Lancashire County Council

Pension Fund Committee

Friday, 4th February, 2011 at 10.00 am in Cabinet Room 'C' - County Hall, Preston

Agenda

Part 1 (Open to Press and Public)

No.	Item	
1.	**Apologies**	
2.	**Disclosure of Personal and Prejudicial Interests** Members are asked to consider any Personal/Prejudicial Interests they may have to disclose to the meeting in relation to matters under consideration on the Agenda.	
3.	**Minutes of the Meeting held on 10 December 2010** To be confirmed, and signed by the chair.	(Pages 1 - 4)
4.	**Principles of Revised Governance Arrangements**	(Pages 5 - 8)
5.	**Lancashire County Pension Fund - Business Plan 2011/12**	(Pages 9 - 18)
6.	**Revised Funding Strategy Statement**	(Pages 19 - 38)
7.	**Procurement of Actuarial Services**	(Pages 39 - 42)
8.	**Urgent Business** An item of urgent business may only be considered under this heading where, by reason of special circumstances to be recorded in the Minutes, the Chair of the meeting is of the opinion that the item should be considered at the meeting as a matter of urgency. Wherever possible, the Chief Executive should be given advance warning of any Member's intention to raise a matter under this heading.	

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9. Date of Next Meeting

The next meeting of the Committee will be held on Friday 15 April 2011 at 10.00 a.m.at County Hall, Preston.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Lancashire County Council

Pension Fund Committee

Minutes of the Meeting held on Friday, 10th December, 2010 at 10.00 am at the Cabinet Room 'D' - County Hall, Preston

Present:

County Councillor David Westley (Chair)

County Councillors

M Welsh	M Green
T Aldridge	F De Molfetta
M Barron	T Pimblett
M Brindle	S Riches
Mrs S Charles	G Roper
M France	

Co-opted members

G Bell	(Blackpool Council)
P Doyle	(Lancashire Leaders' Group)
B Harvey	(Trade Union representative)
P Hyett	(HE/FE Sector Establishments)
R Whittle	(Trade Union representative)

Independent Advisers - Panel Members:

E Lambert N Mills

15. Apologies

Apologies for absence were presented on behalf of County Councillor R Lawrenson and Councillor R O'Keeffe.

16. Disclosure of Personal and Prejudicial Interests

County Councillors D Westley, M France, T Pimblett and M Brindle, and Mr P Hyett and Mr R Harvey disclosed personal non-prejudicial interests in this agenda as they were members of the Local Government Pension Scheme.

County Councillor S Riches disclosed a personal non-prejudicial interest in this agenda as she was related to a member of the Local Government Pension Scheme.

County Councillor M Barron disclosed a personal non-prejudicial interest in this agenda as he was related to an employee of the Mercer Limited. Councillor Barron was also a member of the Lancashire Combined Fire Authority.

County Councillors T Pimblett and G Roper also declared non-prejudicial interests in this agenda as they were members of the Lancashire Police Authority.

17. Minutes of the Meeting held on 16 July 2010

The minutes of the meeting held on 16 July 2010 were presented.

The Committee received an update on progress against the 2010/11 Business Plan.

Resolved: That the minutes of the meeting held on 16 July 2010 be confirmed and signed by the chair.

18. Audit Commission - Annual Governance Report

The Committee considered the Audit Commission's Pension Fund Annual Governance report for the year ended 31 March 2010.

It was noted that the Governance Report had already been considered by the Audit Committee and that the letter of representation and action plan, as set out at Appendices 3 and 4 to the Report, had been approved.

Resolved: That the Audit Commission's Pension Fund Annual Governance report 2009/10 be noted.

19. The Results of the 2010 Actuarial Valuation of the Lancashire County Pension Fund

The Committee considered the initial results of the 2010 Actuarial Valuation of the Lancashire County Pension Fund.

The triennial Valuation of the assets and liabilities of the Lancashire County Pension Fund from 1 April 2007 to 31 March 2010 had been carried out by the Fund Actuary, Mercer. The results of the Valuation, including amendments to individual employer contribution rates, would be effective from 1 April 2011.

The previous Valuation (effective from 1 April 2008) revealed a funding position of 84% and an average employer contribution rate of 17.8%. The 2010 Valuation had revealed a funding level of 80% and an average employer contribution rate of 19.4% which was a small worsening of the previous position. This result was largely due to the unfavourable changes in market conditions over the period but this had been offset to some extent by the impact of revised demographic assumptions adopted by the Actuary for the 2010 Valuation.

Individual employer contribution rates and the options available to mitigate the impact of increased contributions would be presented to Fund employers at a Briefing to be held at County Hall on 14 December 2010.

The formal Actuarial Valuation Report as at 31 March 2010 was expected to be available by 31 March 2011. A copy of the Report would be sent to all members of the Committee.

Resolved: That the initial results and the continuing process in respect of the 2010 Actuarial Valuation of the Lancashire County Pension Fund be noted.

20. Date of Next Meeting

It was noted that the next meeting of the Lancashire Pension Fund Committee would be held on Friday 4 February 2011 at 10.00am at County Hall, Preston.

It was also noted that the meeting scheduled to take place on 25 March 2011 had been rearranged and would now be held on 15 April 2011 at 10.00am.

21. Exclusion of Press and Public

Resolved: That the press and members of the public be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the paragraph of Part 1 of schedule 12A to the Local Government Act, 1972, indicated against the heading to the item. It was considered that in all the circumstances the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

22. Item 8 Investment and liability strategy

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information.)

The Committee considered a report on:

- Proposals for new post valuation investment and liability strategies;
- A proposed investment strategy improvement plan; and
- The value and allocation of assets of the Lancashire County Pension Fund as at 30 September 2010.

It was noted that a further report on proposed changes to the Fund's governance arrangements would be presented to the next meeting of the Committee on 4 February 2011.

Resolved:

1. That the new investment and liability strategies as set out at Appendix 'A' be approved and that the consequent structural changes to the Investment Panel and the Pensions Investment teams be noted.

2. That the proposed investment strategy improvement plan as set out at Appendix 'B' be approved.

3. That the value and allocation of assets of the Lancashire County Pension Fund as set out at Appendix 'C' be noted.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Pension Fund Committee
Meeting to be held on 4 February 2011

Electoral Division affected: None

Principles of Revised Governance Arrangements

Contact for further information:
George Graham, (01772) 538102, Resources Directorate,
george.graham@lancashire.gov.uk

Executive Summary

The approval by the Committee at its last meeting of the revised investment strategy requires a review of certain areas of the Fund's governance arrangements in order to support the operation of the new ways of working required by the Strategy.

This report sets out the nature of the changes required. Subject to the approval of these changes they will be incorporated in a revised "constitution" for the Pension Fund and presented to an appropriate meeting of the Full Council (as the decision making body) for approval.

Recommendation

The Committee is asked:

1. To instruct the County Secretary and Solicitor to draft a "constitution" for the Lancashire County Pension Fund reflecting the proposals in this report in relation to Investment Decision Making, Appointments and Procurement and Reporting for consideration by this Committee and recommendation to the County Council.

2. In the light of the changes at 1 above, to consider whether it would wish to maintain a standing Appointments Sub-Committee.

3. To endorse the recommendation that there be no change in the membership of the Committee.

4. To consider whether it would wish to maintain an Administration Sub-Committee.

5. To instruct the County Secretary and Solicitor to incorporate the Committee's. decisions in relation to 2, 3 and 4 above in the "constitution" to be presented to the County Council.

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Background and Advice

At its last meeting the Committee approved a new investment strategy for the Fund. This strategy has implications for the Fund's decision making and governance arrangements which need to be incorporated in to a revised "constitution" for the Fund. This report sets out the proposed changes for endorsement by the Committee prior to the production of the final "constitution" which must be approved by the full County Council.

The proposed changes set out below reflect a number of key drivers set out in the investment strategy:

- Firstly, the Fund must be managed more dynamically so it is able to take advantage of opportunity and move to avoid risk. To this end decision making arrangements must, subject to appropriate checks and balances, be capable of operating swiftly.
- Secondly, the role of the Committee is to approve strategy and hold the Investment Panel (which will become much more like a private sector fund's Investment Committee) to account for its delivery.

In addition to this the development of the EU Procurement regime as it applies to public authorities means that it is necessary to reconsider the way in which the Fund makes procurement decisions, in order that members role in the process is meaningful.

Investment Decision Making

Over time the investment strategy looks to the Fund making a wider range of individual investment decisions, rather than simply placing funds with managers. Currently other than bringing every such decision back to the Committee there is no explicit mechanism for making such decisions.

The proposal is that the power to make individual investments (for example in a particular PFI scheme) is delegated to the Treasurer to the Fund, as is the case with property transactions. In this case it is proposed that the Treasurer should act on the recommendation of the Investment Panel with the two independent advisers having a veto. Thus if both advisers were to vote against a particular investment it would not take place. This provides an important check and reassurance for members. The Panel would need to report formally on its decisions and the rationale for them at each meeting of the Committee.

Appointments and Procurement

Currently the framework of rules under which the Fund operates does not work particularly well with the EU Procurement rules. This EU rules require the Fund to determine in advance of procurement the criteria it will use to make a decision on which bidder to select. Thus the current arrangement of an Appointments Sub-Committee, making the decision on final selection brings members in to the process at the wrong point as given the rules the Sub-Committee is in effect simply a cipher.

It would be more appropriate to involve members at an earlier stage in agreeing the criteria for award of contracts. It is therefore proposed that where the Fund is going to enter in to a procurement process the criteria for award of the contract should be agreed by the Committee but the award be delegated to the Treasurer on the advice of the Investment Panel. This allows members to exercise genuine influence on the process as opposed to the current situation.

This arrangement would apply to all procurement situations such as Fund Managers, Actuaries and Consultants and in the light of this members may wish to consider whether it is necessary to maintain a separate Appointments Sub-Committee.

There is one situation where it is important that an appointment is made directly by members and which remains, in effect, like a staff appointment. This is the appointment of the two independent advisers. This appointment must remain with the Committee as an important check within the overall governance arrangements. In this case the Committee might wish to appoint an ad hoc sub committee to conduct interviews and make recommendations to the Committee.

Reporting

Given the changed role of the Investment Panel it will be an important part of the accountability framework that the Fund's "constitution" spells out a requirement that the Panel reports on its decisions to each meeting of the Committee. This needs to include specific issues such as the reporting of the Fund's voting record, and the overall performance of the Fund relative to the benchmarks agreed by the Committee.

Composition of the Committee

Members have previously asked whether it is possible to make the Committee more representative of all employers. Currently the group not represented are the smaller admitted bodies, who make up approximately 6% of the Fund's membership. The membership of the Committee currently stands at 21 which puts it at the larger end of such bodies within the Local Government Pension Scheme.

The smaller admitted bodies represent a very diverse range of employers from those such as Leisure Trusts and Stock Transfer Housing Associations which are closely aligned with Councils, to small local charities to major companies which provide services to councils. It is not clear that there is sufficient commonality of interest amongst this group or that effective arrangements could be made to appoint a member to the Committee for such an arrangement to add value. The Fund already has arrangements in place to engage with employers on key issues such as the actuarial valuation and such anecdotal feedback as is available indicates that smaller employers are content with such arrangements.

At this stage it is suggested that the composition of the Committee is not changed.

Administration Sub Committee

While members are engaged in a broad set of changes such as these it is opportune to consider the overall committee structure. Members may wish to consider whether there is sufficient business to justify the maintenance of an Administration Sub-Committee. Alternatively members may consider that it is important that administration issues are not overwhelmed by investment issues in the full committee.

Consultations

County Secretary and Solicitor, Independent Advisers to the Fund.

Implications:

This item has the following implications, as indicated:

Risk management

The new investment strategy is intended to reduce the overall risk exposure of the Fund and allow the Fund to be managed in such a way that risk can be addressed swiftly where it emerges.

Legal

New constitutional arrangements will need to be approved by the Full Council and will need to reflect appropriate checks and balances within the decision making process.

Local Government (Access to Information) Act 1985
List of Background Papers

N/A

Reason for inclusion in Part II, if appropriate

N/A

Pension Fund Committee
Meeting to be held on 4 February 2011

Electoral Division affected: None

Lancashire County Pension Fund – Business Plan 2011/12
(Appendix 'A' refers)

Contact for further information:
George Graham, (01772) 538102, Resources Directorate
George.graham@lancashire.gov.uk

Executive Summary

The attached report outlines the proposed business plan for 2011/12. Once accepted a regular update report will be presented to each meeting of the Pension Fund Committee.

Recommendation

The Committee is asked to accept the proposed Business Plan for 2011/12.

Background and Advice

The Myners Review of Institutional Investment recommends that Pension Funds produce an Annual Business Plan, which sets out the key areas of work for the Fund for the coming year. The Business Plan for the Lancashire County Pension Fund for 2011/12 is attached in Appendix 'A'.

Work over the coming year will focus on the implementation of the new investment strategy and will include:

- revising governance arrangements
- creating a new investment team
- designing and implementing new processes
- transition between existing arrangements and new arrangements
- review and procurement of various fund manager mandates

The plan attached at Appendix 'A' reflects the rolling forward of ongoing activity for 20010/11 and the progress made to date with specific projects included in the 2011/12 plan.

In addition there will continue to be a considerable workload associated with the administration of the Fund. Of particular note for the Committee is the move to implement a new pensioner payroll system integrated with the pensions

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administration system. This is designed to provide a more efficient service to scheme members.

Consultations

Independent Advisers, Managers within the County Council's Finance Group

Implications:

This item has the following implications, as indicated:

Risk management

The policy on risk relating to the investment of the Pension Fund is outlined in the Fund's Statement of Investment Principles, which is available from the Fund and via its website www.lancs-pensions.org.uk

Local Government (Access to Information) Act 1985
List of Background Papers

Myners Review	2001	Mike Jensen (34742)
Local Government Pension Fund Amendment Regulations	2004-2010	Pensions Services (34864)

Reason for inclusion in Part II, if appropriate

N/A

Appendix A

Lancashire County Pension Fund
Business Plan 2011/12

Action plan 2011/12

Task	**Completion Date**
Investment Strategy Implementation plan:	
Revised Governance Arrangements	
• Presentation to Pension Fund Committee	Jan 2011 and April 2011
• Approval by Full Council	May 2011
Creation of Investment Team	
• Approval of resource levels	Jan 2011
• Recruitment process (if required) on a phased basis	Jan 2011 – Jun 2011
Procedure and Process	
• Design and implement new procedures and processes to ensure appropriate checks and balances	April 2011 – Jun 2011
Transition to New Arrangements	
• Phased transfer of assets to new in-house team	Jun 2011 – April 2012

Review/Procurement of Fund Manager Mandates • UK Equity mandate • Property • Hedge Funds • Global Equities	June 2011 April 2011- April 2012 Sept 2011 Sept 2011 – April 2012
Infrastructure implementation: Completion of procurement process of Global Custodian • Review of questionnaire answers and short list of candidates • Visits to short listed candidates • Proposals put to Pension Fund committee • Appointment of Custodian	Jan 2012 Feb 2012 April 2012 July 2012
Tax litigation The County Council is participating in two group litigations being jointly managed by KPMG and McGrigors solicitors to recover tax credits withheld from UK pension funds for the period 1993/4 to 1997/8. Some £10 million of tax credits were withheld from the Pension Fund. The claims are based on the premise that the tax credit regime in place at the time was not in compliance with EU law. The situation will be continuously monitored throughout the year and reports will be presented to the committee as and when updates are received from KPMG and McGrigors. (See current report attached at Annex 1).	Throughout 2011/12

Administration: **2010 Actuarial Valuation**	
• Funding strategy recommended to committee	January 2011
• Funding strategy consultation with fund employers	Jan – March 2011
• Formal actuarial valuation report produced	31 March 2011
• New employer contribution rates take effect	1 April 2011
Transfer of pensioner payroll from Delphi to Altair	
• Specification	February 2011
• Mapping and interfaces	March – April 2011
• Implementation	May – June 2011
• Go live	July - August 2011
Project management of redundancies and early retirements for Scheme Employers	
• Estimate production	October 2010 – March 2011
• Retirements processing	March 2011 Onwards
• Over 65 retirements	Sep – Oct 2011

Annex 1

Tax Claim Update

Current claims

Current tax claims are dealt with by the custodian. Officers review these claims on a regular basis and ensure repayments are made on a timely basis.

Retrospective claims

Background to claims

As UK pension funds are exempt from paying tax on their income, UK pension funds routinely reclaim withholding taxes on dividends and interest received.

However, in applying UK law, HMRC denied repayment of tax credits on dividends designated "Foreign Income Dividends" as well as "Manufactured Overseas Dividends" (being similar to Foreign Income Dividends but on shares in the stock lending programme). Similarly other European states denied tax credits to pension funds registered in other European states.

Following some key decisions by the European Court of Justice (Manninen and Fokus cases), these denials of tax credits by European states to tax exempt bodies have been challenged as being in contravention of EU law. EU law guarantees equal treatment to all European investors, regardless of the income source or the country in which the tax exempt body is registered.

While the principle of equal treatment is now generally accepted, the extent to which retrospective claims can be made is being contested by European states. The Fund has joined a joint UK litigation being managed by the accountants KPMG and solicitors McGrigors, seeking recovery of tax credits from HMRC. It also lodged claims in France, Germany and the Netherlands for the repayment of tax credits suffered on dividends received from those countries.

FID/Manninen claims (claim value - £9,136,142)

See summary of progress in attached KPMG document.

KPMG have advised that they were hoping to receive a decision on the test case before the February committee meeting. If this is received a verbal update on this decision will be given. If not received details of the decision will be reported in April.

Fokus claims

- Netherlands

  Repayment of £264,712 has been received

- Germany (claim value - £284,042)

  Due to recent changes in German law in 2010 and various cases proceeding through the German court system the filing position had become unclear. Based on advice from KPMG these claims have been re-filed at local tax offices in addition to the claim already submitted to the central tax office. We are still awaiting a response on the re-filing of these claims.

- France (claim value –£125,590)

  Awaiting a response from the French tax authorities.

Manufactured Overseas Dividend claims (claim value –£1,634,735)

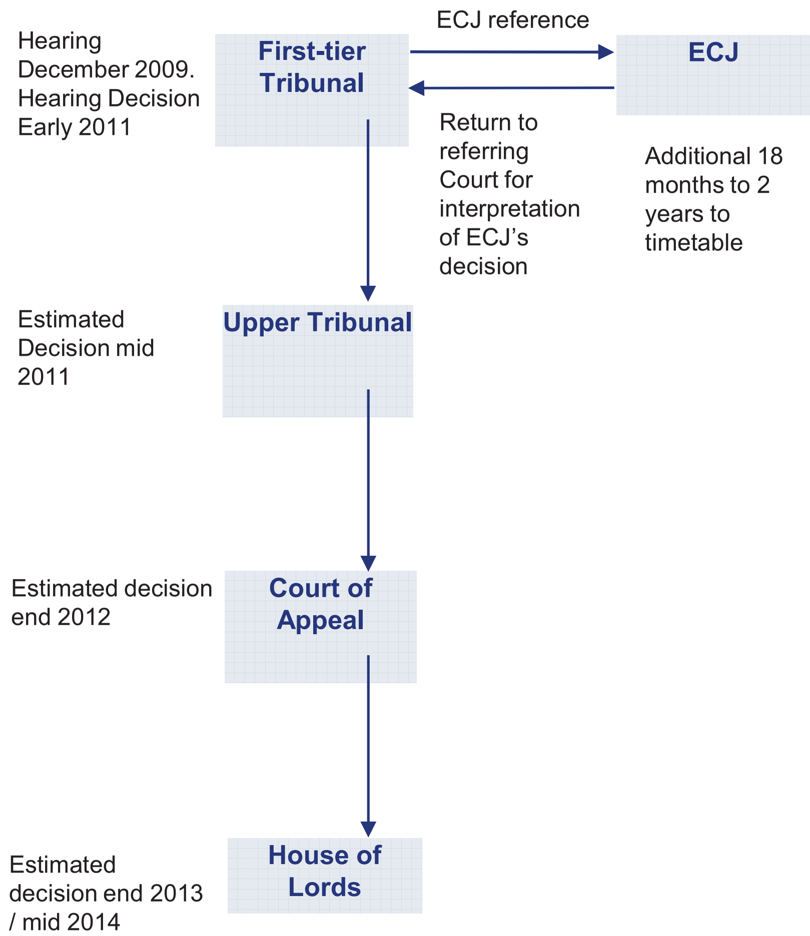
HMRC suggested a meeting in December 2010 to discuss a suitable test case for the first tier tribunal, this meeting has been delayed until 2011 due to resource issues at HMRC.

HMRC have assured McGrigors (solicitors representing the claimants) that they are progressing matters and the case management proposals set out by MGrigors.

McGrigors advise the officers monthly of any updates on this claims and any progress will be reported to the committee.

FID/Manninen Claims – Lancashire Summary

	Key updates
FID/Manninen claims	• A hearing for the test claim by BT Pension Scheme was held on 14 December 2009 – 18 December 2009, after some delay, we now expect a decision in January 2011. • McGrigors have filed detailed Grounds of Appeal in the test case. HMRC have filed their Statement of Case. Facts not in dispute are to be agreed. • LCCPF has submitted a Manninen claim of £9,136,142 and a FID claim of £1,167,065, respectively, in June 2007. • In the course of preparing the detailed Grounds of Appeal KPMG and McGrigors have formed the view, with Counsel, that third country pre-1994 Manninen claims are not a sustainable element of this claim and should be withdrawn. The above Manninen claim values are the amended values so may not tie into your own records. • The judgment of the High Court in the *FII GLO* has been handed down. It is broadly helpful to the appeal before the Special Commissioners. However, many aspects of it relate to the equivalent High Court claims, which have been stayed. • Timetable of the litigation can be found opposite.



Pension Fund Committee
Meeting to be held on 4 February 2011

Electoral Division affected:
None

Revised Funding Strategy Statement
(Appendix 'A' refers)

Contact for further information:
Diane Lister, (01772) 534827, County Treasurer's Department,
Diane.lister@lancashire.gov.uk

Executive Summary

This report sets out the Fund's revised Funding Strategy Statement following the results of the 2010 formal actuarial valuation of the Fund as noted by the Committee at their meeting of 10 December 2010.

Recommendation

The Committee is asked:

1. to approve the revised Funding Strategy Statement (FSS).

2. to agree that the Treasurer to the Lancashire County Pension Fund be authorised to use her discretion in exceptional circumstances where an individual employer wishes to deviate from the deficit recovery plan as set out within the revised Funding Strategy Statement subject to any deviation not impacting on the overall prudent management of the Fund.

Background and Advice

The triennial Valuation of the assets and liabilities of the Lancashire County Pension Fund as at 31 March 2010 has been carried out by the Fund Actuary, Mercer. The results of the Valuation, including amendments to individual employer contribution rates, will be effective from 1 April 2011.

The results of the 2010 Valuation reveal a funding position of 80% and an average employers contribution rate of 19.4%. The Actuary presented these results at the Committee meeting held on 10 December 2010 and the results were also communicated to individual employers at a Directors Briefing on 14 December 2010. Subsequently the Actuary has held one to one "surgery sessions" with individual employers to assist them in understanding the results of the valuation.

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The Fund's revised Funding Strategy Statement (FSS), attached at Appendix 'A', was also communicated to employers at the Directors Briefing and consultation is now underway with individual Fund employers in respect of their individual employer contribution rates and the options available to them via the revised Funding Strategy Statement.

Section 5 of the FSS set out the deficit recovery plan as follows: -.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates:

- *A maximum deficit recovery period of 19 years will apply. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A different period may be applied in respect of particular employers where the Administering Authority considers this to be warranted*

- *In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:*

    - *the size of the funding shortfall;*

    - *the business plans of the employer;*

    - *the assessment of the financial covenant of the Employer;*

    - *any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.*

- *Where increases in employer contribution rates are required from 1 April 2011, following completion of the 2010 actuarial valuation, the increase from the rates of contribution payable in the year 2010/11 may be implemented in equal steps, over a maximum period of 3 years.*

- *Additional contributions will be expressed as a level percentage of pensionable payroll.*

In certain instances, and in particular for Fund employers which are considered by the Administering Authority to provide a high level of covenant, an allowance may be made as part of the recovery plan for investment performance at a higher level than that assumed for assessment of the ***funding target****.*

The Committee is asked to agree that the Treasurer to the Lancashire County Pension Fund be authorised to use her discretion where an individual employer wishes to deviate from the deficit recovery plan as set out within the revised Funding Strategy Statement, subject to any deviation not impacting on the overall prudent management of the Fund.

The formal Actuarial Valuation Report as at 31 March 2010 is expected to be available no later than 31 March 2011. A copy of the Report will be sent to all members of the Pension Fund Committee.

Consultations

Pension Fund Actuaries- Mercer Limited.

Implications:

This item has the following implications, as indicated:

Risk management

Legal

Non compliance with statutory regulation.

Local Government (Access to Information) Act 1985
List of Background Papers

N/A

Reason for inclusion in Part II, if appropriate

N/A

Lancashire County Pension Fund
Funding Strategy Statement (FSS)

This Statement has been prepared by Lancashire County Council (as Administering Authority) to set out the funding strategy for the Lancashire County Pension Fund (the Scheme), in accordance with the Local Government Pension Scheme Regulations and the guidance paper issued in March 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.

1. Introduction

The Local Government Pension Scheme Regulations provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement. The key requirements for preparing the FSS can be summarised as follows:

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

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

    - the guidance issued by CIPFA for this purpose; and

    - the Statement of Investment Principles (SIP) for the Scheme published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended);

- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

Benefits payable under the Scheme are guaranteed by statute and thereby the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.

The Scheme is a defined benefit final salary scheme under which the benefits are specified in governing legislation. The required 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 actuary, including a rates and adjustments certificate. Contributions to the Scheme should be set so as to “secure its solvency”, whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

2. Purpose of the FSS in policy terms

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

The purpose of this Funding Strategy Statement is:

- **to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;**
- **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 be both cohesive and comprehensive for the Scheme as a whole, recognising that there will 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.

3. Aims and purpose of the Pension Fund

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
- manage employers' liabilities effectively
- ensure that sufficient resources are available to meet all liabilities as they fall due, and
- maximise the returns from investments within reasonable risk parameters. (A detailed statement of the Fund's Investment Objective is found in the Statement of Investment Principles)

The purpose of the fund is to:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses,

as defined in the Local Government Pension Scheme Regulations

4. Responsibilities of the key parties

The Administering Authority should:

- collect employer and employee contributions by the due dates
- invest surplus monies in accordance with the LGPS (Management and Investment of Funds) Regulations 2009 (as amended)
- ensure that cash is available to meet liabilities as and when they fall due
- manage the valuation process in consultation with the actuary
- prepare and maintain a Funding Strategy Statement and a Statement of Investment Principles, both after due consultation with interested parties, and
- monitor all aspects of the Scheme's performance and funding and amend Funding Strategy Statement/Statement of Investment Principles.
- Ensure sound corporate governance in respect of all aspects of the administration and investment of the Fund.

The Individual Employer 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, early retirement strain, and
- notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding.

The Fund actuary should:

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the Funding Strategy Statement
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters, and
- advise on funding strategy.

5. Solvency issues and target funding levels

The funding objective

To meet the requirements of the Regulations the Administering Authority’s long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the ”**funding target**”) assessed on an ongoing basis including allowance for projected final pay.

Determination of the funding target and recovery period

The principal method and assumptions to be used in the calculation of the **funding target** are set out in Annex 1.

Underlying these assumptions are the following two tenets:

- that the Scheme is expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer (or employer grouping), following a principle of no cross-subsidy between the various employers in the Scheme.

In attributing the overall investment performance obtained on the assets of the Scheme to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates:

- A maximum deficit recovery period of 19 years will apply. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A different period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan below).
- Where increases in employer contribution rates are required from 1 April 2011, following completion of the 2010 actuarial valuation, the increase from the rates of contribution payable in the year 2010/11 may be implemented in equal steps, over a maximum period of 3 years.
- On the cessation of an employer’s participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer will be due to the Scheme as a termination contribution, unless it is agreed by the Administering Authority and the other

parties involved that the assets and liabilities relating to the employer will transfer within the Scheme to another participating employer.

In determining the above objectives the Administering Authority has had regard to:

- the responses made to the consultation with employers on the FSS principles
- relevant guidance issued by the CIPFA Pensions Panel
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose
- the Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.

Deficit recovery plan

If the assets of the scheme relating to an employer are less than the **funding target** at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall.

Additional contributions will be expressed as a level percentage of pensionable payroll.

In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of the employer;
- the assessment of the financial covenant of the Employer;
- any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.

In certain instances, and in particular for Fund employers which are considered by the Administering Authority to provide a high level of covenant, an allowance may be made as part of the recovery plan for investment performance at a higher level than that assumed for assessment of the **funding target**. This higher level of return assumed will, in particular, reflect the actual investment strategy of the Fund, on the basis that this is to be maintained over the entire recovery period. The assumptions to be used in these Recovery Plan calculations are set out in Annex 1.

The normal cost of the scheme (future service contribution rate)

In addition to any contributions required to rectify a shortfall of assets below the **funding target** contributions will be required to meet the cost of future accrual of benefits for members after the valuation date (the "normal cost"). The method and assumptions for assessing these contributions are also set out in Annex 1.

6. Link to investment policy set out in the Statement of Investment Principles

The results of the 2010 valuation show the liabilities to be 80% covered by the current assets, with the funding deficit of 20% being covered by future deficit contributions due from the participating employers.

In assessing the value of the Scheme's liabilities in the Valuation, allowance has been made for asset out-performance as described in Annex 1, taking into account the investment strategy adopted by the Scheme, as set out in the SIP.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgoings. However, it is possible to construct a portfolio which closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

Investment of the Scheme's assets in line with the least risk portfolio would minimise fluctuations in the Scheme's ongoing funding level between successive actuarial valuations, assuming that the scheme started in a fully funded position.

If, at the Valuation date, the Scheme had been invested in this portfolio, then in carrying out the Valuation it would not be appropriate to make any allowance for out-performance of the investments.

Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The current investment strategy, as set out in the SIP, is shown at Annex 2

7. Identification of risks and counter-measures

Funding of defined benefits is by its nature uncertain. Funding of the Scheme is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the actuary that the greatest risk to the Scheme's funding is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the out-performance currently required on the basis of the 2010 Valuation assumptions.

The responsibility for the investment management of the Lancashire County Pension Fund is detailed in the Statement of Investment Principles and is as follows:

Lancashire County Council is responsible for administering the Fund under the Local Government Pension Scheme Regulations. It discharges its responsibilities through:

- The Pension Fund Committee;
- The Fund's Investment Panel;
- The Fund's Investment Managers.

The division of responsibility is detailed below.

Pension Fund Committee

The Pension Fund Committee has overall responsibility for approval of the investment policy and strategy, the appointment of suitable persons to implement the policy and regular review of the Fund's performance investments and investment managers. The Committee meets at least four times per annum, and currently comprises 14 elected County Councillors, 4 representatives of the District Councils and Unitary Authorities within the Fund, 2 Trade Union representatives, a and representative from Lancashire's Further Education/Higher Education establishments. The 21 members of the Committee have full voting rights. Members of the Investment Panel also attend meetings of the Committee but they do not have any voting rights.

Investment Panel

The Investment Panel consists of two external investment advisors, the Head of Pension Fund and Treasury Management, the Assistant Director of Finance and the Treasurer to the Pension Fund. The Panel meet five times a year to monitor the investment activities and performance of the Fund's investment managers. The Panel is responsible for making recommendations to the Pension Fund Committee regarding taking strategic decisions relating to the broad sector composition of the portfolio, subject to general guidelines set by the Committee.

Investment Managers

The management of the Fund's investments is structured so as to provide diversification of management style and produce an acceptable spread of risk across the portfolio whilst maximising returns.

The Fund Managers have full discretion to invest within the policy limits laid down by the Pension Fund Committee and the Investment Panel.

The Administering Authority ensures that the members of the Pension Fund Committee receive suitable training each year on Pension Fund issues

In addition to the greatest risk, CIPFA have identified a number of other key risks that are shown at Annex 3 of this document. These risks will be subjected to the monitoring and review process as described in section 8 below.

8. Monitoring and Review

The Administering Authority has taken advice from the actuary in preparing this Statement, and has also consulted with the following key stakeholders:

- Fund Employers.
- The Pension Fund Committee

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full Actuarial Valuation. Any review will take account of the current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full Actuarial Valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy

- if there have been significant changes to the Scheme membership, or LGPS benefits

- if there have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy

- if there have been any significant special contributions paid into the Scheme.

Annex 1

Method and assumptions used in calculating the funding target

Method

The actuarial method to be used in the calculation of the funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted (the Attained Age method), which makes advance allowance for the anticipated future ageing and decline of the current closed membership group.

Financial assumptions

<u>Investment return (discount rate)</u>

A yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") of 2.5% p.a. for the period pre-retirement and 1% p.a. post-retirement.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date. The allowance for this out-performance is based on the liability profile of the Scheme, with a higher assumption in respect of the "pre-retirement" (i.e. active and deferred pensioner) liabilities than for the "post-retirement" (i.e. pensioner) liabilities. This approach thereby allows for a gradual shift in the overall equity/bond weighting of the Fund as the liability profile of the membership matures over time.

<u>Individual Employers</u>

Having determined the AOAs as above for the Fund overall, it is important to consider how the financial assumptions in particular impact on individual participating employers. As employers in the Fund will have different mixes of active, deferred and pensioner members, adopting a different pre/post retirement investment return approach is equivalent to hypothecating a different equity/bond mix investment strategy for each employer. Such an approach would be inconsistent with the Fund practice, as set out in the FSS, of allocating investment performance pro rata across all employers based on a "mirror image" investment strategy to the whole Fund. In completing the calculations for individual employers therefore, a single, composite, pre and post retirement asset out-performance assumption of 1.55% has been calculated which, for the Fund as a whole, gives the same value of the funding target as the separate pre and post retirement AOAs.

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities but subject to the following two adjustments.

- An allowance of 0.3% p.a. for supply/demand distortions in the bond market (an "inflation risk premium") is incorporated and

- An allowance of 0.5% p.a. for pensions being increased annually in future by the change in the Consumer Price Index rather than the Retail Price Index, as announced in June 2010. This change will apply from April 2011 and the assumptions make due allowance for this revision as advised by the Actuary.

The overall reduction to RPI inflation as implied by the investment markets at the valuation date is 0.8% per annum.

Salary increases

The assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 2.0% p.a. over the inflation assumption as described above. This includes allowance for promotional increases.

Pension increases

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

Mortality

The mortality assumptions will be based on the most up-to-date information published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the scheme. The derivation of the mortality assumption is based on Fund specific analysis. Members who retire on the grounds of ill heath are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 3 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 1% per annum.

Method and assumptions used in calculating the cost of future accrual

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target except that the financial assumptions adopted will be as described below.

The financial assumptions for assessing the future service contribution rate should take account of the following points:

- contributions will be invested in market conditions applying at future dates, which are unknown at the effective date of the valuation, and which are not directly linked to market conditions at the valuation date; and

- the future service liabilities for which these contributions will be paid have a longer average duration than the past service liabilities.

The financial assumptions in relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real return (i.e. return in excess of price inflation) of 3.75% per annum, with a long term average assumption for price inflation of 3.0% per annum. These two assumptions give rise to an overall discount rate of 6.75% p.a.

Adopting this approach the future service rate is not subject to variation solely due to different market conditions applying at each successive valuation, which reflects the requirement in the Regulations for stability in the “Common Rate” of contributions. In market conditions at the effective date of the 2010 valuation this approach gives rise to a somewhat more optimistic stance in relation to the cost of accrual of future benefits compared to the market related basis used for the assessment of the funding target.

At each valuation the cost of the benefits accrued since the previous valuation will become a past service liability. At that time any mismatch against gilt yields and the asset out-performance assumptions used for the funding target is fully taken into account in assessing the funding position.

Summary of key whole Fund financial assumptions used for calculating funding target and cost of future accrual (the “normal cost”) for the 2010 actuarial valuation

Long-term gilt yields	
Fixed interest	4.5% p.a.
Index linked	0.7% p.a.
Market-implied RPI price inflation	3.8% p.a.
Assumed CPI price inflation	3.0% p.a.
Past service Funding Target financial assumptions	
Investment return pre-retirement	7.0% p.a.
Investment return post-retirement	5.5% p.a.

Salary increases	5.0% p.a.
Pension increases	3.0% p.a.
Future service accrual financial assumptions	
Investment return	6.75% p.a.
CPI price inflation	3.0% p.a.
Salary increases	5.0% p.a.
Pension increases	3.0% p.a.

Assumptions used in calculating contributions payable under the recovery plan

The contributions payable under the recovery plan are calculated using the same assumptions as those used to calculate the **funding target**, with the exception that, for certain employers, the required contributions are adjusted to allow for the following variation in assumptions during the period of the recovery plan:

Investment return on existing assets and future contributions

An overall additional return of 3% p.a. above the liabilities consistent gilt yield (4.5% p.a. effective as at the valuation date) reflecting the underlying investment strategy of the scheme and, in particular, including the assets of the scheme that underlie the pensioner as well as the non-pensioner liabilities.

This is equivalent to a total rate of investment return of 7.5% p.a. effective as at the 2010 valuation date.

The investment return assumed for the contributions under the recovery plan is taken to apply throughout the recovery period. As a result, any change in investment strategy which would act to reduce the expected future investment returns could invalidate these assumptions and therefore the funding strategy.

The above variation to assumptions in relation to the recovery plan can only be applied for those employers which the Administering Authority deems to be of sufficiently high covenant to support the anticipation of investment returns, based on the current investment strategy, over the entire duration of the recovery period. No such variation in the assumptions will apply in any case to any employer which does not have a funding deficit at the valuation (and therefore for which no recovery plan is applicable). Where the variation in the assumptions does apply, the resultant total contribution rate(s) implemented following the 2010 valuation will be subject to a minimum of both:

- the contribution rate(s) originally planned for 2011/12 onwards based on the 2007 actuarial valuation, and
- the normal future service contribution rate for the employer concerned.

SIP INVESTMENT STRATEGY

The investment strategy is currently being revised by the Investment Panel taking into consideration the result of the latest actuarial valuation. A proposed new approach for investment strategy was approved by the Pension Fund Committee in the meeting held on 10 December 2010. The Investment Panel has had approval to dynamically manage the Fund's interest and inflation rate exposure and the Fund's longevity risk.

The Investment Panel are proposing that the fund adopts a "target range" asset allocations for increased flexibility. The specifics of this range and the performance measures for managers is still being finalised by the Investment Panel.

The Fund is currently still being measured by the approved benchmark allocation as shown in the current Statement of Investment Principles (Table 1).

Table 1

Current benchmark asset allocation as shown in the Statement of Investment Principles

Asset Class	Allocation (%)	Managed on an Active Basis (%)	Managed on a Passive Basis (%)
UK Equities	32	14	18
Overseas Equities	32	10	20
Bonds	17	11	6
Property	6	6	
Hedge Fund of Funds	3	3	
Private Equity	3	3	
Index Linked	4	1	3
Cash	3	3	
Total	100	73	27

Performance Targets

The current performance targets are as follows:

- The active equity managers are expected to outperform the Fund specific benchmark return (index return) by 1.5% (net of fees) over rolling three years.
- The active bonds manager is expected to outperform the Fund specific benchmark return by 0.75% (net of fees) over rolling three years.
- The property manager is expected to outperform the IPD small funds benchmark return (£10m to £300m) by 1% over rolling three years.
- The Private Equity manager is expected to outperform the BVCA median return.
- The Hedge Fund of Funds manager is expected to outperform cash returns by 6% (net of fees) over rolling three years.
- The index tracking manager is expected to track indices.

Key Risks Identified

The following risks will be monitored and reviewed in line with the monitoring and review guidelines identified within section 8 of the Funding Strategy Statement

Financial

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 re-allocations in volatile markets may lock in past losses
Pay and price inflation significantly more or less than anticipated
Effect of possible increase in employers contribution rate on service delivery and admitted / scheduled bodies

Demographic

Longevity horizon continues to expand
Deteriorating pattern of early retirements

Regulatory

Changes to Regulations, eg more favourable benefits package, potential new entrants to scheme, eg part time employees.
Changes to national pension requirements and/or Inland Revenue rules

Governance

Administering Authority unaware of structural changes in employers membership (eg large fall in employee numbers, 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 bond.
Lack of frequent Pension Fund Committee meetings
Insufficient member training
Unclear decision making procedures
Changes to Pension Fund Committee membership

It should be noted that this list is not exhaustive and may be amended from time to time as part of the monitoring and review process.

Pension Fund Committee
Meeting to be held on 4 February 2011

Electoral Division affected: All

Procurement of Actuarial Services

Contact for further information:
Diane Lister, (01772) 534827, Resources Directorate,
Diane.lister@lancashire.gov.uk

Executive Summary

At the meeting held on 16 July 2010 the Committee resolved that the Appointments Sub-Committee be authorised to make an appointment for the provision of actuarial services on behalf of the Fund.

A tripartite exercise to tender for actuarial services began on 18 January 2011. This arrangement is between the Lancashire County Pension Fund, the Cumbria Pension Fund and Merseyside Pension Fund with Merseyside acting as the lead authority during the procurement process. The process and timescale is described in detail within the Background and Advice section of this report.

Recommendation

The Committee is asked to note the process and timescale of the procurement exercise for actuarial services.

Background and Advice

Local Government Pension Scheme's are required to appoint an appropriately qualified actuary in order to undertake the triennial valuation of the Fund and set contribution rates. In order to assist with the management of the Fund and also provide required information to scheme employers, the Fund actuary also traditionally undertakes regular interim valuations of the Fund and provides data for accounting purposes. The current actuarial service for Lancashire County Pension Fund is provided by Mercer.

The current terms of engagement were agreed in 2004 and a formal procurement process for the services undertaken is now due. The Cumbria and Merseyside Pension Funds are in a similar position regarding actuarial services and in order to minimise the resources needed for procurement, to provide economies of scale and to put the Fund in a better bargaining position, all three Funds have agreed to a tripartite procurement process with Merseyside acting as lead authority during the process. This has been agreed with the following provisos: -

- All funds involved will appoint the same provider

- Any Contract will be a 3 year agreement with an option to renew for a further 3 years. This arrangement is intended to cover two valuation periods

- Members will consider recommendations and approve any appointment through the committee process.*

Officers from all three Funds will be involved in the process as set out below. A provisional timetable is also shown: -

Action	Date
Publish OJEU notice	18/01/11
Evaluate Pre Qualification Questionnaires	25/02/11
Issue Tender Specification	28/02/11
Evaluate tenders received	13/05/11
Presentations/site visits held	16/05/11
Prepare recommendations & produce committee reports*	20/05/11
Committee consideration (Pension Fund Appointments Sub-Committee) and approval*	01/07/11
Provider in place	01/10/11

The Committee is asked to note the process and timescale of the procurement exercise for actuarial services.

** Committee involvement will be required as indicated. This is in line with current practice*

Consultations

The County Secretary and Solicitor and Head of Procurement have been consulted about the procurement approach.

Implications

Risk management

Regular letting of contracts for the provision of services to the Fund is designed to mitigate the following risks:

- The development of stale relationships where the Fund's needs as customer are not prioritised
- The risk of price and cost creep within contracts
- The risk of legal challenge to the Fund's processes

Financial

The driver for this procurement is not solely financial, however in general terms competitive procurements lead to keener pricing which will benefit the Fund.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
n/a	n/a	n/a

Reason for inclusion in Part II, if appropriate

n/a