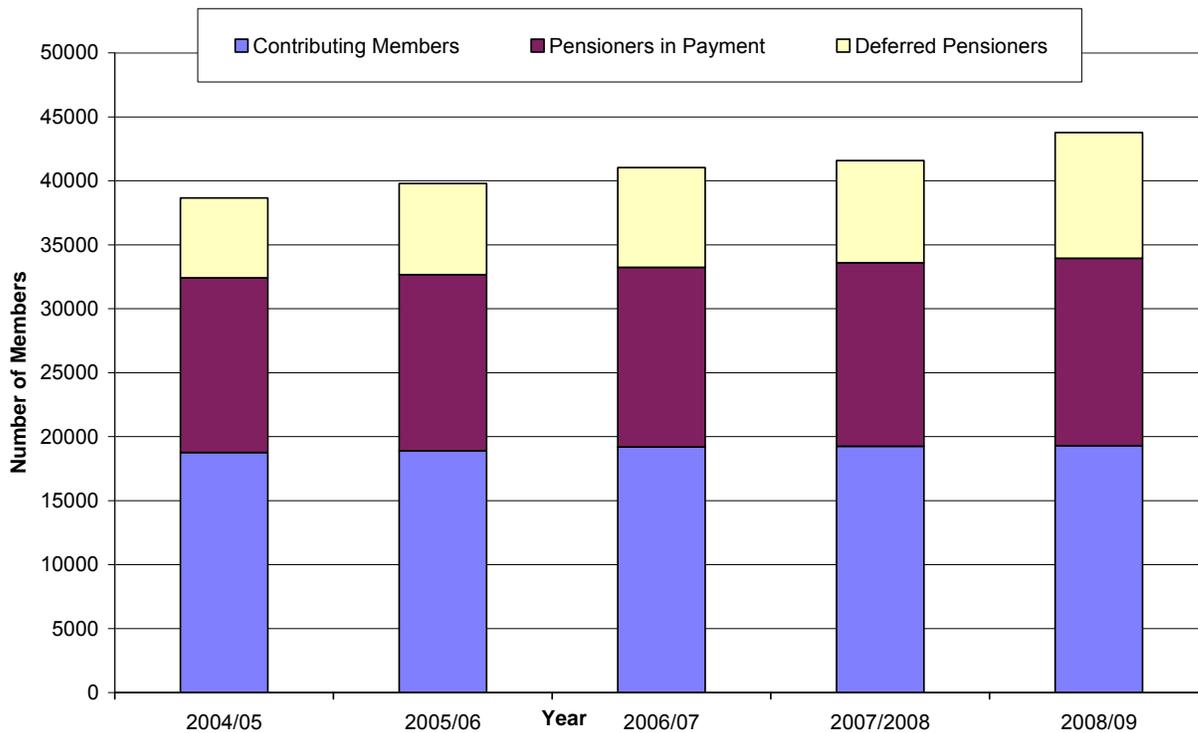
# FINANCIAL SUMMARY

(1)	2004/05 (2)	2005/06 (3)	2006/07 (4)	2007/08 (5)	2008/09 (6)
	£000	£000	£000	£000	£000
<b>INCOME</b>					
Contributions	72,995	77,419	91,705	93,439	99,608
Investment and other income	30,999	35,133	33,854	41,884	40,891
<b>TOTAL INCOME</b>	103,994	112,552	125,559	135,323	140,499
<b>LESS:</b>					
Benefits and other expenses	65,298	71,647	74,908	81,393	79,271
Net income (a)	38,696	40,905	50,651	53,930	61,228
<b>ADD:</b>					
Increase/decrease(-) in market value of investments (b)	77,614	279,513	74,823	-85,250	-243,712
Increase/decrease(-) in Fund during year (a + b)	116,310	320,418	125,474	-31,320	-182,484
Net assets at 31st March (Investments included at market value)	1,013,282	1,333,700	1,459,174	1,427,854	1,245,370



## MEMBERSHIP SUMMARY

(1)	<i>2004/05</i> (2)	<i>2005/06</i> (3)	<i>2006/07</i> (4)	<i>2007/08</i> (5)	<i>2008/09</i> (6)
Contributing Members	18,748	18,905	19,199	19,249	19,303
Pensioners in Payment	13,669	13,758	14,035	14,353	14,641
Pensioners Deferred	6,236	7,124	7,797	7,997	9,823



# MANAGEMENT REPORT

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## THE SCHEME

The Local Government Pension Scheme, a statutory scheme, is governed by the Local Government Pension Scheme Regulations 1997 and subsequent amendment regulations.

## MEMBERSHIP

The Durham County Council Pension Fund is administered by Durham County Council. It was established in 1974 to cover the future pension entitlement of all eligible employees of the County Council and District Councils. The Fund excludes provision for teachers, police officers and fire-fighters, for whom separate arrangements exist.

A number of other bodies also participate in the Scheme. These include Parish and Town Councils, Further Education Colleges and civilian staff from the Police and Fire Authorities. Admitted Bodies are those which, under the Regulations, are able to apply for membership of the Scheme. If the Fund Committee agree to the application, an Admission Agreement is drawn up admitting the body into the Scheme.

Those organisations with employees currently participating in the Scheme are shown in Appendix 1.

During 2008/09 the number of contributing members within the Scheme increased from 19,249 to 19,303 an increase of 0.28%.

In summary, the number of members contributing to the Scheme is:

<b>As at 31<sup>st</sup> March 2008</b>		<b>As at 31<sup>st</sup> March 2009</b>
9,906	Durham County Council	10,128
3,125	District Councils	2,775
2,826	Darlington Borough Council	2,742
203	Town/Parish Councils	195
118	Fire and Rescue Authority	137
923	Colleges	967
962	Police Authority	1,078
283	Probation Service	269
903	Others	1,012
19,249		19,303

The number of pensioners in receipt of payments from the Fund increased by 2.00% to 14,641.

A further analysis of these figures is shown in Appendix 2.

# MANAGEMENT REPORT

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## ADMINISTRATION OF THE SCHEME

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

The Pensions Division assists the Corporate Director - Resources in his statutory duty to ensure that the Pension Scheme remains solvent and is administered effectively adhering to the Local Government Pension Scheme Regulations in order to meet any current and future liabilities. The services provided include:

- Administration of the affairs of the Durham County Council Pension Scheme and also the provision of services in connection with the pensions of uniformed Police and Fire Officers and Teachers.

The division, which is split into two groups, provides a wide range of services including: -

- Calculation of pensions and lump sums and gratuities for retiring members of the Local Government Pension Scheme and provision of early retirement estimates.
- Administration of new starters in the Scheme.
- Calculation of service credit calculations, outgoing transfer value calculations and divorce estimates for the Local Government, Police and Fire Brigade Schemes.
- Collection of employee and employer contributions to be invested into the Local Government Pension Scheme.
- Maintenance of the database of pension scheme members and provision of annual benefit statements and deferred benefit statements
- Production of twice yearly newsletters for active and retired members.
- Calculation of deferred pensions and refunds for early leavers.
- Preparation of reports for the Pensions Committee dealing with benefits-related issues.
- Undertaking the annual pension increase exercise.

## MANAGEMENT REPORT

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- Calculation of widows and dependants benefits for retired and active members.
- Dealing with the administration of in-house AVCs supplied from Prudential and Standard Life.

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

- Preparation of the Pension Fund Accounts for inclusion in Durham County Council's Statement of Accounts
- Preparation of the Annual Report and Accounts of the Pension Fund
- Liaison with External and Internal Audit
- Day-to-day accounting for the Pension Fund
- Completion of statistical and financial returns for Government and other bodies
- Co-ordination of the production of FRS17 information for employers
- Preparation of Pension Fund Committee reports relating to investments and accounting issues
- Co-ordination of reports for Quarterly Pension Fund Committee meetings and the Pension Fund's Annual Meeting
- Liaison with Investment Managers, Advisers and Actuary
- Appointment of Investment Managers, Advisers and Actuary
- Monitoring and Review of Investment Managers, Advisers and Actuary
- Preparation of the Statement of Investment Principles and Funding Strategy Statement
- Allocation of Cash to Investment Managers
- Investment of Pension Fund surplus cash balances
- Calculation of interest on all Managers' cash held by the Pension Fund
- Reconciliation of all Managers' purchases, sales and dividends received

# MANAGEMENT REPORT

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## PERFORMANCE MONITORING

The Fund is also a member of the CIPFA Benchmarking club and measures its performance and costs against similar sized funds.

## POLICY STATEMENTS

The Local Government Pension Scheme (Amendment) (No. 2) Regulations 2005 [SI 2005/3199] require each administering authority in England and Wales, after consulting with such persons as they consider appropriate, to prepare, maintain and publish a governance policy statement setting out whether they delegate their function or part of their function in relation to the maintenance of the pension fund to a committee, sub-committee or an officer.

The Statement was produced in line with guidance from the CIPFA Pensions Panel and was circulated to all employers on 23<sup>rd</sup> March 2006. The Pension Fund's Governance Statement is attached at Appendix 3.

The Local Government Pension Scheme (Amendment) (No. 2) Regulations 2005 [SI 2005/3199] required each administering authority in England and Wales to prepare, maintain and publish a statement setting out their policy on communicating with members, members' representatives, prospective members and employers participating in the Fund. The statement must be revised and re-published following any material change to the pension fund's policy. The Communications Policy is attached at Appendix 4.

## HOW THE SCHEME WORKS

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

## MANAGEMENT REPORT

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An independent actuarial valuation of the Fund is carried out every three years to review the assets and liabilities of the Fund and to determine the rate of contributions which the employers must make to the Fund. The most recent valuation applicable to the period covered by the report was undertaken as at 31<sup>st</sup> March 2007 and a report of the actuary is provided on page 29.

From 1st April 2008 contributors to the scheme are required to pay between 5.5% and 7.5% of their pensionable wage or salary to the Fund. The rate they pay depends on which of seven different salary bands their whole-time equivalent pay falls into. Some individuals who were paying lower contributions before April 2008 paid at a rate of 5.25% during the year ending 31 March 2009, and will see their contribution rate gradually increase to the same level as other scheme members over the following two years. Employee contributions qualify for income tax relief. Since April 1988 a member may have additional voluntary contributions (AVC) deducted from pay (subject to certain limits) and paid into a personal fund.

Employees can invest their AVCs with any of the following companies:-

Standard Life  
Prudential or  
HECM (providing funds through Clerical Medical and Equitable Life) –  
closed for new investors.

Members who leave may transfer their accrued benefits to other approved schemes.

Members who leave with less than three months membership may alternatively take a refund of their contributions (less income tax and a payment to the State Second Pension).

New members may transfer benefits accrued with other schemes into the Fund.

The Local Government Pension Scheme is classified as a “*Final Salary Scheme*” which means that the annual pension and retirement grant are paid based on the period of membership and, usually, the final twelve months pay.

Details of the benefits payable from the Scheme to former employees are shown in Appendix 5.

## MANAGEMENT REPORT

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### PENSION INCREASES

Mandatory increases in pensions and deferred benefits are made in accordance with annual statutory Pension Increase (Review) Orders to help protect pensions against inflation. The pension increase effective from April each year is based on the Retail Price Index as at the previous September. The table below shows the pension increases over the last six years:

<i>Effective Date</i>	<i>Increase</i>
	%
12 <sup>th</sup> April 2004	2.8
11 <sup>th</sup> April 2005	3.1
10 <sup>th</sup> April 2006	2.7
9 <sup>th</sup> April 2007	3.9
7 <sup>th</sup> April 2008	3.9
6 <sup>th</sup> April 2009	5.0

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

### REVIEW OF LEGISLATION ETC.

This was the first year that the 'new-look' Local Government Pension Scheme (LGPS) had been in place. The LGPS now provides a pension of 1/60th of final salary for each year of membership from 1<sup>st</sup> April 2008 onwards and no automatic separate lump sum. This compares with benefits under the 'old' LGPS which are a pension of 1/80th final pay and a separate lump sum of 3/80th final pay for each year of pensionable service before 1<sup>st</sup> April 2008.

During the year four separate sets of amending regulations were issued that made minor changes to the regulations governing the Local Government Pension Scheme (LGPS). One significant change was the introduction of an additional level of ill-health pension. There are now three tiers of ill-health retirement pension benefit, depending on whether the employing authority determines that the member is permanently disabled from obtaining gainful employment, is likely to be able to obtain gainful employment at some stage before his normal retirement age (but not within three years), or is likely to obtain such employment within three years of leaving his local government employment. The employing authority is required to obtain a certificate from a specialist occupational health medical practitioner before making a determination.

## MANAGEMENT REPORT

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Communities and Local Government (CLG) has continued to consult on other possible changes to the LGPS and it is possible that the 'new-look' LGPS may be subject to change again in the near future.

# INVESTMENTS

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## INTRODUCTION

The County Council, as Administering Authority is responsible for the investments of the Pension Fund, this responsibility is delegated to the Corporate Director - Resources. The Pension Fund Committee meets quarterly to review investment performance taking advice from the Corporate Director - Resources and investment advisors. In addition, an Annual Meeting considers the full-year performance of the Pension Fund's investments. The Committee also reviews the performance of the investment managers.

## INVESTMENT POWERS AND DUTIES

The principal powers to invest are contained within the Local Government Pension Scheme Regulations 1997 which permit a wide range of investments, including equities, fixed interest and other bonds, and property, in the UK and overseas markets.

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

## INVESTMENT MANAGEMENT

During 2008/09 the Durham County Council Fund's investments were managed by six specialist external investment managers as set out in the following table.

<b><i>Investment Manager</i></b>	<b><i>%</i></b>	<b><i>Asset Classes</i></b>	<b><i>Investment Style</i></b>
Edinburgh Partners	28	Global Equities	Active
BlackRock	20	UK Equities	Active
AllianceBernstein	16	Global Bonds	Active
RLAM	20	Investment grade sterling bonds	Active
CBRE	8	Global Property	Active
Barings	8	Dynamic Asset Allocation – All major asset classes with derivative overlay	Active

# INVESTMENTS

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## **STATEMENT OF INVESTMENT PRINCIPLES**

With effect from 4<sup>th</sup> January 2000 there is a statutory requirement for administering authorities to prepare and maintain a Statement of Investment Principles. This is a document which provides details of the principles that govern a pension fund's decision about investment. The most recent statement for the Durham Fund was presented to the Fund Committee on 28<sup>th</sup> July 2008 and this meets statutory requirements. A copy of the Statement of Investment Principles is included as Appendix 6. On 16<sup>th</sup> March 2009, the Pension Fund Committee authorised the Corporate Director – Resources to make suitable amendments to the Investment Managers' Agreements and to make consequential changes to the Statement of Investment Principles. However, it is intended to undertake a more thorough review of the Statement of Investment Principles during 2009/10.

## **FUNDING STRATEGY STATEMENT**

The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 provide the statutory framework from which administering authorities are required to prepare a Funding Strategy Statement (FSS). It was approved by Pension Fund Committee on 31<sup>st</sup> January 2005 and is being reviewed at the same time as the Statement of investment Principles.

The FSS provides a means of managing ongoing employers' pension costs and the decision processes of administering authorities. It raises the level of transparency and accountability, and provides a helpful context for adopting higher levels of communication with scheme employers. A copy of the FSS is included at Appendix 7.

## INVESTMENTS

### INVESTMENT MONITORING AND PERFORMANCE STATISTICS

The performance of the investment managers is monitored and reported to the Pension Fund Committee on a quarterly basis, with an Annual Meeting to consider the full-year's performance. At the quarterly meetings of the Committee, the investments are reviewed and advice is given by independent advisers. The Managers submit reports to the meetings giving detailed information on transactions, views on the economy and investment strategy, including any proposed changes in asset allocation, and a valuation of the investments and cash under management as at the end of the quarter.

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

For the year ended 31<sup>st</sup> March 2009, the following tables show the performance of the Fund compared to the Fund's specific benchmark adopted in February 2008.

	Performance (%)	
	2008/09	Since February 2008
<b>Total Plan</b>	-14.69	-14.29
Total Plan Benchmark	-8.72	-8.12
<i>Relative Performance</i>	-5.97	-6.18
<b>WMLA Average</b>	-19.9	

The figures show overall performance below target for the 12 month period. The sources and reasons for this are discussed below. It is worth noting that the Durham Fund's specific benchmark outperformed the WM Local Authority average over the 12 months. A general point can be made in respect of three of the mandates, Broad Bonds, Dynamic Asset Allocation and Global Property. In these cases the performance target is expressed as a margin over a cash return or retail price inflation. However, the assets in which the managers invest have characteristics quite different from the target and therefore short term performance is very likely to diverge significantly from the target.

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

## INVESTMENTS

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The first table shows the performance of the global equity portfolio, managed by Edinburgh Partners Asset Management (EPAM). After very good results in 2008, the March quarter was disappointing and the 12 months performance was roughly in line with target.

Currency GBP	Performance (%)	
	2008/09	Since February 2008
<b>Edinburgh Partners</b>	-18.38	-18.34
MSCI World Index (Gross) +3% pa	-18.18	-17.74
<i>Relative Performance</i>	-0.20	-0.60

EPAM believe that a number of companies now represent excellent value on a five year view (their standard investment horizon). In their own words: "Outstanding long-term opportunities are being created by these price falls, particularly in attractive areas like technology and emerging markets." At 31<sup>st</sup> March EPAM had 25% of the portfolio invested in technology stocks (compared with 11% 12 months previously).

The next table shows the performance of the UK equity portfolio, managed by BlackRock. BlackRock suffered very poor performance in the September quarter and recovered a little ground in the last quarter of 2008. The last quarter's performance was excellent and put them back on track for the 12 month period.

Currency GBP	Performance (%)	
	2008/09	Since February 2008
<b>BlackRock</b>	-27.54	-27.64
FTSE All Share (Gross) +3% pa	-27.16	-26.61
<i>Relative Performance</i>	-0.38	-1.04

With a demanding target to meet, BlackRock have to run a quite concentrated portfolio and single positions can have a large impact on performance. Significant positive contributors to performance in the March quarter were long positions in energy stocks and underweight or zero positions in banks.

## INVESTMENTS

The next table shows the performance of the global bonds portfolio, managed by AllianceBernstein. It is important to note that the objective for this portfolio, and therefore its composition, is quite different from the matching bonds portfolio and this is reflected in the benchmark index.

Currency GBP	Performance (%)	
	2008/09	Since February 2008
<b>Alliance Bernstein</b>	-13.47	-12.39
GBP Libor +3% pa	7.71	7.82
<i>Relative Performance</i>	-21.18	-20.21

The reason for AllianceBernstein's underperformance is due to increased exposure to credit risk after yield spreads rose, but far more damage has since been suffered by the credit markets. Markets are now discounting default rates far higher than anything that has been experienced in the past.

The Barclays Global Aggregate of investment grade bonds (hedged to sterling) returned -0.3% over the March quarter and +4.5% over 12 months. So a typical global bond portfolio has underperformed the target return by over 3% over the 12 month period. The recovery in markets in April has led to an improvement in performance. The AllianceBernstein portfolio returned +5.5% in the month of April alone.

The next table shows the performance of the liability matching bonds portfolio, managed by Royal London Asset Management (RLAM).

Currency GBP	Performance (%)	
	2008/09	Since February 2008
<b>Royal London</b>	-1.80	0.20
FTSE index Linked >5 years +0.5% pa	-2.33	-0.36
<i>Relative Performance</i>	0.53	0.56

## INVESTMENTS

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RLAM's performance has benefited from holding fixed coupon gilts and index-linked bonds in Japan and the US versus the UK index-linked benchmark. This has enabled the manager to meet the out-performance target and exceed it over 12 months. This is the lowest risk element, relative to liabilities, of the Pension Fund's strategy and is so far delivering what is required of it.

The next table shows the performance of the Dynamic Asset Allocation portfolio, managed by Baring Asset Management (BAM). This is a very broad mandate, giving the manager freedom to seek value across asset categories, currencies and commodities. Against the market background the Pension Fund's assets have suffered over the last year, the results were disappointing, but not disastrous.

Currency GBP	Performance (%)	
	2008/09	Since February 2008
<b>Barings</b>	-6.22	-7.22
GBP Libor +4% pa	8.75	8.87
<i>Relative Performance</i>	-14.97	-16.09

BAM concede that during the year they missed, in particular, the opportunity to add value through holding non-sterling government bonds. This was because they had failed to anticipate the sharp deterioration in sterling. (The best performing bonds were Japanese Government index-linked securities).

In the later part of the year BAM have added to their risk positions. This caused negative performance in the short term, but BAM firmly believe that the assets they have added represent good long term value. The negative performance in the last quarter was mitigated by exposure to gold bullion and gold mining shares. Bullion, in particular, was a good diversifier, rising strongly in January and February when equities were at their weakest.

The delivery of this mandate, in particular, needs to be judged over at least a full market cycle, rather than any shorter period. BAM have, to a degree, preserved capital during a severe market downturn. BAM were selected for their record in making good asset allocation decisions and, despite the negative performance so far, the evidence is that their skills are still capable of adding value over the long term.

## INVESTMENTS

The final table below shows the performance of the global real estate portfolio managed by CB Richard Ellis Investors (CBRE). The mandate is divided into two portfolios, because CBRE were asked to assume responsibility for illiquid property pooled vehicles which had formed part of the previous balanced managers' portfolios. These are referred to in the table as "Legacy holdings".

Currency GBP	Performance (%)	
	2008/09	Since February 2008
<b>CBRE</b>	-20.14	-21.24
Headline RPI +5% pa	4.61	4.95
<i>Relative Performance</i>	-24.74	-26.19
<b>CBRE – Legacy Holdings</b>	-42.64	-41.11
Headline RPI +5% pa	4.61	4.95
<i>Relative Performance</i>	-47.25	-46.06

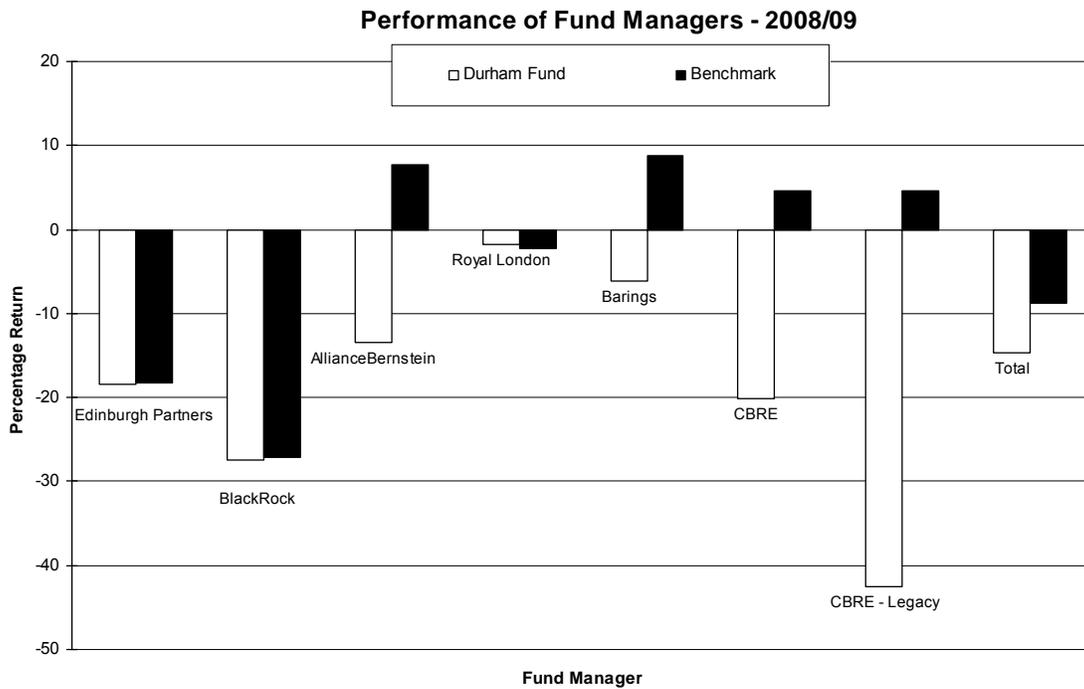
This has been and continues to be a very difficult climate for real estate investment and CBRE have made only limited commitments to new investment so far. It can be seen from the very large fall in value of the legacy holdings that the UK market is in disarray. There is an element of market breakdown here, similar to that seen in the non-government bond markets. There is both threat and opportunity here. Some properties have suffered permanent impairment of value, especially where tenant covenant is poor; but there are opportunities to acquire assets, some with potential for improvement, at bargain prices.

Part of the problem with real estate, as with many other areas of investment, has been the prevalence of high levels of gearing in which the banks were all too ready to collaborate when times were good. As values have fallen and loan covenants have been breached some owners have been forced to sell. However, banks are coming to realise that they do not, ultimately, want to enforce provisions which result in them owning the assets, a role which they are not equipped to fulfil adequately. So there are more flexible work-outs being developed which give owners breathing space to find new financing.

CBRE are finding attractive opportunities in some of the markets which have adjusted most quickly to reality. The re-capitalisations being seen in the listed sector will put the financing of these assets on a sounder footing. The unlisted sector is moving at a less vigorous pace and experience is more patchy, but 2009 looks like being the year of "repair".

# INVESTMENTS

## TOTAL PLAN PERFORMANCE RETURNS AS AT 31<sup>ST</sup> MARCH 2009

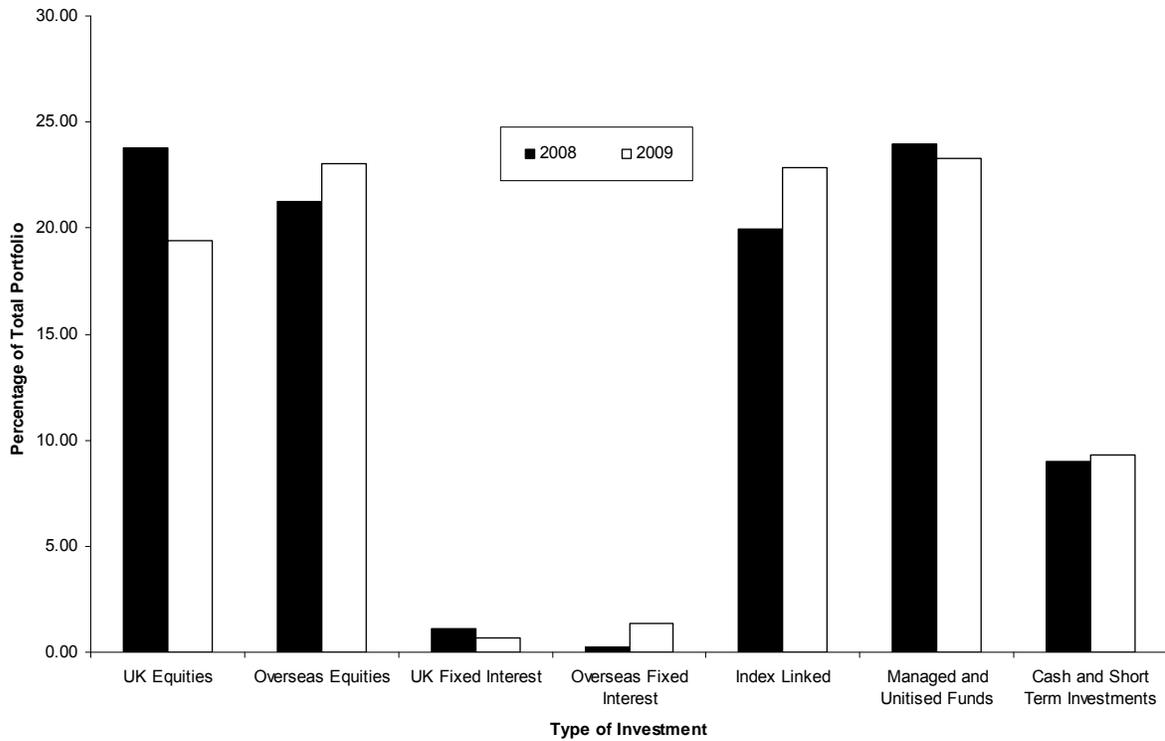


Currency GBP	Performance (%)	
	2008/09	Since February 2008
<b>Total Plan</b>	-14.69	-14.29
Total Plan Benchmark	-8.72	-8.12
<i>Relative Performance</i>	-5.97	-6.18

# INVESTMENTS

## DISTRIBUTION OF INVESTMENTS

The following graph shows the distribution of Fund investments (by market value) at the beginning and end of the year. Further details of the distribution are shown in Appendix 8.

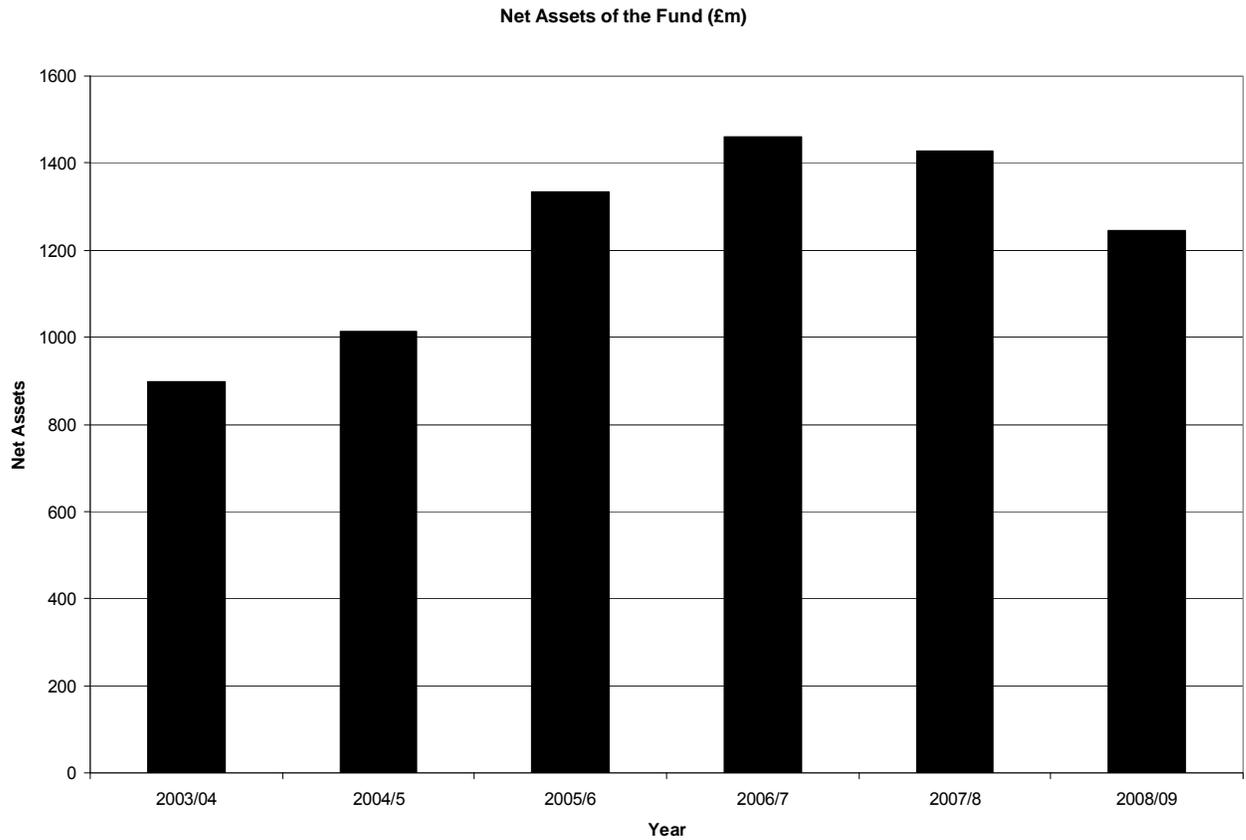


# INVESTMENTS

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## NET ASSETS OF THE FUND

Net Assets are defined as Investments, current assets less current liabilities  
The graph below shows how the net assets of the Fund have changed over the last six years:



# ACTUARIAL VALUATION - STATEMENT OF THE ACTUARY FOR THE YEAR ENDED 31<sup>ST</sup> MARCH 2009

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## INTRODUCTION

The Scheme Regulations require that a full actuarial valuation is carried out every third year. The purpose of this is to establish that the Durham County Council Pension Fund (the Fund) is able to meet its liabilities to past and present contributors and to review employer contribution rates. The last full actuarial investigation into the financial position of the Fund was completed as at 31 March 2007, in accordance with Regulation 77(1) of the Local Government Pension Scheme Regulations 1997.

## ACTUARIAL POSITION

1. Rates of contributions paid by the participating Employers during 2008/09 were based on the actuarial valuation carried out as at 31 March 2007.
2. The valuation as at 31 March 2007 showed that the funding ratio of the Fund had improved since the previous valuation with the market value of the Fund's assets at that date (of £1,459.2M) covering 79% of the liabilities allowing, in the case of current contributors to the Fund, for future increases in pensionable remuneration. The main reasons for the improvement in the funding ratio since 31 March 2004 were higher than expected investment returns on the Fund's assets, along with additional employer contributions paid to reduce the deficit revealed at the 2004 valuation. These had been partially offset by the impact of changes in the actuarial assumptions used to reflect higher price inflation expectations and longevity improvements.
3. The valuation also showed that the required level of contributions to be paid to the Fund by participating Employers (in aggregate) with effect from 1 April 2008 was as set out below:
  - 13.9% of pensionable pay to meet the liabilities arising in respect of service after the valuation date.

### Plus

- 6.3% of pensionable pay to restore the assets to 100% of the liabilities in respect of service prior to the valuation date, over a recovery period of 19 years from 1 April 2008.

These figures are based on the Regulations in force, or enacted by Parliament and due to come into force, at the time of signing the valuation report and, in particular, allowed for the following changes to the Fund benefits since the previous valuation:

## ACTUARIAL VALUATION - STATEMENT OF THE ACTUARY FOR THE YEAR ENDED 31<sup>ST</sup> MARCH 2009

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- The Rule of 85 retirement provisions were reinstated, and subsequently removed again. Transitional protections for some categories of member were extended to widen their coverage.
  - Changes were made consistent with the Finance Act 2004.
  - A new scheme has been put in place which comes into effect as at 1 April 2008. All existing members will transfer to the new scheme as at that date.
4. The majority of Employers participating in the Fund pay different rates of contributions depending on their past experience, their current staff profile, and the recovery period agreed with the Administering Authority.

The rates of contributions payable by each participating Employer over the period 1 April 2008 to 31 March 2011 are set out in a certificate dated 28 March 2008 which is appended to our report of the same date on the actuarial valuation.

Contribution rates will be reviewed at the next actuarial valuation which is due to be carried out as at 31 March 2010.

5. The contribution rates were calculated using the projected unit actuarial method and taking account of the Fund's funding strategy as described in the Funding Strategy Statement.
6. The main actuarial assumptions were as follows:

### Discount rate for periods

In service	
Admitted Bodies	6.2% a year
Scheduled Bodies	6.2% a year
Left service	
Admitted Bodies:	5.2% a year
Scheduled Bodies:	6.2% a year
Rate of general pay increases	4.7% a year
Rate of increases to pensions in payment	3.2% a year
Valuation of assets	market value

## **ACTUARIAL VALUATION - STATEMENT OF THE ACTUARY FOR THE YEAR ENDED 31<sup>ST</sup> MARCH 2009**

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7. This statement has been prepared by the Actuary to the Fund, Hewitt Associates Limited (previously Hewitt Bacon & Woodrow Limited), for inclusion in the accounts of Durham County Council. It provides a summary of the results of the actuarial valuation which was carried out as at 31 March 2007. The valuation provides a snapshot of the funding position at the valuation date and is used to assess the future level of contributions required.

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

Hewitt Associates Limited does not accept any responsibility or liability to any party other than our client, Durham County Council, in respect of this statement.

**Hewitt Associates Limited**  
**June 2009**



# Pension Fund Accounts

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## PENSION FUND ACCOUNTS

### PENSION FUND ACCOUNT

31st March 2008			31st March 2009	
£000	£000		£000	£000
<b>CONTRIBUTIONS AND BENEFITS</b>				
93,439		Contributions receivable (see note 12)	99,608	
<u>8,947</u>		Transfers in	<u>8,463</u>	
	102,386			108,071
72,810		Benefits payable (see note 13)	73,359	
5,200		Payments to and on account of leavers (see note 14)	7,168	
<u>1,276</u>		Administration expenses (see note 11)	<u>1,077</u>	
	79,286			81,604
	<u>23,100</u>	<b>Net additions or withdrawals (-) from dealings with members</b>		<u>26,467</u>
<b>RETURN ON INVESTMENTS</b>				
32,937		Investment income (see note 15)	37,942	
-85,250		Change in market value of investments (see note 5)	-243,712	
<u>-2,107</u>		Investment management fees (see note 10)	<u>-3,181</u>	
	<u>-54,420</u>	<b>Net returns on investments</b>		<u>-208,951</u>
		<b>-31,320 NET INCREASE / DECREASE (-) IN THE FUND DURING THE YEAR</b>		<u>-182,484</u>
		<b>1,459,174 NET ASSETS OF THE FUND AT 1ST APRIL</b>		<u>1,427,854</u>
		<b>1,427,854 NET ASSETS OF THE FUND AT 31ST MARCH</b>		<u>1,245,370</u>

### NET ASSETS STATEMENT

As at 31st March 2008			As at 31st March 2009	
£000	£000		£000	£000
<b>Investments (see note 5)</b>				
19,560		Fixed interest securities	25,431	
642,607		Equities	529,019	
285,311		Index linked securities	284,293	
342,099		Managed and unitised funds	289,903	
128,294		Cash and short term investments	115,510	
	1,417,871			1,244,156
<b>Current assets and liabilities (see note 9)</b>				
7,311		Investment related	1,724	
<u>2,672</u>		Other	<u>-510</u>	
	9,983			1,214
		<b>1,427,854 NET ASSETS OF THE FUND AT 31ST MARCH</b>		<u>1,245,370</u>

# NOTES TO THE PENSION FUND ACCOUNTS

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## 1. FUND OPERATION AND MEMBERSHIP

Durham County Council is the Administering Authority for the Durham County Council Pension Fund. The County Council administers the Scheme on behalf of 70 contributing employers including District, Parish and Town Councils, Statutory Bodies and Colleges. These include:

### **Local Authorities -**

Durham County Council  
Darlington Borough Council  
Chester-le-Street District Council  
Derwentside District Council

Durham City Council  
District of Easington  
Sedgefield Borough Council  
Teesdale District Council  
Wear Valley District Council

### **Parish Councils -**

Brandon and Byshottles  
Chilton  
Easington Colliery  
Easington Village  
Esh  
Fishburn  
Framwellgate Moor  
Horden  
Hutton Henry  
Monk Hesleden  
Murton  
North Lodge  
Shotton  
South Hetton  
Thornley  
Trimdon  
Wheatley Hill  
Wingate

### **Town Councils -**

Ferryhill  
Great Aycliffe  
Peterlee  
Seaham  
Sedgefield  
Shildon  
Spennymoor  
Stanley

### **Statutory Bodies -**

Durham Police Authority  
Valuation Tribunal Service  
Central Durham Joint Crematorium Committee  
County Durham and Darlington Fire and Rescue Authority  
National Probation Service County Durham  
East Durham Homes  
Dale and Valley Homes  
Eastbourne Academy  
North East Fire Control Company

### **Colleges -**

Bishop Auckland College  
Darlington College  
Queen Elizabeth Sixth Form College  
Derwentside College  
New College, Durham  
East Durham & Houghall Community College

### **Admitted Bodies -**

Barnard Castle School  
Leisureworks  
Derwentside Leisure Ltd  
Shildon & Darlington Training Ltd  
Bowes Museum  
Three Rivers Housing  
Murton Welfare Association  
Hobson Golf Club  
Peterlee Fire Company  
Mitie PFI Ltd  
Compass Group UK  
The Forge  
Teesdale Housing Association  
Mitie Cleaning  
Derwentside Homes  
Cestria Community Housing Association  
Mears Limited  
Kier Support Services Limited  
Sedgefield Borough Homes  
Taylor Shaw

## NOTES TO THE PENSION FUND ACCOUNTS

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Apart from teachers, who have their own unfunded arrangements, membership of the LGPS is open to all County Council employees. Membership is automatic for staff with a contract of employment of at least 3 months. Employees can opt not to join the Scheme. The County Council is not required to administer a Stakeholder Scheme, so employees have to make their own arrangements with an appropriate provider.

The Fund provides benefits for employees of the bodies listed above. On retirement, contributors receive payments of lump sums and annual pensions. Entitlement to these benefits arises mainly on the grounds of reaching retirement age and retirement through ill health, through early retirement schemes or being made redundant. Contributors who leave and who are not immediately entitled to these benefits may have their pension rights transferred or preserved until reaching retirement age. In a minority of cases refunds of contributions can be made.

In 2008/09, the number of pensionable employees in the Fund was 19,303 (19,249 in 2007/08), and the number of pensioners was 14,641 (14,353 in 2007/08).

Contributions represent the total amounts receivable from employing authorities in respect of their own contributions which are at a rate determined by the Fund's Actuary and those made by pensionable employees which are set by statute. The benefits and contributions are analysed as follows:

2007/08			2008/09	
Benefits £000	Contributions £000		Benefits £000	Contributions £000
35,847	43,032	Administering Authority	32,814	45,982
36,498	48,481	Scheduled Bodies	39,305	47,626
465	1,926	Admitted Bodies	1,240	6,000
72,810	93,439		73,359	99,608

Further information about the Fund can be obtained from its separately published Annual Report, available from the Corporate Director - Resources, County Hall, Durham, DH1 5UE and is available on the County Council's website: [www.durham.gov.uk](http://www.durham.gov.uk).

# NOTES TO THE PENSION FUND ACCOUNTS

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## 2. STATEMENT OF ACCOUNTING POLICIES

### BASIS OF PREPARATION

The Pension Fund accounts have been prepared in accordance with the accounting recommendations of Financial Reports of Pension Schemes Section 2: A Statement of Recommended Practice. However, disclosures have been limited to those required by the Code of Practice on Local Authority Accounting in the United Kingdom 2008: A Statement of Recommended Practice.

The financial statements summarise the transactions and the net assets of the Fund. They do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial valuations of the Fund, which do take account of such obligations, are carried out every three years. The Actuary undertook a valuation during 2007/08, which determined the contribution rates from 1<sup>st</sup> April 2008 to 31<sup>st</sup> March 2011. The previous valuation was undertaken as at 31<sup>st</sup> March 2004, and set contribution rates from 1<sup>st</sup> April 2005 to 31<sup>st</sup> March 2008. Details of the latest valuation are included in Note 3.

The following principal accounting policies, which have been applied consistently, have been adopted in the preparation of the financial statements:

### BASIS OF ACCOUNTING

The accounts have been prepared on the normal accruals basis of accounting.

Transfer values are the only exception to this; they have been prepared on a cash basis as the amount payable or receivable is not determined until payment is made and accepted by the recipient.

### INVESTMENTS

#### a) Valuation of investments –

Investments are shown at their market value, which has been determined as follows:

- Securities traded through the Stock Exchange Electronic Trading Service (SETS) are valued on the basis of the latest mid-market price. Other quoted investments are valued on the basis of the mid-market value quoted on the relevant stock market at 31<sup>st</sup> March.
- Unit Trusts and managed funds are valued at the average of the bid and offer prices provided by the relevant fund managers, which reflect the market value of the underlying investments.

## NOTES TO THE PENSION FUND ACCOUNTS

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- Overseas securities and cash are translated into sterling at the rate ruling at the Balance Sheet date.
- Fixed Interest Stocks have been included in the accounts at market value, which do include accrued interest.
- Unlisted securities are valued by the fund managers at the year-end in accordance with generally accepted guidelines.

### **b) Investment income -**

Income from equities is accounted for on the date stocks are quoted ex-dividend. Income from overseas investments is recorded net of any withholding tax where this cannot be recovered.

Income from fixed interest and index-linked securities, cash and short-term deposits is accounted for on an accruals basis.

Income from other investments is accounted for on an accruals basis.

Foreign income has been translated into sterling at the date of the transactions, when received during the year, or at the exchange rates applicable at 31<sup>st</sup> March where amounts were still outstanding at the year-end.

### **c) Investment transactions -**

Investment transactions arising up to 31<sup>st</sup> March but not settled until later are accrued in the accounts.

### **d) Investment Management Expenses -**

The fees relating to the managers are described in Note 10.

### **e) Acquisitions costs of investments -**

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

### **f) Interest on property development -**

The Fund holds no direct property investments; all property investment is made through Pooled Investment Vehicles.

## NOTES TO THE PENSION FUND ACCOUNTS

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### **g) Administrative expenses -**

A proportion of relevant officers' salaries have been charged to the Fund on the basis of actual time spent on investment and related matters and pension administration. Certain specific expenses have been charged directly to the Fund and other office expenses and related overheads have been charged to the Fund in proportion to the salaries charged.

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

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

### **3. ACTUARIAL POSITION OF THE FUND**

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

The latest valuation of the Fund was undertaken as at 31<sup>st</sup> March 2007, by the Pension Fund's actuary, Hewitt Associates Limited (formerly Hewitt Bacon and Woodrow Limited). Contribution rates were set for the period 1<sup>st</sup> April 2008 to 31<sup>st</sup> March 2011. The results disclosed a funding deficit of £382.1m and a funding ratio of 79%. This was the result of the market value of the fund's assets of £1,459.2m compared to a funding target of £1,841.3m.

The actuary has set contribution rates for all employers who contribute to the Fund to eliminate the funding deficit over an agreed period of time; the recovery period. The Administering Authority has agreed that the recovery period should be 19 years apart from those employers who are now closed to new entrants and those whose contract period ends at an earlier date. Nine of the 64 employers have recovery periods which are different to 19 years.

For some employers the contribution rate payable increases in 3 steps up to the rate required to finance the funding target over the recovery period. Different rates are payable by different employers.

The Projected Unit Method with a one year control period has been used for most employers to calculate the future service contribution rate. The Attained Age Method has been used for some employers who do not permit new employees to

## NOTES TO THE PENSION FUND ACCOUNTS

join the Fund. The actuary has taken into account the Pension Fund's funding strategy as described in the Funding Strategy Statement.

The valuation results are sensitive to the choice of financial assumptions. The table below shows the key financial assumptions used for the valuation:

	%
In Service Discount Rate:	
Scheduled Bodies	6.2
Admitted Bodies	6.2
Left Service Discount Rate:	
Scheduled Bodies	6.2
Admitted Bodies	5.2
Rate of Pay increases	4.7
Rate of Price Inflation	3.2
Rate of Pension Increases:	
On benefits in excess of guaranteed minimum pension (GMP)	3.2
on post 5 <sup>th</sup> April 1988 GMP's	2.7
Rate of deferred pension increases	3.2
Rate of GMP increases in deferment	4.7

The shortfall relative to the funding target will be removed through payment of additional contributions, expressed as a percentage of pay, by employers over a range of different recovery periods. The majority of employers in the Fund will pay contributions over a recovery period of 19 years from 1<sup>st</sup> April 2008. The overall contribution rate applicable from 1<sup>st</sup> April 2008 to 31<sup>st</sup> March 2011 is 20.2% of pensionable pay. This consists of 13.9%, which is the long-term rate, the rate of contribution that would be appropriate if the Fund had no shortfall, and 6.3%, the rate of contribution which will recover the shortfall over 19 years.

The overall contribution rate applicable from 1<sup>st</sup> April 2008 to 31<sup>st</sup> March 2011 can be summarised as follows:

	% Pensionable Pay
Long-term rate	13.9
Deficit funding (19 years from 1 <sup>st</sup> April 2008)	6.3
<b>Overall Contribution rate</b>	<b>20.2</b>

#### 4. VALUATION OF INVESTMENTS

The Pension Fund has six investment managers: Edinburgh Partners Limited ('Edinburgh Partners'), BlackRock Investment Management (UK) Limited ('BlackRock'), AllianceBernstein Limited ('AllianceBernstein'), Royal London Asset Management ('RLAM'), CB Richard Ellis Collective Investors Limited ('CBRE') and Baring Asset Management Limited ('Barings') to manage its assets.

## NOTES TO THE PENSION FUND ACCOUNTS

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

Investment Manager	%	Asset Classes	Investment Style
Edinburgh Partners	28	Global Equities	Active
BlackRock	20	UK Equities	Active
AllianceBernstein	16	Global Bonds	Active
RLAM	20	Investment grade sterling bonds	Active
CBRE	8	Global Property	Active
Barings	8	Dynamic Asset Allocation – All major asset classes with derivative overlay	Active

The market values of investments in the hands of each manager were as follows:

At 31st March 2008			At 31st March 2009	
£000	%		£000	%
363,220	28.16	Edinburgh Partners	319,548	28.28
263,774	20.45	Blackrock	191,487	16.95
221,296	17.16	Alliance Bernstein	191,498	16.95
288,098	22.34	RLAM	281,618	24.93
59,275	4.60	CBRE	47,576	4.21
93,436	7.25	Baring Asset Management	97,193	8.6
2	0.00	Morley - Residual	-	0
-	0.00	DCC - Residual	906	0.08
477	0.04	<b>Managed in-house</b>	-	0
<b>1,289,578</b>	<b>100.00</b>		<b>1,129,826</b>	<b>100.00</b>

### 5. ANALYSIS OF INVESTMENTS

Value at 31/3/08	Purchases at cost	Sales proceeds	Change in market value	Value at 31/03/09
£000	£000	£000	£000	£000
1,417,871	1,089,743	-1,019,746	-243,712	1,244,156

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

## NOTES TO THE PENSION FUND ACCOUNTS

31/03/2008 £000	31/03/2009 £000
<b>Fixed interest securities</b>	
13,406 UK - Government	13
2,388 UK - other	8,322
3,766 Overseas - Government	10,151
Overseas - other	6,945
<b>19,560</b>	<b>25,431</b>
<b>Equities</b>	
338,891 UK quoted	241,439
477 UK unquoted	544
303,239 Overseas quoted	287,036
<b>642,607</b>	<b>529,019</b>
<b>Index linked securities</b>	
285,311 UK quoted	284,293
<b>285,311</b>	<b>284,293</b>
<b>Managed and unitised funds</b>	
221,298 Managed funds - non property - UK	191,498
1,890 Managed funds - non property - Overseas	49,043
55,005 Unit Trusts - non property - UK	-
63,906 Unit Trusts - property	49,362
<b>342,099</b>	<b>289,903</b>
<b>Cash and Short Term Investments</b>	
484 Loans - long term - local authorities	471
71,144 Loans - short term - money market	95,035
56,666 Managers' Cash	23,897
- Cash in Hand	-3,893
<b>128,294</b>	<b>115,510</b>

### 6. CURRENCY HEDGING

All investment managers have agreement subject to prior consultation with the Corporate Director - Resources to enter into foreign exchange contracts in order to hedge against inflation in foreign currencies.

## NOTES TO THE PENSION FUND ACCOUNTS

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### 7. TAXATION

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

- United Kingdom Tax

The Fund is an exempt approved Fund under the Finance Act 1970 and is therefore not liable to UK income tax on interest, dividends and property income, or to capital gains tax.

- Value Added Tax

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

- Foreign Withholding Tax

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

### 8. CAPITAL COMMITMENTS

At present the Pension Fund has invested £425,000 in Capital North East, but has entered into a commitment to invest up to £500,000 in this organisation, which provides start-up and development capital for businesses in the North East.

## NOTES TO THE PENSION FUND ACCOUNTS

### 9. CURRENT ASSETS AND LIABILITIES

2007/08 £000	2008/09 £000
<b>Investment related</b>	
267 Investment Transactions	-4,273
6,975 Dividend Accruals	5,329
69 Recoverable Taxation	668
<b>7,311</b>	<b>1,724</b>
<b>Other</b>	
8,551 Contributions	8,392
-2 Transfer values	-
-737 Refunds and pensions	-163
-2,262 Administration expenses	-2,069
- Other	-677
-2,896 DCC	-5,622
- HMRC	-346
18 Fire Authority	-25
<b>2,672</b>	<b>-510</b>
<b>9,983 Total Current Assets and Liabilities</b>	<b>1,214</b>

### 10. INVESTMENT MANAGEMENT FEES

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

The new managers were allocated their assets for management on 11<sup>th</sup> February 2008. This increased the fees payable by the Pension Fund for the management of the assets only in the last quarter of 2007/08. The full year impact of the higher fees payable reflect the more challenging performance targets that have been given to the investment managers.

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

## NOTES TO THE PENSION FUND ACCOUNTS

2007/08 £000	2008/09 £000
1,971 Administration, management and custody	3,124
136 Other advisory fees	57
<b><u>2,107</u></b>	<b><u>3,181</u></b>

### 11. ADMINISTRATION EXPENSES

2007/08 £000	2008/09 £000
1,020 Recharge from Durham County Council	963
66 CLASS - CPX	62
2 FRS17	2
26 Actuarial consultancy fees - Triennial valuation	-
16 Audit fees	40
2 Subscriptions	8
5 FIDS and Manninen Claim	10
135 Consultancy Fees - Actuarial Services	127
90 Legal Services	2
4 Euraplan	27
6 Publications	-
Receipts -	
-22 costs received on pensions increase	-27
-74 consultancy fees recharged	-137
<b><u>1,276</u></b>	<b><u>1,077</u></b>

Regulations permit local authorities to charge scheme administration to the Fund. A proportion of relevant officers' salaries have therefore been charged to the Fund on the basis of actual time spent on investment and related matters and pension administration. Certain specific expenses have been charged directly to the Fund and other office expenses and related overheads have been charged to the Fund in proportion to the salaries charged.

## NOTES TO THE PENSION FUND ACCOUNTS

### 12. CONTRIBUTIONS RECEIVABLE

2007/08 £000		2008/09 £000
	Employers -	
70,177	normal contributions	70,092
-	additional contributions	-
1,486	special contributions	2,625
	deficit payments	2,700
	Employees -	
21,507	normal contributions	21,333
269	additional contributions	2,858
<b>93,439</b>		<b>99,608</b>
	43,032 Durham County Council	45,982
	48,481 Scheduled Bodies	47,626
	1,926 Admitted Bodies	6,000
<b>93,439</b>		<b>99,608</b>

### 13. BENEFITS PAYABLE

2007/08 £000		2008/09 £000
60,106	Pensions	63,514
16,578	Commutations and lump sum retirement grants	13,176
1,026	Lump sum death grants	1,675
-4,900	Recharged benefits	-5,006
<b>72,810</b>		<b>73,359</b>
	35,847 Durham County Council	32,814
	36,498 Scheduled Bodies	39,340
	465 Admitted Bodies	1,205
<b>72,810</b>		<b>73,359</b>

## NOTES TO THE PENSION FUND ACCOUNTS

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### 14. PAYMENTS TO AND ON ACCOUNT OF LEAVERS

2007/08 £000	2008/09 £000
20 Refunds to members leaving service	20
3 Payments for members joining state scheme	-1
5,177 Individual transfers to other schemes	7,149
<b>5,200</b>	<b>7,168</b>

### 15. INVESTMENT INCOME

2007/08 £000	2008/09 £000
2,612 Fixed interest securities	1,130
1,344 Index linked securities	4,298
20,361 Equities	20,708
7,515 Income from cash deposits	1,405
1,105 Property unit trusts	10,401
<b>32,937</b>	<b>37,942</b>

### 16. RELATED PARTY TRANSACTIONS

Durham County Council: Durham County Council administers the Durham County Council Pension Fund on behalf of 70 bodies, including district, parish and town councils, colleges, statutory bodies and admitted bodies. During 2008/09, the Pension Fund had an average balance of £84.386m (£109.756m in 2007/08) of surplus cash deposited with the Council. In 2008/09 the Council paid the fund a total of £4.085m (£6.559m in 2007/08) in interest on these deposits. The Council charged the fund £1.077m in 2008/09 (£1.276m in 2007/08) for expenses incurred in administering the Fund.

Long-Term Loans: The Long-Term Loans referred to in note 5 are loans made to a number of the current and former participating employers of the Fund. The loans outstanding were made between March 1964 and May 1967, this being common practice at the time. No further loans have been granted since January 1974. The Pension Fund receives interest of between 5.75% and 6.875% of the outstanding balance per annum in addition to capital repayments. The maximum

## NOTES TO THE PENSION FUND ACCOUNTS

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amount outstanding on these loans at any time during the year was the opening balance. The table below shows the balance outstanding on these loans as at 31<sup>st</sup> March 2009:

<b>Amount outstanding 31st March 2008 £000</b>	<b>Employer</b>	<b>Amount outstanding 31st March 2009 £000</b>
	316 Sedgefield District Council	309
	168 Sunderland City Council	162
<b>484</b>		<b>471</b>

### 17. STATEMENT OF INVESTMENT PRINCIPLES

The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999 require the County Council to prepare and review a written statement of the investment policy of the Pension Fund. Such a Statement has been adopted by the Pension Fund Committee and is published in the Annual Report.

A copy of the Annual Report can be obtained from the Corporate Director - Resources, County Hall, Durham DH1 5UE and is available on the County Council's website: [www.durham.gov.uk](http://www.durham.gov.uk)

### 18. FUNDING STRATEGY STATEMENT

The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 require Administering Authorities to prepare a Funding Strategy Statement. The Funding Strategy Statement was published in March 2005. It is to be revised whenever there is a material change in policy in matters set out in the Funding Strategy Statement or the Statement of Investment Principles. The Funding Strategy Statement is available on the County Council's website: [www.durham.gov.uk](http://www.durham.gov.uk)

### 19. ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVC)

Regulation 5(2)(c) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 do not permit AVCs to be paid into the Pension Fund, so contributions administered by the County Council have not been consolidated into the figures disclosed in the accounts.

## NOTES TO THE PENSION FUND ACCOUNTS

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The Pension Fund offers two types of AVC arrangement:

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

The table below refers only to the money purchase AVCs:

	Value at 31/03/08 £000	Purchases £000	Sales £000	Change in Market Value £000	Value at 31/03/09 £000
HECM	2,586	82	250	-113	2,305
Prudential	2,129	1,136	670	-73	2,522
Standard Life	1,295	138	15	-253	1,165
<b>Total</b>	<b>6,010</b>	<b>1,356</b>	<b>935</b>	<b>-439</b>	<b>5,992</b>

# Appendices

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## APPENDIX 1

### PARTICIPATING BODIES AND THEIR CONTRIBUTION RATES

The contribution rates of participating bodies are shown below, expressed as a percentage of employees' pensionable pay:

<i>Employer</i>	<i>% Pay</i>	<i>Employer</i>	<i>% Pay</i>
Durham County Council	18.9	Sedgefield Town Council	19.1
Easington District Council	26.7	Shildon Town Council	19.1
Wear Valley District Council	21.3	Spennymoor Town Council	19.1
City of Durham Council	24.9	Durham Valuation Tribunals	19.1
Chester-Le-Street District Council	23.9	Central Durham Joint Crematorium Committee	19.1
Derwentside District Council	25.7	Bishop Auckland College	14.3
Teesdale District Council	21.2	Darlington College	14.6
Sedgefield Borough Council	21.8	Derwentside College	16.1
Darlington Borough Council	18.5	East Durham College	14.3
Brandon & Byshottle Parish Council	19.1	New College, Durham	16.4
Chilton Parish Council	19.1	Queen Elizabeth Sixth Form College	15.7
Easington Colliery Parish Council	19.1	Barnard Castle School	19.7
Easington Village Parish Council	19.1	County Durham & Darlington Fire & Rescue Service	17.6
Esh Parish Council	19.1	Durham County Police Authority	16.0
Fishburn Parish Council	19.1	Durham Probation Service	17.1
Framwellgate Moor Parish Council	19.1	Bowes Museum	29.5
Healeyfield Parish Council	19.1	Compass Group UK	16.6
Horden Parish Council	19.1	Dale and Valley Homes	15.2
Hutton Henry Parish Council	19.1	Derwentside Homes	17.4
Lanchester Parish Council	19.1	East Durham Homes Ltd	15.0 plus £307,000
Monk Hesledon Parish Council	19.1	Hobson Golf Club	13.9
Murton Parish Council	19.1	MITIE Cleaning	17.3
North Lodge Parish Council	19.1	MITIE PFI Ltd	17.7
Pelton Parish Council	19.1	Murton Welfare Association	14.0
Shotton Parish Council	19.1	Peterlee Fire Company	23.1 plus £2,900
South Hetton Parish Council	19.1	Shildon & Darlington Training Ltd	36.7
Thornley Parish Council	19.1	Teesdale Housing Association	17.6
Trimdon Foundry Parish Council	19.1	The Forge	14.2
Trimdon Parish Council	19.1	Three Rivers Housing	9.4
Wheatley Hill Parish Council	19.1	Eastbourne Academy	18.5
Wingate Parish Council	19.1	Cestria Community Housing Association	16.8
Ferryhill Town Council	19.1	Mears Limited	19.6
Great Aycliffe Town Council	19.1	Kier Support Services Ltd	23.1
Peterlee Town Council	19.1	NE Fire Control Company	18.0
Seaham Town Council	19.1	Sedgefield Borough Homes	14.7

## APPENDIX 2

### MEMBERSHIP STATISTICS

(1)	Summary of Pensionable Employees				Summary of Pensioners			
	Pensionable employees as at 31.3.08 (2)	Add New-comers during year (3)	LESS Leavers during year (4)	Pensionable employees as at 31.3.09 (5)	Pension-ers as at 31.3.08 (6)	Add New pensioners during year (7)	LESS Pensioner Deaths During Year (8)	Pension-ers as at 31.3.09 (9)
<b>Durham CC</b>	9906	1175	953	10128	7510	411	254	7667
<b>Darlington BC</b>	2826	228	312	2742	1230	92	28	1294
<b>District Councils:</b>								
Chester-le-Street	279	11	29	261	442	18	22	438
Derwentside	434	27	47	414	821	32	34	819
Durham City	585	65	51	599	832	28	19	841
Easington	593	27	50	570	926	21	35	912
Teesdale	112	6	20	98	97	9	2	104
Sedgefield	759	28	261	526	827	57	37	847
Wear Valley	363	0	56	307	523	13	14	522
<b>Town Councils</b>	151	3	9	145	83	0	2	81
<b>Parish Councils</b>	52	1	3	50	35	1	3	33
<b>Joint Crem.Comm</b>								
Central Durham	7	0	0	7	7	0	0	7
<b>Statutory Bodies:</b>								
Local Valuation Panels	3	0	2	1	5	2	1	6
Durham Police Authority	962	212	96	1078	147	17	3	161
County Durham & Darlington Fire & Rescue Authority	118	25	6	137	17	1	1	17
Durham Probation Service	283	1	15	269	32	9	0	41
Magistrates Court	0	0	0	0	73	4	2	75
East Durham Homes	272	11	78	205	47	12	0	59
Dale & Valley Homes	48	0	4	44	0	0	0	0
Eastbourne Academy	28	7	0	35	0	0	0	0
<b>Colleges:</b>								
Bishop Auckland	152	43	18	177	19	2	1	20
Darlington College	216	31	27	220	50	0	0	50
DarlingtonQE6 <sup>th</sup> Form	56	9	1	64	5	1	0	6
Derwentside	82	12	13	81	53	3	0	56
NewCollege Durham	212	39	21	230	79	5	0	84
East Durham & Houghall Comm. College	205	29	39	195	42	6	1	47
<b>Admitted Bodies:</b>								
Barnard Castle School	57	0	3	54	18	1	0	19
Shildon & Darlington Training Limited	1	0	0	1	4	0	0	4
Leisureworks	50	0	8	42	8	6	1	13
Bowes Museum	9	0	0	9	11	0	0	11
3 Rivers Housing	2	0	0	2	0	0	0	0
Hobson Golf Club	2	0	0	2	0	0	0	0
Murton Welfare Ass.	4	0	0	4	0	0	0	0
Peterlee Fire Co	2	0	0	2	0	0	0	0
Mitie PFI	2	0	0	2	1	0	0	1
Compass Group UK	9	0	0	9	1	0	0	1
The Forge	2	0	0	2	0	0	0	0

## APPENDIX 2

(1)	<b>Summary of Pensionable Employees</b>				<b>Summary of Pensioners</b>			
	<i>Pensionable employees as at 31.3.08</i>	<i>Add New-comers during year</i>	<i>LESS Leavers during year</i>	<i>Pensionable employees as at 31.3.09</i>	<i>Pension-ers as at 31.3.08</i>	<i>Add New pensioners during year</i>	<i>LESS Pensioner Deaths During Year</i>	<i>Pension-ers as at 31.3.09</i>
(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	
<b>Admitted Bodies (cont'd):</b>								
Teesdale Housing	11	0	1	10	0	0	0	0
Mitie Cleaning	1	0	0	1	1	0	0	1
Derwentside Homes	198	3	7	194	8	8	0	16
Cestria	96	22	11	107	0	6	0	6
Mears	99	0	6	93	0	4	0	4
Sedgefield Homes	0	147	0	147	0	0	0	0
North East Fire CC	0	3	0	3	0	0	0	0
Kier Support Services	0	39	3	36	0	1	0	1
<b>Former Admitted Bodies</b>	0	0	0	0	360	7	29	338
<b>Commission for New Towns</b>	0	0	0	0	5	0	0	5
<b>Other Employers Pre 1974</b>	0	0	0	0	34	0	0	34
<b>Total</b>	19249	2204	2150	19303	14353	777	489	14641

## **APPENDIX 3**

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### **GOVERNANCE POLICY STATEMENT**

This statement sets out the Fund's scheme of delegation and the terms of reference, structure and operational procedures of the delegation.

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

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

### **PENSION FUND COMMITTEE**

The Committee is comprised of 17 voting members as follows:

- 11 are Members from Durham County Council
- 4 are District Council Members nominated by the Durham County District Councils Association
- 2 are Members from Darlington Borough Council

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

Two Trade Union representatives are also invited as observers.

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

The constitution of the Council delegates to the Pension Fund Committee "powers and duties arising from Section 7 of the Superannuation Act 1972 and Regulations made thereunder including:

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

### **CORPORATE DIRECTOR - RESOURCES**

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

“To take all necessary actions of a routine nature to properly administer the financial affairs of the Council including:

... the Council’s functions as a pension fund administering authority under the Superannuation Act 1972 and associated regulations.”

## APPENDIX 4

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### COMMUNICATIONS POLICY STATEMENT

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

#### *Who we communicate with*

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

#### *Key objectives*

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

### COMMUNICATING WITH SCHEME MEMBERS

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

The Council provides:

- Scheme literature

The pension section produces a summary guide to benefits in the scheme along with specific guides for certain circumstances, such as how divorce can affect scheme benefits or on the internal dispute resolution procedure.

- Annual benefit statements

All active members are sent a benefit statement each year setting out:

- the benefits they have earned in the scheme up to 31 March that year
- the benefits they will be entitled to if they stay in the scheme and retire at the date they are entitled to unreduced benefits (their 'rule of 85' date)
- the benefits they will be entitled to if they stay in the scheme and retire at age 60
- the benefits they will be entitled to if they stay in the scheme and retire at age 65

We are introducing combined benefit statements for active members – these include information on an individual's state pension entitlement. Combined benefit statements are already provided to the active members of around 20 employers and over the next year or so we intend to extend this to cover all employers if possible.

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

- Newsletters

All pensioners (including dependants) are sent two copies a year of our pensioner newsletter 'Pensions Today'.

All active members are sent two copies a year of our newsletter 'Pensions News'.

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

- Telephone helpline

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

## **APPENDIX 4**

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

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

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

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

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

### **COMMUNICATING WITH PROSPECTIVE MEMBERS**

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

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

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

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

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

## APPENDIX 4

### FUND PUBLICATIONS – AVAILABILITY AND WHEN PUBLISHED:

<b>Communication document</b>	<b>Available to</b>	<b>When published</b>
Newsletter – Pensions Today	Pensioners	Twice a year
Newsletter – Pensions News	Active members	Twice a year
Summary scheme guide	Active members, prospective members	When required
Annual benefit statement	Active members, deferred members	Once a year
Update letter on changes to regulations and other issues	Employers	As required
Report and accounts	All	Once a year – distributed to all employers and available on request to all
Valuation report	Employers	Every three years
P60s	Pensioners	Once a year

## APPENDIX 5

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### PENSION BENEFITS

The pension is paid at the rate of one-eightieth of pay for each year of membership before 1 April 2008, and one-sixtieth of pay for each year of membership on or after 1 April 2008.

Retirement grants are based on three-eightieths of pay for each year of membership before 1 April 2008. A married man with service prior to 1st April 1972, who has not elected to purchase this service (or did not complete the purchase of service), will have the membership value of the unpurchased service reduced by 11%.

Where a member dies in service a lump sum in the form of a death grant would be paid to the member's estate. This death grant is equal to three years' pay.

Widows' and children's pensions are paid in appropriate circumstances. The widow's pension is at a rate of half the member's pension calculated on membership before 1 April 2008 and 37.5% of the member's pension calculated on membership on or after 1 April 2008. Eligible children receive a pension of one-half of the widow's pension, subject to a maximum of half for two or more children. Widower's pensions are also payable (based on membership from April 1988 unless the employer has resolved to include all service).

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

- (a) On reaching sixty-five years of age (both men and women).
- (b) Between age sixty and sixty-five (if the employee was a Scheme member on 31<sup>st</sup> March 1998):
  - (i) full benefits would be paid if the member had twenty-five years membership or more;
  - (ii) reduced benefits may be paid if the member had at least three months but less than twenty-five years membership.
- (c) At age 50 or over with at least three months membership if the member retires under the Rule of 85. The member will require employer consent if under age 60 years. The 85 year Rule means that if a member's age (in whole years) and membership (in completed years) equals or exceeds 85 in total, then full benefits would be paid. Otherwise reduced benefits may be paid. From 1<sup>st</sup> October 2006 the Rule of 85 has been removed for all new entrants and there are some protections against the removal of the Rule of 85 for individuals who were in the Scheme before October 2006.

- (d) At any age with at least three months membership if the member retired on ill-health. Three different levels of ill-health benefit are payable, depending on how soon it is judged that an individual will be able to obtain gainful employment again in future. In the case of death in service, dependants' benefits are paid even if the membership is less than three months. For death in service an additional period of membership is awarded under the Local Government Pension Scheme Regulations where membership is at least three months.
  
- (e) At age fifty-five and over with at least three months membership if the member is made redundant, or retires under an employer's early retirement scheme. If the redundancy / efficiency retirement is before 31 March 2010 and the individual joined the Scheme before 1 April 2008, immediate access to pension benefits is given if the individual is age fifty or over at the date of leaving.

If a member leaves with at least three months membership and is not entitled to immediate payment of benefits and does not elect for a transfer of accrued benefits, deferred benefits are awarded. Deferred benefits are benefits which are '*frozen*' in the Fund and are paid when the member reaches retirement age. Such benefits are subject to cost of living increases between the date of leaving and the date of payment. A table showing the Pension Increases applicable over the last 5 years is on Page 17 of this report.



# Pension Fund

## Statement of Investment Principles

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### **1. Introduction**

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

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

## APPENDIX 6

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### 2. Investment Responsibilities

The County Council, as Administering Authority, has delegated the investment arrangements of the Pension Fund to the Pension Fund Committee (the “Pension Fund Committee”) who decide on the investment policy most suitable to meet the liabilities of the Pension Fund and the ultimate responsibility for the investment policy lies with it. The Committee is made up of elected representatives of the County Council, Darlington Borough Council and District Councils, as nominated by the Durham County District Council’s Association.

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

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

- Determining overall investment strategy and strategic asset allocation and ensuring that investments are sufficiently diversified, are not over concentrated in any one type of investment, and that the Pension Fund is invested in suitable types of investments;
- Preparing policy documents including the Statement of Investment Principles. Monitoring compliance with the Statement and reviewing its contents following any strategic changes and at least every three years;
- Appointing the investment managers, custodian, the Pension Fund actuary and any independent external advisers felt to be necessary for the good stewardship of the Pension Fund;
- Reviewing on a regular basis the investment managers’ performance against established benchmarks, and satisfying themselves as to the investment managers’ expertise and the quality of their internal systems and controls;
- Reviewing on a regular basis the performance of the independent external advisers;
- In cases of unsatisfactory performance of the investment managers and independent external advisers, taking appropriate action;
- Reviewing policy on social, environmental and ethical matters and on the exercise of rights, including voting rights; and
- Reviewing the resources allocated to investment managers on a regular basis.

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

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

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

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

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

- Assisting the Corporate Director - Resources and Pension Fund Committee in determining the overall investment strategy, the strategic asset allocation and that the Pension Fund is invested in suitable types of investment, and ensuring that investments are sufficiently diversified.
- Assisting the Corporate Director - Resources and Pension Fund Committee in the preparation and review of Policy documents;
- Assisting the Corporate Director - Resources and Pension Fund Committee in their regular monitoring of the investment managers' performance;
- Assisting the Corporate Director - Resources and Pension Fund Committee in the selection and appointment of investment managers, custodians and Pension Fund Actuary;

## APPENDIX 6

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- Advising and assisting the Corporate Director - Resources and the Pension Fund Committee on other investment related issues, which may arise from time to time; and
- Providing continuing education and training to the Pension Fund Committee.

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

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

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

- Ensuring compliance with this document and bringing breaches thereof to the attention of the Pension Fund Committee;
- Ensuring that this document is regularly reviewed and updated in accordance with the Regulations;
- Exercising delegated powers granted by the County Council to:
  - Administer the financial affairs in relation to the County Council's functions as a pension fund administering authority;
  - Exercise those discretions under the Local Government Pension Scheme Regulations 1997 as appear from time to time in Pension Fund Statements of Policy; and
  - Authorise, in cases of urgency, the taking of any action by an investment manager of the Pension Fund which is necessary to protect the interests of the Pension Fund.
- Managing the cash balances of the Pension Fund which the Investment Managers have not invested.

### **3. Authorised Investments**

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

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

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

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

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

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

## APPENDIX 6

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### 3.2 Investment Risk

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

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

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

### 3.3 Realisation of Investments

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

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

#### In-House Management

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

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

#### ii. Capital North East

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

#### External Investment Management

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

#### **4. Allocation Strategy**

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

<b>Asset Class</b>	<b>Permitted Assets</b>	<b>Benchmark &amp; Performance Target</b>	<b>Proportion of Total Fund *</b>
Conventional Bonds	Investment grade sterling bonds	FTSE Over 5 Year Index-Linked Gilt Index +0.5%	20%
Broad Bonds	Global bonds	UK 3-month LIBOR +3.0%	16%
UK Equity	UK equities	FTSE All Share Index +3.0%	20%
Global Equities	Global Equities	MSCI AC World Index +3.0%	28%
Dynamic Asset Allocation	All major asset classes with derivative overlay	UK 3-month LIBOR +4.0%	8%
Global Property	Global property	UK Retail Price Inflation +5.0%	8%

\* Excluding in-house managed funds

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

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

## **APPENDIX 6**

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### **5. Stock Selection**

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

### **6. Investments Requiring Prior Approval**

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

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

### **7. Socially Responsible Investing**

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

### **8. Corporate Governance**

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

### **9. Fee Structure**

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

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

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

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### 10. Reporting Requirements

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

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

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- Dealing errors and action taken.
- Any breach of confidentiality.
- Any breach of this Agreement.

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

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### **Appendix A – Principles**

This appendix sets out the extent to which Durham County Council as the Administering Authority of the Durham County Council Pension Fund complies with the ten principles of investment practice set out in the document published in April 2002 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom" (Guidance note issue No. 5).

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

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

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

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

#### **Principle 3 – Focus on asset allocation**

Fully compliant: All major asset classes are considered. An asset liability modelling exercise is being considered as part of the ongoing review of the administration of the Pension Fund.

#### **Principle 4 – Expert advice**

Fully compliant: Two independent advisers were appointed in November 2004. Actuarial services have been subject to a separate open tender process.

#### **Principle 5 – Explicit mandates**

Fully compliant: Explicit written mandates agreed with all investment managers. Investment managers have been asked to report on transaction costs and commission.

#### **Principle 6 – Activism**

Partial compliance: Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. Normal practice is to allow the Investment Managers to follow their in-

house voting policy unless otherwise instructed by the Pension Fund Committee. The mandates do not specifically incorporate the principle of the US Department of Labor Interpretative Bulletin on activism.

### **Principle 7 – Appropriate benchmark**

Fully compliant: Appropriate benchmarks have been set in consultation with the independent advisers and the actuary.

### **Principle 8 – Performance measurement**

Partial compliance: Performance of the Pension Fund is measured; separate monitoring of Pension Fund Committee performance and independent adviser performance has yet to be established.

### **Principle 9 – Transparency**

Fully compliant: Investment objective and asset allocation strategy covered in the Funding Strategy Statement or Statement of Investment Principles. Investment Manager and independent adviser fee structures are included.

### **Principle 10 – Regular reporting**

Fully Compliant: The Funding Strategy Statement including the Statement of Investment Principles is available on the internet and is included in the Pension Fund's Annual Report and Accounts. A summary of overall Pension Fund performance is reported to members of the Pension Fund annually.

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### Appendix B - Investment Managers

The Pension Fund Committee has appointed six Investment Managers: Edinburgh Partners Limited ('Edinburgh Partners'), BlackRock Investment Management (UK) Limited ('BlackRock'), AllianceBernstein Limited ('AllianceBernstein'), Royal London Asset Management ('RLAM'), CB Richard Ellis Collective Investors Limited ('CBRE') and Baring Asset Management Limited ('Barings') to manage the assets of the Pension Fund.

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

<b>Investment Manager</b>	<b>%</b>	<b>Asset Classes</b>	<b>Investment Style</b>
Edinburgh Partners	28	Global Equities	Active
BlackRock	20	UK Equities	Active
AllianceBernstein	16	Global Bonds	Active
RLAM	20	Investment grade sterling bonds	Active
CBRE	8	Global Property	Active
Barings	8	Dynamic Asset Allocation – All major asset classes with derivative overlay	Active

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

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

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

**Edinburgh Partners**

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

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Global Equities	MSCI AC World Index

Edinburgh Partners intend to invest in the following to achieve their objective:

<b>Portfolio</b>	<b>%</b>
EP Global Equity	100

Edinburgh Partners have a number of guidelines in place at the regional, sectoral and stock level when considering the control of risk within the portfolio. These are detailed below:

<b>Sector</b>	<b>Range</b>
Number of Stocks	Typically holding 30 to 50 stocks
Maximum holding in one stock	5% of the portfolio’s value at time of investment. With market movement max. 7.5% before reduction in holding
Holding in cash	Typically not expected to exceed 5% of the portfolio’s value following the initial investment process
Maximum holding in one sector	Diversified (e.g. Financials/Industrials) 40% Partially Diversified (e.g. Consumer Goods) 30% Homogeneous (e.g. Oil) 20%
Maximum holding in any one country	US, Japan, UK max 50% each Other developed markets max 20% each Emerging Market Country (as defined by MSCI Emerging Markets Index) max 10% each

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

<b>Asset Class</b>	<b>Maximum Holding</b>
Collective Investment Schemes (CIS)	10% of the Portfolio or as otherwise advised in writing from time to time
CIS	No CIS sponsored by AllianceBernstein may be held
FM Funds (a sub-class of CIS)	10% of the portfolio or as otherwise advised from time to time
CIS of any one body (a sub-class of CIS)	10% of the Portfolio or as otherwise advised from time to time

**BlackRock**

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

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
UK Equity	FTSE All-Share Index

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

<b>Portfolio</b>	<b>%</b>
UK Focus approach	100

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

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

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

<b>Asset Class</b>	<b>Maximum Holding</b>
Collective Investment Schemes (CIS)	0% to 10% of the Portfolio or as otherwise advised in writing from time to time

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### AllianceBernstein

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

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

The benchmark allocation is as follows:

<b>Asset Class</b>	<b>Benchmark</b>
Broad Bonds	UK 3-month LIBOR

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

<b>Portfolio</b>	<b>%</b>
Diversified Yield Plus Fund	100

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

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

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

- 1 month holding period
- 99% confidence level.

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The limitations that apply to the investments are detailed below:

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

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

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### RLAM

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

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

The benchmark allocation is as follows:

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

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

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

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

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

\*Includes government and non-government bonds

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

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

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

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

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### CBRE

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

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

The benchmark allocation is as follows:

Asset Class	Benchmark
Global Property	UK Retail Price Inflation

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

Portfolio	%
CB Richard Ellis RPI +5%	100

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

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

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

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### Baring Asset Management

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

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

The benchmark allocation is as follows:

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

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

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

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

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

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

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

\* Equities and Commodities, aggregate maximum 80%

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

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

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

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

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



# Pension Fund

## Funding Strategy Statement

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### (A) STATUTORY BACKGROUND AND KEY ISSUES

1. The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 come into effect on 1<sup>st</sup> April 2004. They provide the statutory framework from which Local Government Pension Schemes (LGPS) administering authorities are required to prepare a Funding Strategy Statement (FSS) by 31<sup>st</sup> March 2005.
2. Key issues:
  - After consultation with relevant interested parties involved with the Fund, e.g. local authority employers, admitted bodies, scheduled/resolution bodies, the administering authority is required to prepare and publish their funding strategy.
  - In preparing the FSS, the administering authority has to have regard to:
    - o CIPFA guidance
    - o Its Statement of Investment Principles (SIP) published under Regulation 9A of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended).
  - The first statement must be published by 31<sup>st</sup> March 2005.
  - The FSS must be revised and published whenever there is a material change in policy either on the matters set out in the FSS or the Statement of Investment Principles.
  - Each Fund Actuary must have regard to the FSS as part of the fund valuation process and the Fund Actuary has therefore been consulted on the contents of this FSS.
  - Benefits payable under the Scheme are secure, because they are guaranteed by statute. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, allowing for scrutiny and accountability through improved transparency and disclosure.

- The Scheme is a defined benefit final salary scheme. The benefits are specified in the governing legislation, the Local Government Pension Scheme Regulations 1997 (the Regulations). Constraints on the levels of employee contributions are also specified in the Regulations.
- Employer contributions are determined in accordance with the Regulations, which require that an actuarial valuation is completed every three years by the Fund Actuary.

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

3. The purpose of this Funding Strategy Statement (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 requirement to maintain as nearly constant employer contribution rates as possible; and
- To take a prudent longer-term view of funding those liabilities.

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

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

4. The aims of the fund are to:

- **Enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies**

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

- o the regulatory requirement to secure solvency
- o the requirement to ensure that costs are reasonable, and
- o maximising return from investments

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In order to achieve nearly constant employer contribution rates there may be a need to invest in assets that match the employer's liabilities.

The Administering Authority currently invests a large proportion of the Fund in equities, which are perceived as having higher long-term rates of return. These assets are more risky in nature than fixed interest investments, and this can lead to more volatile returns in the short-term.

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

There is a balance to be struck between the Fund's investment policy, actuarial smoothing adjustments and employer's contribution rates.

- **Manage employers' liabilities effectively**

The Administering Authority seeks to manage employers' liabilities effectively. This is achieved by seeking actuarial advice and regular monitoring of the investment of the Fund's assets through quarterly meetings of the Pension Fund Committee.

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

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

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

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

- o Taking advice from its professional advisers, e.g. the Fund Actuary, Investment advisers and investment managers
- o Controlling levels of investment in asset classes through the Statement of Investment Principles
- o Restricting investment to asset classes recognised as appropriate for UK Pension Funds.

5. The purpose of the fund is to:

- Receive money in respect of contributions, transfer values and investment income, and
- Pay out money in respect of scheme benefits, transfer values, costs, charges and expenses,

as defined in the Local Government Pension Scheme Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.

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

6. Although a number of parties including investment fund managers and external auditors have responsibilities to the fund, the following are considered to be of particular relevance:

7. The administering authority should:

- Collect employer and employee contributions
- Determine a schedule of due dates for the payment of contributions - Section 70(1)(a) of the Pensions Act 2004 suggests that Administering Authorities are now required to report breaches as defined in Section 70 (2) of the 2004 Act. This places monitoring of the date of receipt of employer contributions on the Administering Authority and therefore places a duty to report late payments of contributions to the Occupational Pensions Regulatory Authority (Opra).
- Take action to recover assets from admission bodies whose Admission Agreement has ceased.
- Invest surplus monies in accordance with the regulations.

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

Ensure effective communications with the Fund's Actuary to:

- o Ensure that the Fund Actuary is clear about the Funding Strategy;
  - o Ensure reports are made available as required by guidance and regulation;
  - o Agree timetables for the provision of information and valuation results;
  - o Ensure provision of accurate data; and
  - o Ensure that participating employers receive appropriate communications.
- Consider the appropriateness of interim valuations.
  - Prepare and maintain an FSS and a SIP, both after proper consultation with interested parties, and
  - Monitor all aspects of the fund's performance and funding and amend the FSS and SIP on an annual basis as part of the on-going monitoring process.

### 8. The individual employers should:

- Deduct contributions from employees' pay correctly.
- Pay all contributions, including their own as determined by the actuary, promptly by the due date.
- Exercise discretions within the regulatory framework.
- Make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain, and
- Notify the administering authority promptly of all changes to membership, or as may be proposed, which affect future funding.

9. The fund actuary should:
- Prepare triennial valuations including the setting of employers' contribution rates after agreeing assumptions with the administering authority and having regard to the FSS.
  - Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.
  - In response to a request from the Administering Authority, assess the impact of Regulatory changes on costs.

### **(E) SOLVENCY ISSUES AND TARGET FUNDING LEVELS**

10. LGPS administering authorities prudentially seek to achieve full funding. The scheme regulations refer to each administering authority securing solvency by means of employer contribution rates established by mandatory valuation exercises and to the desirability of maintaining as nearly constant a rate as possible.
11. The LGPS however remains outside of the solvency arrangements established for private sector occupational pension schemes. It is not therefore unreasonable for administering authorities to establish longer-term recovery periods than those in the private sector where this is considered to be prudentially appropriate and relevant to local circumstances, and linked to the scheme's triennial valuation exercise requirements.
12. The Administering Authority will prudentially seek to secure the solvency of the Fund. Solvency is defined as being achieved when the value of the Fund's assets is greater than or equal to the value of the Fund's liabilities, as measured by the Fund's Actuary. Solvency is not defined in the Regulations, and its definition is therefore the Administering Authority's interpretation. Funding can be interpreted differently depending on the assumptions used. The liabilities are measured on 'on-going' actuarial methods and assumptions where 'on-going' actuarial assumptions and methods are taken to be measurement by use of the projected unit method of valuation, using assumptions generally recognised as suitable for open, ongoing UK pension fund with a sponsoring employer of sound covenant.

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13. The Administering Authority will agree with the Fund's Actuary the assumptions used in this calculation prior to each actuarial valuation.
14. The Administering Authority has agreed with the Fund Actuary that a market led approach should be used for future valuations at least for the foreseeable future. Under this method of valuation, the assets are taken into account at their mid market value and the value is then compared with the value of the Fund's liabilities calculated using consistent, market rates of interest. The Administering Authority has also agreed with the Fund Actuary that some element of smoothing of the assets can be used in the valuations. The size of the smoothing adjustment will be discussed at each valuation.
15. The rates of interest are obtained by examination of prevailing yields in the long term gilt market, which are then adjusted to make partial allowance for excess returns expected on other types of riskier investments such as equities. The risk of this approach is that the additional returns may not be achieved.
16. Where a valuation shows the Fund to be in surplus or deficit against the solvency measure, employer's contribution rates will be adjusted to reach the solvent position over a number of years. The 'recovery period' for reaching 'full' funding is set by the Administering Authority in consultation with the Actuary and the employer.
17. It is recognised that a large proportion of the Fund's liabilities are expected to arise as benefits payments over a long period of time. The Administering Authority is therefore prepared to agree recovery periods that are longer than the average future working lifetime of the membership of that employer. There is however a risk involved in relying on long recovery periods and the Administering Authority has agreed with the Actuary a maximum recovery period of 30 years. It is the intention of the Administering Authority to agree with employers a recovery period of as short a time as possible within this 30 year limit having regard to the affordability of the revised contribution rate in general taking into account the legislative requirements of securing solvency and maintaining as nearly a constant a contribution rate as possible. For each individual employer the following will also be taken into account:
  - covenant and strength of any guarantee relating to an employer and hence the risk of default
  - length of participation in the Fund
  - whether the employer is closed to new entrants or is likely to have a contraction in its membership of the Fund

18. The Administering Authority will also consider at each valuation whether new contribution rates should be payable immediately or reached by being stepped over a number of years. Stepping is a generally accepted method of smoothing the impact of rate changes for local authority pension funds. In consultation with the Actuary the Administering Authority accepts that long term employers may step up to the new rates in equal annual steps. This is in line with the aim of having contribution rates as nearly constant as possible. The Administering Authority usually allows a maximum of three steps however, in exceptional circumstances up to six steps may be used.
19. The Administering Authority will permit some employers to be treated as a group for the purposes of setting contribution rates. For smaller employers the contribution rate can be volatile due to the increased likelihood that demographic movements could have a material effect. The Administering Authority's policy is to consider the position carefully at each valuation and to notify each employer that is grouped that this is the case and which other employers it is grouped with. If the employer objects to this grouping, it will be offered its own contribution rate. The Administering Authority recognises that grouping can give rise to cross subsidies from one employer to another over time.
20. For employers whose participation is for a fixed period, grouping is unlikely to be permitted.

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

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

#### **General Principles and diversification**

22. The Fund believes that the emphasis of investment over the long term should be on real assets, particularly equities and property. These are most likely to maximise the long term returns. The balance between UK and Overseas equities is, however, a matter of investment judgement. The Fund should also be diversified to include other real assets, such as Index-Linked and 'monetary' assets, such as Bonds and Cash.
23. The neutral benchmark proportions of the various asset classes have been determined by the Fund in consultation with the Investment Advisers and are reviewed at least once every three years to coincide with the Triennial Actuarial Valuation.

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24. The active Investment managers are expected to adopt an active asset allocation policy to take advantage of the shorter term relative attractions of the various asset types.
25. The Administering Authority has produced this Funding Strategy Statement having taken a view on the level of risk inherent in the investment policy set out in the Statement of Investment Principles (SIP) and the funding policy set out in this document. The SIP is attached at Annex 1 to this document.
26. The SIP sets out the investment responsibilities and policies relevant to the Fund.
27. The Administering Authority will continue to review both documents to ensure that the overall risk profile remains appropriate.

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

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

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

#### 29. Financial

These include:

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment fund managers fail to achieve performance targets over the longer term
- Asset reallocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- The effect of a possible increase in employer's contribution rate on service delivery and admitted or scheduled bodies

### 30. Demographic

These include:

- The longevity horizon continues to expand
- Deteriorating pattern of early retirements

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

### 31. Regulatory

These include:

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

The Administering Authority will keep up to date with all proposed changes, and, if appropriate, request the Actuary to assess the impact on costs of the changes. The Administering Authority will notify employers of the likely impact of changes.

### 32. Governance

These include:

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

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

## APPENDIX 7

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### 33. Solvency

These include:

- Allowing for future investment returns in excess of those available on government bonds introduces an element of risk, in that those additional returns may not materialise

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

### 34. Smoothing of Assets

These include:

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

The Administering Authority's policy is to review the impact of this adjustment at each valuation to ensure that it remains within acceptable limits.

### 35. Recovery Period

These include:

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

The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of recovery period to no longer than 30 years.

### 36. Stepping

These include:

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

The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the number of permitted steps to three annual steps or, in exceptional circumstances, to six annual steps.

### **(H) MONITORING AND REVIEW**

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

## APPENDIX 8

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### UK EQUITIES

The following twenty largest holdings account for 83.9% of the Fund's investment in UK equities and 16.3% of the total Fund investments:

<i> Holding </i>	<i> Market Value as at 31<sup>st</sup> March 2009 </i>
	£000
Vodafone	27,070
Glaxosmithkline	21,043
B G Group	19,342
BHP Billiton	14,242
HSBC	14,149
Astrazeneca	13,435
Reckitt Benckiser	13,398
Tullow	9,200
Cairn Energy	8,483
Standard Chartered	8,174
Compass	7,996
Next	7,813
British Sky Broadcasting	6,773
SSL International	6,709
MAN Group	5,482
ICAP	4,987
Qintetiq	4,208
John Wood	4,010
Aviva	3,929
Royal Bank of Scotland	2,529
	<b>202,972</b>

**FIXED INTEREST HOLDINGS**

The following ten largest holdings account for 82.6% of the Fund's fixed interest holdings and 20.5% of the total portfolio:

<i><b>Holding</b></i>	<i><b>Market Value as at 31<sup>st</sup> March 2009</b></i>
	£000
Treasury 2.5% Index Linked 26/07/16	44,261
Treasury 2.5% Index Linked 17/07/24	38,737
Treasury 2.5% Index Linked 16/04/20	35,283
Treasury 4.125% Index Linked 22/07/30	25,468
Treasury 1.25% Index Linked 11/37	23,449
Treasury 1.25% Index Linked 11/27	21,797
Treasury 2.0% Index Linked 26/01/35	19,113
Treasury 1.25% Index Linked 11/55	16,805
Treasury 1.875% Index Linked 22	15,517
Treasury 0.75% Index Linked 11/47	15,431
	255,861

## APPENDIX 8

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### FUNDS AND UNITS

The following ten holdings account for 97.8% of the Fund's holdings in Funds and Units and 18.9% of the total Fund investments:

<i> Holding </i>	<i> Market Value as at 31<sup>st</sup> March 2009 </i>
	£000
Alliance Bernstein Diversified Yield	191,498
BAM International HK China Fund	8,570
Gold Bullion NTS	8,447
BAM Select Hedge Fund	5,500
BAM Themed Fixed Interest Fund	4,904
I Shares D J Stox	4,720
BAM Agriculture Fund	4,105
RWC Global Convertibles	3,753
BlackRock Int Gold	2,724
BAM Emerging Market Fund	1,071
	235,292

**OVERSEAS HOLDINGS**

The following ten largest overseas equity holdings account for 35.5% of the Fund's investment in overseas equities and 8.2% of the total portfolio:

<i> Holding </i>	<i> Market Value as at 31<sup>st</sup> March 2009 </i>
	£000
Cisco Systems	14,541
ENI Spa	11,751
Baidu Inc	11,158
Sanofi - Aventis	10,486
Unilever	9,308
Gazprom	9,060
France Telecom	9,024
Nokia	8,950
Fanuc Limited	8,325
	101,985

## APPENDIX 8

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### PROPERTY UNIT TRUSTS

The following holdings in property unit trusts comprise 2.6% of the total Fund investments:

<i> Holding</i>	<i> Market Value as at 31<sup>st</sup> March 2009</i>
	£000
Schroder	5,282
LAMIT	5,108
Henderson Mall	4,978
Hanover	3,926
ING Asia Retail	3,393
Prologic Europe	2,518
BAM Property Com Fund	2,109
BlackRock	1,967
Corestate German Res	1,745
Stam Rei III	1,416
	32,442

# Glossary of Terms

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## GLOSSARY OF TERMS

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### **Accounting Policies**

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

### **Accruals**

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

### **Actuary**

An actuary is an expert on pension scheme assets and liabilities, life expectancy and probabilities for insurance purposes. An actuary works out whether enough money is being paid into a pension scheme to pay the pensions when they are due.

### **Added Years**

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

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

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

### **Admitted Bodies**

Bodies whose staff can become members of the Pension Fund by virtue of an admission agreement.

### **Asset Allocation**

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

### **Balanced Management**

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

### **Benchmark**

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

# GLOSSARY OF TERMS

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## **Corporate Bonds**

Investments in certificates of debt issued by a company. When a bond is issued, the company promises to return the money on a specified date, paying a stated rate of interest.

## **Corporate Governance**

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

## **Custody**

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

## **Deferred Pension**

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

## **Derivative**

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

## **Dividend**

The part of a company's after tax earnings that is distributed to shareholders in the form of cash or shares.

## **Equities**

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

## **Fixed Interest Securities**

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

## GLOSSARY OF TERMS

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### **FIDs and Manninen**

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

### **Futures**

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

### **Gilts**

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

### **Index Linked Securities**

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

### **Investments**

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

### **Managed Funds**

A type of investment where a number of investors pool their money into a fund which is then invested by a fund manager.

### **Market Value**

The price at which an investment can be bought or sold at a given date.

### **Myners' Principles**

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

### **Net Book Value**

The amount at which fixed assets are included in the Balance Sheet. It represents historical cost or current value less the cumulative amounts provided for depreciation or impairment.

## **GLOSSARY OF TERMS**

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### **Passive Management**

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

### **Pooled Fund**

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

### **Return**

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

### **Risk**

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

### **Resolution Bodies**

An organisation which must make a statutory resolution covering some or all of its employees, stating that they may be fund members.

### **Scheduled Bodies**

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

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

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

### **Transfer Values**

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

### **Unit Trusts**

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

## CONTACTS FOR FURTHER INFORMATION

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

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[www.durham.gov.uk](http://www.durham.gov.uk)

