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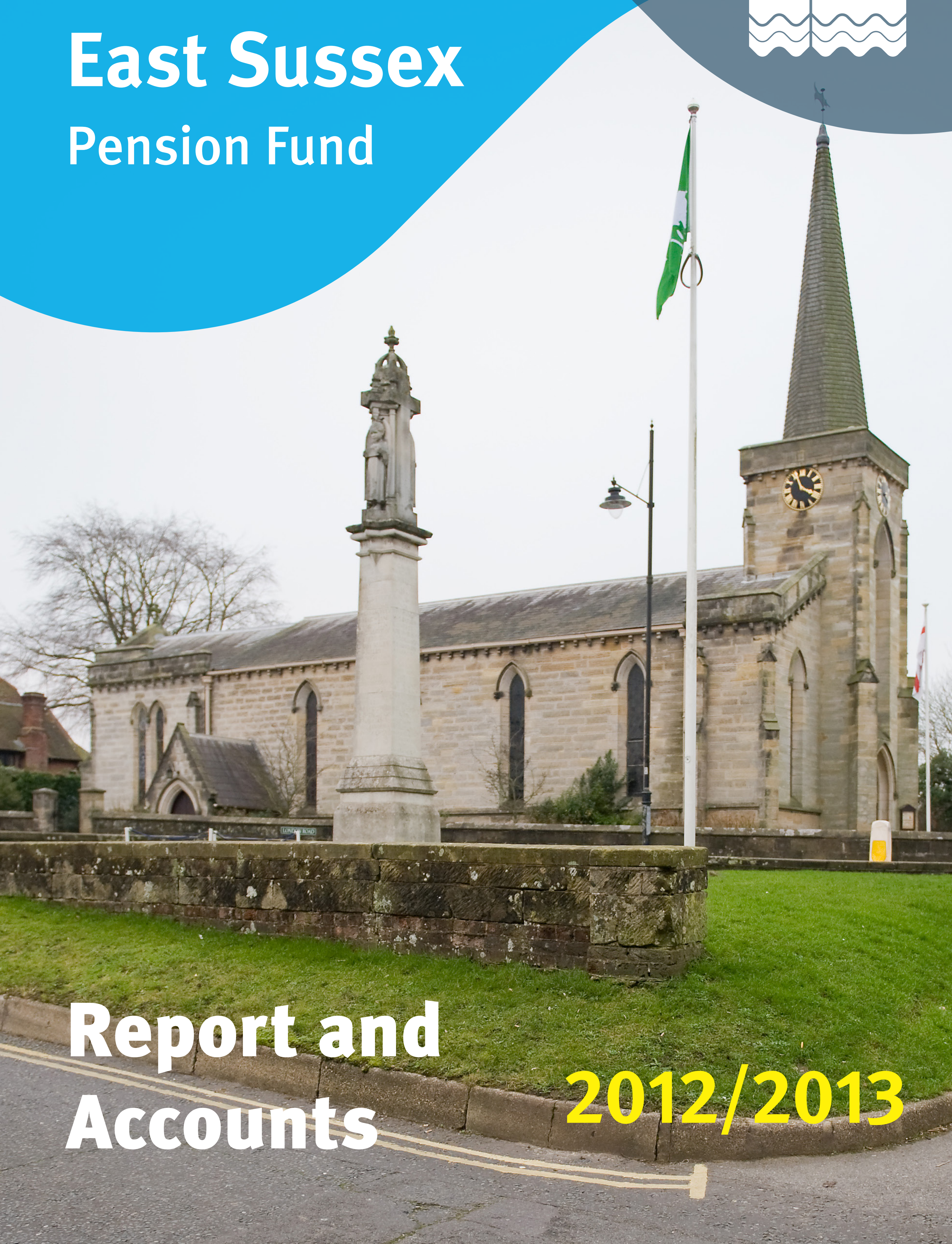
East Sussex
County Council

East Sussex
Pension Fund



Report and Accounts

2012/2013

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East Sussex Pension Fund

PSR Number 10079157

ANNUAL REPORT

MEMBERS, EXTERNAL ADVISERS AND OFFICERS

Pension Fund Investment Panel (for 2012/13)

Members:

County Councillors:	Tony Reid (Chairman) David Tutt Richard Stogdon
Brighton & Hove Councillors:	Andrew Wealls Sven Rufus
District Councillor:	Brian Redman
Staff Rep (Observer):	Tony Watson

FUND MANAGERS:

UBS Infrastructure	Harbourvest	Marathon
Prudential M&G	Adams Street Partners	Lazard
Schroders	Fidelity	Newton
Custodian – Northern Trust	Legal and General	Ruffer

INVESTMENT ADVISER:	Hymans Robertson
INDEPENDENT ADVISER:	John Hemingway
TREASURER:	Mo Hemsley Acting Chief Finance Officer East Sussex County Council
ACTUARY:	Hymans Robertson 20 Waterloo Street Glasgow G2 6DB

Contact Addresses:

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LOCAL GOVERNMENT PENSION SCHEME

Introduction

The Local Government Pension Scheme (LGPS) is a statutory pension scheme, whose rules are governed by Parliament in accordance with the Superannuation Act 1972. The rules of the scheme are mainly provided between two separate sets of regulation; the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 and the Local Government Pension Scheme (Administration) Regulations 2008, both of which came into force on 1 April 2008 and provide the statutory basis within which the Scheme can operate. Separate transitional regulations provide the link between the old and new scheme provisions.

Although a national pension scheme, set up for the benefit of local government employees the LGPS is in fact administered locally. The LGPS is open to all employees of the County Council, District and Borough Councils and Unitary Authorities in East Sussex, as well as Colleges of Further Education, Town and Parish Councils and a small number of charitable organisations who have applied to be treated as "admission bodies". In addition, the LGPS allows employees of private contractors to participate in the Scheme where they are providing a service or assets in connection with the functions of a scheme employer, in accordance with the specific requirements of the LGPS Regulations. The scheme is not open to teachers or fire fighters, as these groups of employees have separate pension schemes.

A summary of the provisions of the scheme is given below.

Currently within the East Sussex Pension Fund there are 82 participating employers. A full list of participating employers is given at note 27.

Administering Authority Responsibilities

East Sussex County Council has a statutory responsibility to administer and manage the East Sussex Pension Fund on behalf of all the participating employers of the Fund in East Sussex, and in turn the past and present contributing members, and their dependents.

The Fund receives contributions from both employees and employers, as well as income from its investments. All of these elements put together then meet the cost of paying pensions, as well as other benefits. As part of its responsibilities as the administering authority the County Council is responsible, through the Pension Fund Investment Panel, to set the investment policy and review the performance of the Fund's external investment managers. Non investment issues concerning the Fund (such as administering authority discretions or the admission of new employers via admission agreements) are considered by the County Council's Governance Committee, with responsibilities delegated to the Acting Chief Finance Officer Business Services Department.

The County Council has contracted SERCO to undertake the day to day functions associated with the administration of the LGPS. The main services provided by SERCO include maintenance of scheme members' records, calculation and payment of retirement benefits including premature retirement compensation, transfers of pension rights, calculation of annual pension increases and the provision of information to scheme members, employers and the Fund's Actuary.

Although the day to day work associated with administering the LGPS has been passed to SERCO, the County Council takes its statutory responsibility very seriously. It has therefore, set up procedures to ensure that SERCO undertake the work associated with the administration of the LGPS in accordance with an agreed service specification. The County Council also ensures that all the participant employers within the East Sussex Pension Fund are aware of their own responsibilities, as well as any changes to the provisions of the Scheme that may be introduced.

A major responsibility of the County Council as the administering authority is to undertake a valuation of the Pension Fund's assets and liabilities (triennial valuation). The main purpose of this exercise is to assess the size of the Fund's current and future liabilities against the Fund's assets, and then set the employer contribution to the Fund for each participating employer for the following three year period. The most recent actuarial valuation of the Fund was carried out as at 31 March 2010 (see note 18 to the accounts). In addition to the triennial valuation of the Pension Fund, the County Council also receives requests each year from scheme employers to obtain appraisal reports from the Fund actuary, to enable them to comply with requirements of the Financial Reporting Standards FRS17 or IAS19. The provision of these reports, however, falls outside of the functions of the County Council as an administering authority.

It is important to note that ultimate responsibility for both the administration of the Pension Fund and the investment of all monies associated with the Fund remains with the County Council. In 2002 the County Council established an annual employers' pension forum, to update and involve all the participating employers of the East Sussex Pension Fund, which is always well attended.

Changes affecting the LGPS during 2012/2013, and future developments

There have been no major changes to the rules governing the current benefit structure of the LGPS in the previous financial year.

Following Lord Hutton's review of public service pensions in 2010, a final report was published on 10 March 2011. At the Budget on 23 March 2011 the Chancellor accepted Lord Hutton's recommendations as a basis for further consultation on bringing in changes to the benefit structures of public service schemes, including the LGPS. There were, also separate Treasury proposals regarding the increase of member contributions to the public service pensions schemes from 2011. After pressure from the local government employers and unions it was agreed that the Hutton and Treasury related changes should be considered as a consolidated exercise rather than introduced separately.

As a result, there were negotiations between the local government employers and unions resulting in agreement on changes to the future shape of the LGPS. The revised arrangements will be effective from 1 April 2014. Consultation is still taking place on the rules of the new LGPS, with the expectation that new Regulations will be in place so that they can be taken account in setting employer contribution rates as part of the latest formal valuation of the Fund as at 31 March 2013.

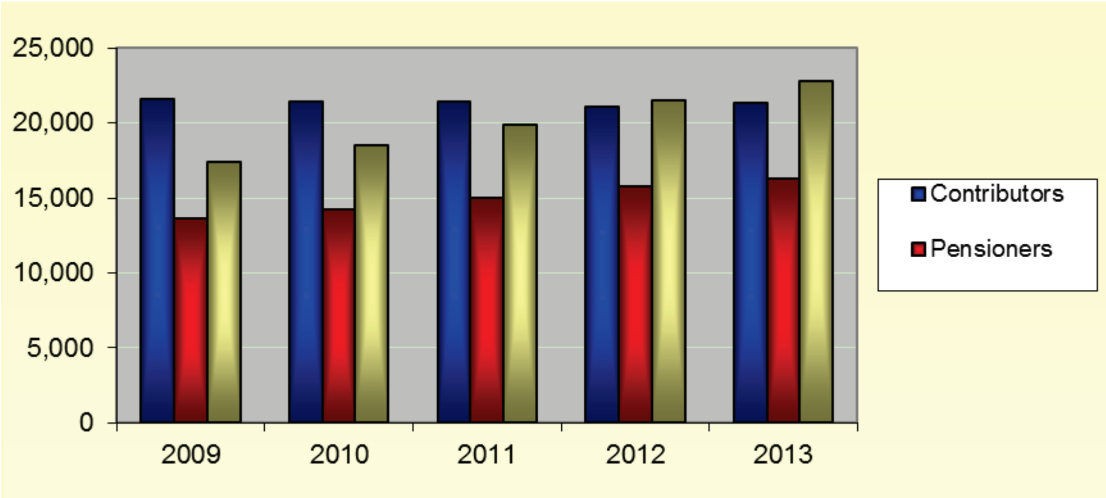
The proposals include:

- A Career Average Revalued Earnings (CARE) scheme, revalued by CPI;
- Accrual rate of 1/49th (currently 1/60th);
- Normal Pension Age in line with the member's State Pension Age;
- Employee contribution rates based on actual pay (currently based on whole-time equivalent salary for part time members);
- Minimum period of membership to qualify for a deferred pension to increase to 2 years (currently 3 months);
- Average employee contribution rates 6.5% (same as current scheme) but contribution banding rates designed to take account of differing tax bands – contributions range from:
    - 5.5% gross (4.40% net of basic rate (20%) tax relief on contributions - actual pay below £13,501; to
    - 12.5% gross (6.88% net of higher rate (50%) tax relief on contributions - actual pay over £150,000;
- Members can opt to pay half contributions for half the pension, while retaining full value of other benefits (the 50/50 option) – not currently provided;
- Accrued benefits up to 31 March 2014 are protected, including:
    - Past service benefits based on final salary and current Normal Pension Age;
    - Retention of existing "Rule of 85" protections;

The LGPS in East Sussex

Membership of the East Sussex Pension Fund as at 31 March 2013 is detailed below:

	March 2012	March 2013
Active Members (contributors)	21,050	21,347
Pensioners (inc dependants)	15,738	16,276
Deferred Members	21,504	22,822



Summary of the provisions of the LGPS

The LGPS is contracted out of the State Second Pension (S2P) and provides defined benefits which compare favourably with many private schemes.

The following summary is provided as an illustration of the type and range of benefits the LGPS provides. It is not intended as a detailed guide, nor does it detail the specific conditions that must be met before benefits can be obtained.

Contributions

Participating members are required to pay contributions, which are assessed by reference to their pensionable pay band as at the start of each financial year by their employer. These contributions currently range between 5.5% to 7.5% of pensionable pay. An individual can be re-attributed into a different band (and pay a different contribution rate, which could be higher or lower) if their employer believes they have had a permanent, material change in the terms of their contract. The pay bands are subject to increases at 1 April each year, in line with the annual pensions increase figure for that year.

Employer contribution rates are set every three years following a valuation of the Pension Fund's assets and potential liabilities. The most recent actuarial valuation was as at 31 March 2010 with the new employer rates being effective from 1 April 2011. The next three years employer rates certificate will be available later in 2013/14.

Benefits

As a final salary scheme, pension benefits are generally calculated by reference to a member's pensionable earnings during the final year of membership. Annual pensions are based on 1/80th of the final pensionable pay for each year of membership up to 31 March 2008 and 1/60th of the final pensionable pay for each year of membership from 1 April 2008.

In addition to the annual pension, scheme members are also entitled to a lump sum retirement grant based on 3/80ths of final pensionable pay for each year of membership up to 31 March 2008. There is no automatic lump sum in respect of membership from 1 April 2008, but members also have the flexibility to increase their lump sum, within HMRC limits, to 25% of the value of their pension savings, by converting some of their annual pension. Within the LGPS every £1 of annual pension forgone provides an additional lump sum of £12. The lump sum is currently paid tax free.

Annual Allowance / Lifetime Allowance changes from April 2011

As part of the 2011 Budget the Treasury has made changes to the Annual Allowance and Lifetime Allowances from April 2011.

The Annual Allowance has reduced to £50,000, (from £255,000) from April 2011, with the facility to carry forward any unused Annual Allowance in the previous 3 tax years. Future Annual Benefit Statements for active members will include details of the Annual Allowance used in the relevant tax year. Members are required to advise HMRC if the growth in their accrued pension in the year exceeds the Annual Allowance. Where an Annual Allowance tax charge becomes due, this tax charge would be payable by the member unless the tax charge is in excess of £2,000, in which case there are provisions for the Fund to pay the tax due, with a reduction to the member's accrued benefits to take account of the tax being paid by the scheme.

The Lifetime Allowance has been reduced to £1.5million (from £1.8million) from April 2012. Members likely to be affected by this change were able to apply for "Fixed Protection" to HMRC to retain the £1.8million Lifetime Allowance. Applications had to be received by HMRC before 6 April 2012. "Fixed Protection" is lost if members have real growth (i.e. ignoring inflation) in their pension in any year after the 2011/12 Fund Year.

Ill health

The ill health benefits can be put into payment at any age and are awarded depending on the circumstances in each individual case as certified by an independent qualified occupational health doctor. There are three tiers of ill health award, in which some tiers offer some element of enhancement to accrued pension benefits, as follows –

Tier one – accrued benefits plus 100% prospective future service enhancement where there is no likelihood of obtaining further gainful employment with any employer (LGPS or otherwise) before age 65.

Tier two – accrued benefits plus 25% prospective future service enhancement where there is a reduced likelihood of obtaining further gainful employment with any employer (LGPS or otherwise) before age 65.

Tier three – accrued benefits with no prospective future service enhancement where there is a likelihood that further gainful employment with any employer (LGPS or otherwise) will be obtained within 3 years (this level of award is subject to review and will cease by no later than 3 years after the award is made or could be converted to a tier two ill health benefit if it was certified that the required criteria was met);

April 2013 Pensions Increase

The Chancellor of the Exchequer announced that from April 2013 Public Sector pensions would be increased annually by the rise in CPI for the year to the preceding September. The Office for National Statistics has announced that the rise in CPI for the year to September 2012 was 2.2%. This increase was applied on 8 April 2013.

Death Benefits

The LGPS provides for the payment of a lump sum death grant, should a member die in service. The amount of the death grant payable from the Scheme is 3 times the final year's pensionable pay.

If a member dies within ten years of starting to receive their pension, and before age 75, a death grant equal to 10 times the individual's annual pension (less payments already made) is due.

The LGPS also provides for the payment of a survivors pension to spouses, civil partners and nominated co-habiting partners. Survivors' pensions are based on $1/160^{th}$ of the final pensionable pay for each year of the deceased member's membership. These are payable for life. Where appropriate the LGPS also provides for the payment of pensions to eligible children.

Added Years/ARCs/AVCs

The facility for a scheme member to purchase additional scheme membership was removed from 1 April 2008, although existing elections made up to but commencing after 31 March 2008 were honoured.

Scheme members are able to purchase additional pension (in multiples of £250) up to a maximum of £5,000 pa by the payment of additional regular contributions (ARCS). Employers can also award additional pension of up to £5,000 p.a. (although they don't have to do so in multiples of £250). A member may purchase additional pension for the member only or for the member and his or her dependents. Where an employer purchases additional pension, it will provide additional pension for the member only.

Scheme members may also elect to pay additional contributions to be invested in an Additional Voluntary Contribution Scheme set up by the Fund. The East Sussex Pension Fund has chosen Prudential as its AVC provider. The accumulated AVC fund may then be used at retirement in a number of ways. It can be used to provide an additional pension, either through the LGPS or through the purchase of an annuity from an insurance company. Alternatively the accumulated AVC fund can be used to provide additional lump sum (within HMRC limits) rather than the member converting annual pension at a rate of £1:£12, as highlighted previously.

Prudential have introduced a withdrawal penalty in respect of new AVC contracts where the first contribution is received after 18 August 2012, and the benefits are drawn within 5 years of retirement. There is no penalty where the AVC is held for more than 5 years or where the first contribution was received before 19 August 2012. These withdrawal penalties are:

Year of withdrawal	**Withdrawal during Year 1**	**Withdrawal during Year 2**	**Withdrawal during Year 3**	**Withdrawal during Year 4**	**Withdrawal during Year 5**
%	15%	10%	8%	6%	5%

AVCs may also be paid independently to a Free Standing AVC Scheme, to whichever provider the individual chooses. The Free Standing AVC benefits are, however, separate from the member's LGPS benefits. A member would, therefore, only be able to take a maximum 25% lump sum from the Free Standing AVC, and have to purchase an annuity from the AVC provider, or an alternative insurance company.

Scheme members are also able to contribute to Stakeholder Pensions, which are similar to personal pensions and are designed to provide a cost effective method of providing a pension in retirement. In order to ensure the ability to contribute to a Stakeholder Pension was not abused restrictions were initially applied as to who could make use of such an arrangement. These restrictions have since been removed, resulting in Stakeholder pensions being available to all. Any LGPS scheme member would need to make their own arrangements were they to wish to contribute to a Stakeholder Pension.

Discretions

The LGPS provides the framework in which the statutory basis of the Scheme may work. In addition to the standard scheme benefits there are also a number of discretionary areas for the employer and the administering authority. There is an additional requirement for certain discretionary policies to be published as a matter of public record. Key discretionary areas where a published policy is required by the employer are:

- The award of additional scheme membership
- The award of additional scheme pension
- The choice of early payment of benefits from age 55 (but before age 60)
- The agreement to flexible retirement from age 55

Further details on participating employers' policies can be obtained from each individual employer.

Additionally, the County Council in its role as administering authority must publish its policy on the abatement of pension on re-employment.

Resolving Complaints

The LGPS is required by statute to make arrangements for the formal resolution of any disagreements on matters in relation to the scheme that may arise between, the managers of the Scheme and the, active, deferred and pensioner members of their representatives.

There is access to a two stage dispute resolution procedure. This procedure consists of an initial application to the person or persons appointed by the individual's employer to consider the matter. If the complainant is still dissatisfied with the decision they then have the right to refer the matter to the County Council to consider the matter under dispute. The person appointed for this role in the East Sussex Pension Fund is the Assistant Director Legal and Democratic Services.

In addition to the dispute procedure the Social Security Act 1990 and the Pensions Act 1995 have created a framework of national organisations to control occupational and personal pension schemes, to which LGPS members have access.

Communication

The Administering Authority must publish a statement of its policy concerning communications with members and employers in the pension fund.

The Administering Authority is also required to issue an annual benefit statement to each of its active, deferred and pension credit members.

Governance Compliance Statement

1. Scope of responsibility

East Sussex County Council has a statutory responsibility to administer and manage the East Sussex Pension Fund on behalf of all the participating employers of the Fund in East Sussex, and in turn past and present contributing members, and their dependents. The County Council is responsible for ensuring that pension fund administration is conducted in accordance with the law and proper standards, and that members money is safeguarded and properly accounted for, efficiently and effectively.

As part of its responsibilities as the administering authority the County Council is responsible, through the Pension Fund Investment Panel, to set the investment policy and review the performance of the Fund's external investment managers. The Investment Panel meets five times a year. Non investment issues concerning the Fund (such as administering authority discretions or the admission of new employers via admission agreements) are considered by the County Council's Governance Committee, which meets at least five times a year. These arrangements comply with the guidance given by the Secretary of State.

East Sussex County Council has adopted a Local Code of Corporate Governance, which is consistent with the principles of the CIPFA/SOLACE Framework Delivering Good Governance in Local Government. This Local Code covers all of the staff, systems and other activities involved in or related to the County Council's role as administering authority of the Pension Fund. A copy of the Local Code is on ESCC website at www.eastsussex.gov.uk or can be obtained from the Council's Monitoring Officer.

The Pension Fund has also adopted its own Governance Policy Statement, which sets out in more detail its key governance arrangements, and a Statement of Investment Principles, (attached as Appendix Three / page 85 of this report) both of which have been in place at East Sussex County Council for the year ended 31 March 2013 and up to the date of the approval of the Pension Fund accounts.

Investment Panel Training

As the administering authority of the East Sussex Pension Fund, the Council recognises the importance of ensuring that all staff and members charged with the financial management and decision making with regard to the Fund are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them. It therefore seeks to appoint individuals who are both capable and experienced and will provide training for staff and members of the decision making bodies to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

It is not the intention that elected representatives should individually become technical experts, but collectively they have the ability, knowledge and confidence to question and challenge the information and advice they are given, and to make effective and rational decisions.

The following training has been given during the year:

Training for Panel members is primarily provided as an adjunct to Panel meetings by presentation from the Funds professional advisers. During 2012/2013 presentations were given on:

- Fund valuation and funding strategy
- Economic Reviews
- Corporate Governance
- Risk Assessments
- Derivatives
- Environmental, Social and Governance issues
- Current Investment Issues
- Fund Manager Reviews

The most recent Annual East Sussex Pension Fund Investment Panel Training Day was organised by Newton Asset Management on 3 April 2013.

All new Panel members are given initial training on the operation of the Fund and their responsibilities. This is supplemented by external training provided by the Funds consultants Hymans Robertson LLP and panel training days.

Current Investment Arrangements

The Investment Panel ("the Panel") made slight changes to the Fund's investment manager structure and asset allocation over the course of the financial year to 31 March 2013.

Firstly, the mandate with Marathon (global equities) was terminated given the Panel's concerns relating to key personnel changes at the firm. The assets formerly managed by Marathon were transferred to Legal & General in September 2012 and remained so at the end of the financial year.

Secondly, 5% of the Fund's assets were transferred to the Fund's Absolute Return managers (Newton and Ruffer) from Legal & General, where they were previously invested in global equities. This marked a small change to the Fund's overall strategy and represented a rebalancing of the risks in the Fund, whilst maintaining a similar level of expected return.

The Fund continues to employ Lazard to actively manage global equities. In addition, a new global equity manager, Longview, has been appointed to manage the assets formerly managed by Marathon. Longview started to manage assets for the Fund after the financial year end (in April 2013).

The future arrangements for the ex-Fidelity assets, currently managed by Legal & General, have now been agreed by the Panel. The assets will be transferred to State Street in due course and will be managed to a specialist passive mandate which aims to replicate the performance of the RAFI 3000 global equity index. This "alternative indexation" is intended to diversify the Fund's exposure to market capitalisation based passive management.

The Fund has continued to build its alternatives portfolio during the year, making new commitments to several private equity funds with the Fund's existing private equity managers.

When considering the investment portfolio, diversification is one of the most important issues that the Panel considers. Rather than relying on a single investment decision, making a larger number of smaller decisions can reduce risk. For example, any investment in equities is spread across many stocks, across a wide range of industries and across a number of countries. If a particular company, industry or country has a period of poor returns, this should have a limited impact on the portfolio.

The Fund's investments are very well diversified, as a way of controlling risk. This applies in two ways:-

1. Asset Allocation

Although the benchmark is heavily weighted towards equities (as the asset class expected to provide the highest return over the medium to long term), there is a significant exposure to property and infrastructure ("real" assets with a different performance cycle to equities) and a small exposure to bonds (which more closely "match" the Fund's liabilities). The allocation to absolute return mandates provides further diversification. Uniquely, within those mandates, the managers have the flexibility to alter asset allocation between asset classes.

Within equities, diversification is achieved by investing in different markets across the world, which provides exposure to many different stocks and sectors.
The Fund is further diversifying some of the equity exposure by making annual allocations to unquoted equity. This allocation is expected to lead to higher returns over the longer term, without adding significantly to overall risk (which is consistent with the objectives of the Fund).

2. Manager Structure
The Fund employs a number of managers with differing styles and management approaches. This is a deliberate policy to avoid over-dependence on the fortunes of a single manager and to concentrate on managers' particular areas of expertise. All managers are expected to maintain well diversified portfolios. The Fund's structure is broadly as follows:

- Legal & General Investment Management remains the Fund's largest single equity manager; all of the assets are managed passively against UK and Global equity market benchmarks. The Fund's remaining two global equity managers (now Lazard and Longview) employ active approaches which both differ in terms of style and the inherent risk. The Investment Panel believes that global equity mandates offer the most efficient way to access world equity markets.

- The two absolute return managers are expected to add diversification away from the Fund's other mandates due to their flexible and unconstrained management approach.

- A single property manager is employed (Schroders); however, the "fund of fund" approach provides manager diversification within the underlying holdings.

- Corporate bonds and absolute return bonds are managed by M&G.

- The Fund's allocations to infrastructure and unquoted equities are split into four portfolios, each managed by separate managers.

The objective is to seek to ensure:

1. each active manager adds value, net of the fees which it charges;

2. each manager brings something different - specialist skills or a different approach to investment - to the mix.

In this way, the Fund seeks to achieve an appropriate return and added value over the medium term, but in a risk controlled fashion.

Prepared by:-
Scott Donaldson - Partner
James Sheehan – Investment Analyst
May 2013
For and on behalf of Hymans Robertson LLP

STATEMENT OF RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

The authority is required:

- To make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Acting Chief Finance Officer Business Services Department.

- To manage its affairs to secure, economic, efficient and effective use of resources and safeguard its assets.

The responsibilities of the Acting Chief Finance Officer, Business Services Department

The Acting Chief Finance Officer, Business Services Department is responsible for the preparation of the Fund's statement of accounts which, in terms of the Chartered Institute of Public Finance and Accountancy / Local Authorities (Scotland) Accounts Advisory Committee Code of Practice on Local Authority Accountancy in Great Britain ("the Code") is required to present fairly the position of the Fund at the accounting date and its income and expenditure for the year ended 31 March 2013.

In preparing this statement of accounts, the Acting Chief Finance Officer, Business Services Department has:

- Selected suitable accounting policies and then applied them consistently.

- Made judgements and estimates that were reasonable and prudent.

- Complied with the code.

The Acting Chief Finance Officer, Business Services Department has also:

- Kept proper accounting records which were up-to-date.

- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

NOTES TO THE ACCOUNTS

East Sussex Pension Fund Account

2011/12 £000		Notes	2012/13 £000
	Dealings with members, employers and others directly involved in the fund		
	Contributions	7	
78,364	From Employers		80,556
26,979	From Employees or Members		26,345
105,343			106,901
38,637	Transfers in from other pension funds	8	7,854
143,980			**114,755**
104,690	Benefits	9	106,076
4,176	Payments to and on account of leavers	10	4,816
1,608	Administration expenses	11	1,464
110,474			**112,356**
33,506	Net additions from dealings with members		**2,399**
	Returns on investments		
25,865	Investment income	12	22,490
(1,122)	Taxes on income	13	(735)
17,681	Profit and losses on disposal of investments and changes in the market value of investments	15a	256,500
(6,979)	Investment management expenses	14	(7,449)
35,445	Net return on investments		**270,806**
68,951	Net increase in fund during the year		273,205
2,002,120	Add opening net assets of the scheme		2,071,071
2,071,071	Closing net assets of the scheme		**2,344,276**

Net Assets Statement for the year ended 31 March 2013

31 March 2012 £000		Notes	31 March 2013 £000
(Restated)			
2,019,482	Investment assets	15	2,281,664
35,905	Other Investment balances	20	80,284
45,273	Cash deposits	15	58,468
2,100,660			**2,420,416**
(35,147)	Investment liabilities	21	(81,629)
9,930	Current assets	20	9,780
(4,372)	Current liabilities	21	(4,291)
2,071,071	**Net assets of the fund available to fund benefits at the year end.**		**2,344,276**

The fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end. The actuarial present value of promised retirement benefits is disclosed at Note 19.

<u>Treasurers Certificate</u>

I certify that the accounts of the East Sussex Pension Fund provide a true and fair view of the Pension Fund at 31 March 2013 and of the movements for the year then ended.

Mo Hemsley
Acting Chief Finance Officer
Business Services Department

Notes to the East Sussex Pension Fund Accounts for the year ended 31 March 2013

1: Description of fund

The East Sussex Pension Fund ("the fund") is part of the Local Government Pension Scheme and is administered by East Sussex County Council. The County Council is the reporting entity for this pension fund and the fund is overseen by the East Sussex Pension Fund Investment Panel.

The following description of the fund is a summary only. For more detail, references should be made to the East Sussex Pension Fund Annual Report 2012/13 and the underlying statutory powers underpinning the scheme, namely the Superannuation Act 1972 and the Local Government Pension Scheme (LGPS) Regulations.

a) General

The fund is governed by the Superannuation Act 1972. The fund is administered in accordance with the following secondary legislation:

- the LGPS (Benefits, Membership and Contributions) Regulations 2007 (as amended).

- the LGPS (Administration) Regulations 2008 (as amended).

- the LGPS (Management and Investment of Funds) Regulations 2009.

It is a contributory defined benefit pension scheme administered by East Sussex County Council to provide pensions and other benefits for pensionable employees of East Sussex County Council, the district councils in East Sussex County and a range of other scheduled and admitted bodies within the county area. Teachers, police officers and Fire fighters are not included as they come within other national pension schemes.

b) Membership

Membership of the LGPS is voluntary and employees are free to choose whether to join the scheme, remain in the scheme or make their own personal arrangements outside the scheme.

Organisations participating in the East Sussex Pension Fund include:

- Scheduled bodies, which are local authorities and similar bodies whose staff are automatically entitled to be members of the fund
- Admitted bodies, which are other organisations that participate in the fund under an admission agreement between the fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

There are 82 employer organisations within East Sussex Pension Fund including the County Council itself, as detailed below:

East Sussex Pension Fund	31 March 2012	31 March 2013
Number of employers participating in the scheme	73	82
Number of employees		
County Council	9,504	9,336
Other employees	11,546	12,011
Total	**21,050**	**21,347**
Number of pensioners		
County Council	6,966	7,160
Other employers	8,772	9,116
Total	**15,738**	**16,276**
Deferred pensioners		
County Council	10,242	10,782
Other employers	11,262	12,040
Total	**21,504**	**22,822**

c) Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the fund in accordance with the LGPS (Benefits, Membership and Contributions) Regulations 2007 and range from 5.5% to 7.5% of pensionable pay for the financial year ending 31 March 2013. Employer contribution rates are set every three years following a valuation of the Pension Fund's assets and potential liabilities. The most recent actuarial valuation was as at 31 March 2010 with the new employer rates being effective from 1 April 2011.

d) Benefits

Pension benefits under the LGPS are based on final pensionable pay and length of pensionable service, summarised below:

	Service pre 1 April 2008	Service post 31 March 2008
Pension	Each year worked is worth 1/80 x final Pensionable salary	Each year worked is worth 1/60 x final Pensionable salary
Lump sum	Automatic lump sum of 3 x salary. In addition, part of the annual pension can be exchanged for a one-off -tax Free cash payment. A lump sum of £12 is paid for each £1 of pension given up	No automatic lump sum. Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid Paid for each £1 of pension given up.

There are a range of other benefits provided under the scheme including early retirement, disability pensions and death benefits. For more details, please refer to the East Sussex Pension Fund scheme handbook available on the Pension Fund Website.

Benefits are index-linked in order to keep pace with inflation. In June 2010, the Government announced that the method of indexation would change from the retail prices index to the consumer prices index. This change took effect from 1 April 2011.

2: Basis of preparation

The Statement of Accounts summarises the fund's transactions for the 2012/13 financial year and its position at year-end as at 31 March 2013. The accounts have been prepared in accordance with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008, the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 issued by CIPFA which is based upon International Financial Reporting Standards (IFRS) as amended for UK public sector and the Financial Reports of Pension Schemes Statement of Recommended Practice.

The accounts summarise the transactions of the fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed at Note 19 of these accounts.

The Pension Fund publishes a number of statutory documents, including a Statement of Investment Principles, a Funding Strategy Statement, Governance Policy Statement, Communications Policy Statement, Employers Contributions, Responsibilities of Key Parties, and Statements of Compliance. Copies can be obtained by contacting the Council's Accounts and Pensions team or alternatively are available from - http://www.eastsussex.gov.uk

3: Summary of significant accounting policies

Fund account – revenue recognition

a) Contribution income

Normal contributions, both from the members and from the employer, are accounted for on an accruals basis at the percentage rate recommended by the fund actuary in the payroll period to which they relate.

Employers' augmentation contributions and pensions strain contributions are accounted for in the period in which the liability arises. Any amount due in year but unpaid will be classed as a current financial asset. Amounts not due until future years are classed as long-term financial assets.

b) Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations (see notes 8 and 10).

Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their Additional Voluntary Contributions (see below) to purchase additional scheme benefits are accounted for on a receipts basis and are included in Transfers In (see Note 8).
Bulk (group) transfers are accounted for on a receipts basis in accordance with the terms of the transfer agreement.

c) Investment income

i. Interest income - Interest income is recognised in the fund account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii. Dividend income - Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iii. Distributions from pooled funds - Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iv. Movement in the net market value of investments - Changes in the net market value of investments are recognised as income and comprise all realised and unrealised profits/losses during the year.

Fund account – expense items

d) Benefits payable

Pensions and lump-sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

e) Taxation

The fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a fund expense as it arises.

f) Administrative expenses

All administrative expenses are accounted for on an accruals basis. Regulations permit the County Council to charge administration costs to the fund. A proportion of relevant County Council costs have been charged to the fund on the basis of actual time spent on pension scheme administration and investment related business and in safeguarding Fund assets.

g) Investment management expenses

All investment management expenses are accounted for on an accruals basis except where noted below for performance related fees.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change. In addition the fund manager mandate with Marathon Asset Management was performance related. This global equities mandate was terminated in September 2012.

The performance fee is calculated at the anniversary of the initial investment which commenced in June 2010. This is accounted for as a cash paid basis and £0.4m performance related fees were charged to 2011/12 in respect of the 12 months ended June 2011. The final fee for the period July 2011 until the termination in September 2012 was £0.5m and this was charged in the 2012/13 accounts.

The cost of obtaining investment advice from external consultants is included in investment management charges.

Net assets statement

h) Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the fund becomes party to contractual acquisition of the asset. From this date any gains or losses arising from changes in the fair value of asset are recognised by the fund.

The values of investments as shown in the net assets statement have been determined as follows:

i) Market-quoted investments
The value of an investment for which there is a readily available market price is determined by the bid market price ruling on the final day of the accounting period.

ii) Fixed interest securities are recorded at net market value based on their current yields.

iii) Unquoted investments
The fair value of investments for which market quotations are not readily available is determined as follows:

- Directly held investments include investments in limited partnerships, shares in unlisted companies, trusts and bonds. Other unquoted securities typically include pooled investments in property, infrastructure, debt securities and private equity. The valuation of these pools or directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The valuation standards followed in these valuations adhere to industry guidelines or to standards set by the constituent documents of the pool or the management agreement.

- Investments in unquoted property and infrastructure pooled funds are valued at the net asset value or a single price advised by the fund manager.
- Investments in private equity funds and unquoted listed partnerships are valued based on the fund's share of the net assets in the private equity fund or limited partnership using the latest financial statements published by the respective fund managers in accordance with the guidelines set out by the British Venture Capital Association.

iv) Limited partnerships
Fair value is based on the net asset value ascertained from periodic valuations provided by those controlling the partnership.

v) Pooled investment vehicles are valued at closing bid price if both bid and offer prices are published; or if single priced, at the closing single price. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income which is reinvested in the fund, net of applicable withholding tax.

i) Foreign currency transactions

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of transaction. End-of-year spot market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchases and sales outstanding at the end of the reporting period.

j) Derivatives

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

Derivative contract assets are fair valued at bid prices and liabilities are fair valued at offer prices. Changes in the fair value of derivative contracts are included in change in market value.

The value of exchange traded options is determined using the exchange price for closing out the option at the reporting date. The value of over-the-counter contract options is based on quotations from an independent broker. Where this is not available, the value is provided by the Custodian using generally accepted option-pricing models with independent market data.

The future value of forward currency contracts is based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.

k) Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

l) Financial liabilities

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

m) Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS 26, the fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statement (Note 19).

n) Additional voluntary contributions

East Sussex Pension Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the pension fund. The fund has appointed Prudential as its AVC provider. AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

AVCs are not included in the accounts in accordance with section 4(2) (b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093) but are disclosed as a note only (Note 22).

4: Critical judgements in applying accounting policies

Unquoted private equity investments

It is important to recognise the highly subjective nature of determining the fair value of private equity investments. They are inherently based on forward-looking estimates and judgements involving many factors. Unquoted private equities are valued by the investment managers using guidelines set out by the British Venture Capital Association. The value of unquoted private equities at 31 March 2013 was £127.4 million (£108.6 million at 31 March 2012).

Pension fund liability

The pension fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 18. This estimate is subject to significant variances based on changes to the underlying assumptions.

Use of Financial Instruments

The Fund uses financial instruments to manage its exposure to specific risks arising from its investments. In applying the accounting policies set out within the notes that accompany the financial statements the Council has had to make certain judgements about complex transactions or those involving uncertainty about future events. The critical judgements made in the financial statements are based around determining a fair value for the alternative investments shown in the Net Asset Statement. It is important to recognise valuations for these types of investments are highly subjective in nature. They are inherently based on forward-looking estimates and judgements that involve many factors.

5: Future assumptions and other estimated uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Net assets statement at 31 March 2013 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgments relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, for the 2010 Valuation the actuary advised that: • A 0.5% increase in the discount rate assumption would result in a decrease in the pension liability of approximately £170 million (8%) • A 0.5% increase in assumed earnings inflation would increase the value of liabilities by approximately £46 million (2%). • A 1 year increase in assumed life expectancy would increase the liability by approximately £43 million (2%).
Debtors	At 31 March 2013, the fund had a balance of sundry debtors of £1.9 million. The fund makes allowance for doubtful debts based on an assessment of the recoverability of receivables. Allowances are applied to receivables where events or changes in circumstances indicate that the carrying amounts may not be recoverable.	Where the expectation is different from the original estimate, such difference will affect the carrying value of receivables.
Private equity	Private equity investments are valued at fair value in accordance with British Venture Capital Association guidelines. These investments are not publicly listed and as a such there is a degree of estimation involved in the valuation.	The total private equity investments in the financial statements are £127.4 million. There is a risk that this investment may be under or overstated in the accounts depending on use of estimates applied in the valuation models by the fund managers.

6: Events after the balance sheet date

There have been no events since 31 March 2013, and up to the date when these accounts were authorised that require any adjustments to these accounts.

7: Contributions Receivable

By category

2011/12 £000		2012/13 £000
78,364	Employers	80,556
26,979	Members	26,345
105,343		**106,901**

By authority

2011/12 £000		2012/13 £000
61,808	Scheduled bodies	60,949
1,976	Admitted bodies	5,135
41,559	Administrative Authority	40,817
105,343		**106,901**

8: Transfers in from other pension funds

2011/12 £000		2012/13 £000
29,039	Group transfers	1,816
9,598	Individual transfers	6,038
38,637		**7,854**

All employees of Surrey Probation, a scheme employer in the Surrey Pension fund, transferred to Surrey and Sussex probation service in 2011/12 and now are members of the East Sussex Pension fund. The fund agreed with the actuary the value of the bulk transfer in and the fund received income of £26.4m in October 2011. This is included in the group transfer value above for 2011/2012.

9: Benefits payable

By category

2011/12 £000		2012/13 £000
73,302	Pensions	79,776
28,766	Commutation and lump sum retirement benefits	25,096
2,622	Lump sum death benefits	1,204
104,690		**106,076**

By authority

2011/12 £000		2012/13 £000
59,072	Scheduled bodies	62,500
2,558	Admitted bodies	2,783
43,060	Administrative Authority	40,793
104,690		**106,076**

10: Payments to and on account of leavers

2011/12 £000		2012/13 £000
90	Refunds to members leaving service	5
4,086	Individual transfers	4,811
4,176		**4,816**

11: Administrative expenses

2011/12 £000		2012/13 £000
1,305	Administration and Processing	1,243
9	Legal fees	18
40	External audit fees	24
24	Internal audit fees	22
230	Actuarial fees	157
1,608		**1,464**

The External auditor appointed to audit the fund is BDO. Fees include only the statutory audit of the fund and no non-audit services have been provided.

12: Investment income

2011/12 £000		2012/13 £000
2,119	Fixed interest securities	2,030
655	Index linked securities	547
14,159	Equity dividends	9,850
5,290	Pooled property investments	6,380
3,148	Pooled investments - unit trusts and other managed funds	3,419
473	Interest on cash deposits	243
21	Class Actions	21
25,865		**22,490**

13: Taxes on income

2011/12 £000		2012/13 £000
(1)	Withholding tax - fixed interest securities	-
(760)	Withholding tax - equities	(433)
(361)	Withholding tax - pooled	(302)
(1,122)		**(735)**

14: Investment expenses

2011/12 £000		2012/13 £000
6,594	Management fees	7,097
173	Custody fees	119
17	Performance monitoring service	17
195	Investment consultancy	216
6,979		**7,449**

15: Investments

2011/12 £000		2012/13 £000
(restated)	**Investment assets**	
141,896	Fixed interest securities	156,837
52,549	Index Linked	64,412
484,310	Equities	586,818
1,087,520	Pooled Investments	1,209,533
189,360	Pooled property investments	192,773
51,910	Infrastructure	58,898
10,984	Commodities	11,998
-	Multi Asset	1,297
	Derivative contracts:	
668	Forward Currency Contracts	92
315	Purchased /written options	202
2,019,512		**2,282,860**
45,273	Cash deposits with Custodian	58,468
35,905	Other Investment balances (Note 20)	80,284
2,100,690	**Total investment assets**	**2,421,612**
(35,147)	Investment Liabilities (Note 21)	(81,629)
(30)	Derivative Contracts - Forward Currency	(1,196)
(35,177)	**Total Investment Liabilities**	**(82,825)**
2,065,513	**Net investment assets**	**2,338,787**

15a: Reconciliation of movements in investments and derivatives

	Market Value 1 April 2012 £000	Purchases during the year and derivative payments £000	Sales during the year and derivative receipts £000	Change in market value during the year £000	Market value 31 March 2013 £000
	(restated)				
Fixed interest securities	**141,896**	2,059	-	12,882	**156,837**
Index Linked	**52,549**	22,604	(15,333)	4,592	**64,412**
Equities	**484,310**	121,253	(90,593)	71,848	**586,818**
Pooled investments	**1,087,520**	162,372	(202,974)	162,615	**1,209,533**
Pooled property investments	**189,360**	6,354	(2,147)	(794)	**192,773**
Infrastructure	**51,910**	1,154	(4)	5,838	**58,898**
Commodities	**10,984**	10,788	(10,135)	361	**11,998**
Multi Asset	**-**	2,165	-	(868)	**1,297**
	2,018,529	328,749	(321,186)	256,474	**2,282,566**
Derivative contracts					
■ **Futures**	-	-	-	-	-
■ **Purchased/written options**	315	3,836	(1,726)	(2,223)	202
■ **Forward currency contracts**	638	4,397	(9,232)	3,093	(1,104)
	2,019,482	**336,982**	**(332,144)**	**257,344**	**2,281,664**
Other investment balances:					
■ **Cash deposits**	45,273			(844)	58,468
■ **Other Investment Balances**	35,905				80,284
■ **Investment Liabilities**	(35,147)				(81,629)
Net investment assets	**2,065,513**			**256,500**	**2,338,787**

	Market Value 1 April 2011	Purchases during the year and derivative payments	Sales during the year and derivative receipts	Change in market value during the year	Market value 31 march 2012
	£000	£000	£000	£000	£000
Fixed interest securities	**132,623**	3,091	(950)	7,132	**141,896**
Index Linked	**46,979**	12,693	(14,440)	7,317	**52,549**
Equities	**730,368**	196,589	(400,216)	(42,431)	**484,310**
Pooled investments	**735,467**	354,596	(40,232)	37,689	**1,087,520**
Pooled property investments	**173,175**	21,818	(10,924)	5,291	**189,360**
Infrastructure	**38,762**	10,261	(894)	3,781	**51,910**
Commodities	**13,015**	1,018	(1,865)	(1,184)	**10,984**
	1,870,389	600,066	(469,521)	17,595	**2,018,529**
Derivative contracts					
■ **Futures**	-	-	(2,175)	2,175	-
■ **Purchased/written options**	302	5,996	(3,952)	(2,031)	315
■ **Forward currency contracts**	(116)	5,351	(4,493)	(104)	638
	1,870,575	**611,413**	**(480,141)**	**17,635**	**2,019,482**
Other investment balances:					
■ **Other Investment Balances**	55,683				35,905
■ **Investment Liabilities**	(54,221)				(35,147)
Net investment assets	**1,872,037**			**17,635**	**2,020,240**

Transaction costs are included in the cost of purchases and in sale proceeds. These include costs charged directly to the fund, such as fees, commissions, stamp duty and other fees.
Transaction costs incurred during the year total £286k (£537k in 2011/12). In addition to these costs, indirect costs are incurred through the bid-offer spread on investments within pooled investments.

15b: Analysis of investments (excluding derivative contracts)

2011/12 £000		2012/13 £000
	Fixed interest securities	
	UK	
141,896	Corporate quoted	156,837
141,896		**156,837**
	Index linked Securities	
	UK	
24,096	Public sector quoted	35,105
	Overseas	
28,453	Public sector quoted	29,307
52,549		**64,412**
	Equities	
	UK	
44,369	Quoted	57,933
12,310	Unquoted	14,439
	Overseas	
319,062	Quoted	387,580
108,569	Unquoted	126,866
484,310		**586,818**
	Pooled funds - additional analysis	
	UK	
594,385	Unit trusts	699,428
	Overseas	
493,135	Unit trusts	510,105
1,087,520		**1,209,533**
189,360	Pooled property investments	192,773
51,910	Infrastructure	58,898
10,984	Commodities	11,998
-	Multi Asset	1,297
252,254		**264,966**
2,018,529		**2,282,566**

Analysis of derivatives

Objectives and policies for holding derivatives

Derivatives can be used to hedge liabilities or hedge exposures to reduce risk in the fund. Derivatives maybe used to gain exposure to an asset more efficiently than holding the underlying asset. The use of derivatives is managed in line with the investment management agreement agreed between the fund and the various investment managers.

a) Futures

The scheme's objective is to decrease risk in the portfolio by entering into futures positions to match assets that are already held in the portfolio without disturbing the underlying assets.

b) Forward foreign currency

In order to maintain appropriate diversification and to take advantage of overseas investment returns, a significant proportion of the fund's quoted equity portfolio is in overseas stock markets. The fund can participate in forward currency contracts in order to reduce the volatility associated with fluctuating currency rates.

c) Options

The fund wants to benefit from the potentially greater returns available from investing in equities but wishes to minimise the risk of loss of value through adverse equity price movements. During the year the fund bought equity option contracts that protect it from falls in value in the main markets in which the scheme invests.

Open forward currency contracts

Settlement	Currency bought	Local value 000	Currency sold	Local value 000	Asset value £000	Liability value £000
Greater than 2 months	GBP	46,836	JPY	(6,687,968)	-	(51)
Up to 2 months	EUR	2,005	GBP	(1,735)	-	(38)
Up to 2 months	GBP	29	CAD	(44)	-	-
Up to 2 months	GBP	5,437	CHF	(8,005)	-	(132)
Up to 2 months	GBP	5,524	EUR	(6,421)	91	-
Up to 2 months	GBP	714	SEK	(7,046)	1	-
Up to 2 months	GBP	16,925	USD	(27,177)	-	(975)
					92	(1,196)
Net forward currency contracts at 31 March 2013						**(1,104)**
Prior year comparative						
Open forward currency contracts at 31 March 2012					**668**	**(30)**
Net forward currency contracts at 31 March 2012						**638**

Purchased/written options

Investment underlying option contract	Expires	Put / call	Notional holding £000	Market value 31 March 2012 £000	Notional holding £000	Market value 31 March 2013 £000
Assets						
Overseas equity purchased	Less than 1 month	Put	-	315	-	202
Net purchased/written options				**315**		**202**

Investments analysed by fund manager

Market value 31 March 2012 £000	%		%	Market value 31 March 2013 £000
82,679	4.0%	Prudential M&G	4.0%	94,010
15,438	0.8%	East Sussex Pension Fund Cash	0.5%	12,861
5	0.0%	Fidelity International	0.0%	-
20,922	1.0%	UBS Infrastructure Fund	1.1%	25,487
30,988	1.5%	Prudential Infracapital	1.4%	33,411
816,259	39.5%	Legal & General	42.2%	987,433
12,310	0.6%	M&G UK Financing Fund	0.6%	14,439
194,808	9.4%	Schroders Property	8.5%	199,421
50,928	2.5%	Harbourvest Strategies	2.6%	61,717
57,642	2.8%	Adams St Partners	2.8%	65,669
59,217	2.9%	M&G Absolute Return Bonds	2.7%	62,828
165,573	8.0%	Ruffer LLP	9.9%	228,645
289,616	14.0%	Lazard Asset Management	14.4%	336,334
164,974	8.0%	Newton Investment Management	9.3%	217,877
102,758	5.0%	Marathon Asset Management	0.0%	-
2,064,117				**2,340,132**

The following investments represent more than 5% of the investment assets of the scheme -

Security	Market Value 31 March 2012 £000	% of total fund	Market value 31 March 2013 £000	% of total fund
L&G UK Equity Index	413,031	20.0%	452,754	19.3%
Newton Real Return (Pooled Fund)	164,974	8.0%	217,877	9.3%
L&G North America Equity Index	141,857	6.9%	213,329	9.1%
L&G Europe (EX UK) Equity Index	115,052	5.6%	126,872	5.4%
Marathon (Pooled Fund)	102,758	5.0%	-	-

15c: Stock lending

The East Sussex Fund has not operated a Stock Lending programme since 13th October 2008.

16: Financial instruments

16a: Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of financial assets and liabilities (including cash) by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 March 2012				31 March 2013		
Market value Designated as fair value through profit and loss	Loans and receivables	Financial liabilities at amortised cost		Market value Designated as fair value through profit and loss	Loans and receivables	Financial liabilities at amortised cost
£000	£000	£000		£000	£000	£000
			Financial Assets			
141,896	-	-	Fixed interest securities	156,837	-	-
52,549	-	-	Index linked	64,412	-	-
484,310	-	-	Equities	586,818	-	-
1,087,520	-	-	Pooled investments	1,209,533	-	-
189,360	-	-	Pooled property investments	192,773	-	-
51,910	-	-	Infrastructure	58,898	-	-
10,984	-	-	Commodities	11,998	-	-
-	-	-	Multi Asset	1,297	-	-
983	-	-	Derivative contracts	294	-	-
-	45,273	-	Cash	-	58,468	-
-	977	-	Cash held by ESCC	-	-	-
35,905	-	-	Other investment balances	80,284	-	-
-	8,953	-	Debtors	-	9,780	-
2,055,417	**55,203**	**-**		**2,363,144**	**68,248**	**-**
			Financial liabilities			
(30)	-	-	Derivative contracts	(1,196)	-	-
(35,147)	-	-	Other investment balances	(81,629)	-	-
-	-	(4,372)	Creditors	-	-	(4,291)
(35,177)	**-**	**(4,372)**		**(82,825)**	**-**	**(4,291)**
2,020,240	**55,203**	**(4,372)**		**2,280,319**	**68,248**	**(4,291)**

16b: Net gains and losses on financial instruments

31 March 2012 £000		31 March 2013 £000
	Financial assets	
17,595	Fair value through profit and loss	256,473
46	Loans and receivables	(843)
	Financial liabilities	
40	Fair value through profit and loss	870
17,681		**256,500**

16c: Fair value of financial instruments and liabilities

The following table summarises the carrying values of the financial assets and financial liabilities by class of instrument compared with their fair values.

31 March 2012			31 March 2013	
Carrying value £000	Fair value £000		Carrying value £000	Fair value £000
		Financial assets		
2,055,417	2,055,417	Fair value through profit and loss	2,363,144	2,363,144
55,203	55,203	Loans and receivables	68,248	68,248
2,110,620	**2,110,620**	**Total financial assets**	**2,431,392**	**2,431,392**
		Financial liabilities		
(35,177)	(35,177)	Fair value through profit and loss	(82,825)	(82,825)
(4,372)	(4,372)	Financial liabilities at amortised cost	(4,291)	(4,291)
(39,549)	**(39,549)**	**Total financial liabilities**	**(87,116)**	**(87,116)**

The authority has not entered into any financial guarantees that are required to be accounted for as financial instruments.

16d: Valuation of financial instruments carried at fair value

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

Level 1

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

Level 2

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

Level 3

Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data.

Such instruments would include unquoted equity investments which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investment in private equity are based on valuations provided by the general partners to the private equity funds in which East Sussex Pension Fund has invested.

These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines, which follow the valuation principles of IFRS and US GAAP. Valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	Quoted market price	Using observable inputs	With Significant unobservable inputs	
Values at 31 March 2013	**Level 1 £000**	**Level 2 £000**	**Level 3 £000**	**Total £000**
Financial assets				
Financial assets at fair value through profit and loss	1,916,787	218,996	227,361	2,363,144
Loans and receivables	68,248	-	-	68,248
Total financial assets	**1,985,035**	**218,996**	**227,361**	**2,431,392**
Financial liabilities				
Financial liabilities at fair value through profit and loss	(82,825)	-	-	**(82,825)**
Financial liabilities at amortised cost	(4,291)	-	-	**(4,291)**
Total financial liabilities	**(87,116)**	**-**	**-**	**(87,116)**
Net financial assets	**1,897,919**	**218,996**	**227,361**	**2,344,276**

	Quoted market price	Using observable inputs	With Significant unobservable inputs	
Values at 31 March 2012	**Level 1 £000**	**Level 2 £000**	**Level 3 £000**	**Total £000**
Financial assets				
Financial assets at fair value through profit and loss	1,651,669	203,206	200,542	2,055,417
Loans and receivables	55,203	-	-	55,203
Total financial assets	**1,706,872**	**203,206**	**200,542**	**2,110,620**
Financial liabilities				
Financial liabilities at fair value through profit and loss	(35,177)	-	-	(35,177)
Financial liabilities at amortised cost	(4,372)	-	-	(4,372)
Total financial liabilities	**(39,549)**	**-**	**-**	**(39,549)**
Net financial assets	**1,667,323**	**203,206**	**200,542**	**2,071,071**

17: Nature and extent of risks arising from financial instruments

Risk and risk management

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

Responsibility for the fund's risk management strategy rests with the pension fund committee. Risk management policies are established to identify and analyse the risks faced by the fund's pensions operations. Policies are reviewed regularly to reflect changes in activity and in the market conditions.

a) Market risk

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix.

The objective of the fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

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

The fund manages these risks in two ways:

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

Equity futures contracts and exchange traded option contracts on individual securities may also be used to manage market risk on equity investments. It is possible for over-the-counter equity derivative contracts to be used in exceptional circumstances to manage specific aspects of market risk.

Other price risk

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

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

The fund's investment managers mitigate this price risk through diversification and the selection of securities and other financial instruments is monitored by the fund to ensure it is within limits specified in the fund investment strategy.

Other price risk – sensitivity analysis

Following analysis of historical data and expected investment return movement during the financial year, in consultation with the fund's investment advisors, the fund has determined that the following movements in market price risk are reasonably possible for the 2013/14 reporting period:

Asset Type	Potential Market Movements (+/-)
Bonds	11.0%
UK equities	16.0%
Overseas equities	19.0%
Overseas equity unit trusts	19.0%
Pooled property investments	15.0%
Private Equity	28.0%
Infrastructure funds	16.0%
Commodities	14.0%
Cash	1.0%

The potential price changes disclosed above are broadly consistent with a one-standard deviation movement in the value of the assets. The sensitivities are consistent with the assumptions contained in the investment advisors' most recent review. This analysis assumes that all other variables, in particular foreign currency exchange rates and interest rates, remain the same.

Had the market price of the fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as follows.

Asset Type	Value as at 31 March 2013 £000	Percentage change %	Value on increase £000	Value on decrease £000
Cash and Cash Equivalents	58,468	1.0	59,053	57,883
Investment portfolio assets:				
Total Bonds	221,249	11.0	245,587	196,912
UK equities inc Private Equity	898,666	16.0	1,042,452	754,879
Overseas equities	387,580	19.0	461,220	313,940
Overseas equity unit trusts	510,105	19.0	607,025	413,185
Pooled property investments	192,773	15.0	221,689	163,857
Infrastructure funds	58,898	16.0	68,321	49,474
Commodities	11,998	14.0	13,678	10,318
Multi Asset	1,297	-	1,297	1,297
Net derivative assets	(903)	-	(903)	(903)
Investment income due	2,410	-	2,410	2,410
Amounts receivable for sales	714	-	714	714
Amounts payable for purchases	(1,769)	-	(1,769)	(1,769)
Total assets available to pay benefits	**2,341,486**		**2,720,774**	**1,962,197**

Asset Type	Value as at 31 March 2012 (Restated) £000	Percentage change %	Value on increase £000	Value on decrease £000
Cash and cash equivalents	45,273	1.0	45,635	44,911
Investment portfolio assets:				
Total Bonds	194,445	11.0	207,667	181,223
UK equities inc Private Equity	759,634	16.0	872,819	646,448
Overseas equities	319,062	19.0	366,283	271,841
Overseas equity unit trusts	493,135	19.0	570,064	416,206
Pooled property investments	189,360	15.0	194,473	184,247
Infrastructure funds	51,910	16.0	55,959	47,861
Commodities	10,984	14.0	10,984	10,984
Net derivative assets	953	-	953	953
Investment income due	2,175	-	2,175	2,175
Amounts receivable for sales	931	-	931	931
Amounts payable for purchases	(976)	-	(976)	(976)
Total assets available to pay benefits	**2,066,886**		**2,326,967**	**1,806,804**

Interest rate risk

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

The fund’s interest rate risk is routinely monitored by the Fund and its investment advisors in accordance with the fund’s risk management strategy, including monitoring the exposure to interest rates and assessment of actual interest rates against the relevant benchmarks.

The fund’s direct exposure to interest rate movements as at 31 March 2013 and 31 March 2012 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value.

Asset type	As at 31 March 2012 £000	As at 31 March 2013 £000
Cash with Custodian	45,273	58,468
Cash balances	977	(176)
Fixed interest securities:		
UK bonds	141,896	156,837
Total	**188,146**	**215,129**

Interest rate risk sensitivity analysis

The fund recognises that interest rates can vary and can affect both income to the fund and the value of the net assets available to pay benefits. An 100 basis point (bps) movement in interest rates is consistent with the level of sensitivity applied as part of the fund's risk management strategy. The fund's investment adviser has advised that this is consistent with an annual one standard deviation move in interest rates, where interest rates are determined by the prices of fixed interest UK government bonds.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits of a +/- 100 BPS change in interest rates:

Asset type	Carrying amount as at 31 March 2013	Change in year in the net assets available to pay benefits	
		+ 100 BPS	- 100 BPS
	£000	£000	£000
Cash and cash equivalents	58,468	585	(585)
Cash balances	(176)	(176)	176
Fixed interest securities			
UK bonds	156,837	1,568	(1,568)
Total change in assets available	**215,129**	**1,977**	**(1,977)**

Asset type	Carrying amount as at 31 March 2012	Change in year in the net assets available to pay benefits	
		+ 100 BPS	- 100 BPS
	£000	£000	£000
Cash and cash equivalents	45,273	453	(453)
Cash balances	977	10	(10)
Fixed interest securities			
UK bonds	141,896	1,419	(1,419)
Total change in assets available	**188,146**	**1,882**	**(1,882)**

Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the land (£UK). The fund holds both monetary and non-monetary assets denominated in currencies other than £UK.

The fund's currency rate risk is routinely monitored by the fund and its investment advisors in accordance with the fund's risk management strategy, including monitoring the range of exposure to currency fluctuations.
The following table summarises the fund's currency exposure as at 31 March 2013 and as at the previous period end:

Currency exposure - asset type	Asset value as at 31 March 2012	Asset value as at 31 March 2013
	£000	£000
Overseas Index Linked	28,453	29,307
Overseas quoted securities	319,062	387,580
Overseas unit trusts	493,135	510,105
Total overseas assets	**840,650**	**926,992**

Currency risk – sensitivity analysis

Following analysis of historical data in consultation with the fund investment advisors, the fund considers the likely volatility associated with foreign exchange rate movements to be 13% (as measured by one standard deviation).

This assumes no diversification with other assets, and in particular, interest rates remain constant.

A 13% strengthening/weakening of the UK pound against the various currencies in which the fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Currency exposure - asset type	Asset value as at 31 March 2013	Change to net assets available to pay benefits	
		+13%	-13%
	£000	£000	£000
Overseas Index Linked	29,307	33,117	25,497
Overseas quoted securities	387,580	437,965	337,194
Overseas unit trusts	510,105	576,419	443,792
Total change in assets available	**926,992**	**1,047,501**	**806,483**

Currency exposure - asset type	Asset value as at 31 March 2012	Change to net assets available to pay benefits	
		+13%	-13%
	£000	£000	£000
Overseas Index Linked	28,453	32,152	24,754
Overseas quoted securities	319,062	360,540	277,584
Overseas unit trusts	493,135	557,242	429,027
Total change in assets available	**840,650**	**949,934**	**731,365**

Summary	Asset value as at 31 March 2012	Asset value as at 31 March 2013
	£000	£000
Money market funds		
NTGI Global Cash Fund	44,823	57,762
Bank deposit accounts		
Non NT cash accounts	7	9
Bank current accounts		
NT custody cash accounts	443	697
Total overseas assets	**45,273**	**58,468**

b) Credit risk

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

In essence the fund's entire investment portfolio is exposed to some form of credit risk, with the exception of the derivatives positions, where the risk equates to the net market value of a positive derivative position. However the selection of high quality counterparties, brokers and financial institutions minimise credit risk that may occur through the failure to settle a transaction in a timely manner.

Contractual credit risk is represented by the net payment or receipt that remains outstanding, and the cost of replacing the derivative position in the event of a counterparty default. The residual risk is minimal due to the various insurance policies held by the exchanges to cover defaulting counterparties.

Credit risk on over-the-counter derivative contracts is minimised as counterparties are recognised financial intermediaries with acceptable credit ratings determined by a recognised rating agency.

The fund believes it has managed its exposure to credit risk, and has had no experience of default or uncollectable deposits in recent years.

c) Liquidity risk

Liquidity risk represents the risk that the fund will not be able to meet its financial obligations as they fall due. The fund therefore takes steps to ensure that the pension fund has adequate cash resources to meet its commitments. This will particularly be the case for cash from the cash flow matching mandates from the main investment strategy to meet the pensioner payroll costs; and also cash to meet investment commitments.

The fund has immediate access to its pension fund cash holdings and the fund also has access to an overdraft facility for short-term cash needs. This facility is only used to meet timing differences on pension payments. As these borrowings are of a limited short-term nature, the fund’s exposure to credit risk is considered negligible.

All financial liabilities at 31 March 2013 are due within one year.

Refinancing risk

The key risk is that the fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The fund does not have any financial instruments that have a refinancing risk as part of its treasury management and investment strategies.

18: Funding arrangements

The latest actuarial valuation of the fund was carried out as at 31 March 2010. The purpose of the triennial valuation is to calculate the contribution rates required to be made by each employer participating in the fund which together with investment growth will be sufficient to meet the fund's future liabilities. The 2010 valuation shows the fund has a past service deficit, being 87% funded in respect of past liabilities. This compares with 89% funded at the 2007 valuation. A recent survey of valuation results for County Council funds carried out by the Society of County Treasurers has shown that all County Council funds are in deficit. This places the East Sussex Pension Fund at 87% funding, as best funded out of the 34 County Council Funds.

East Sussex Pension Fund (“the Fund”)

Actuarial Statement for 2012/13

This statement has been prepared by **Hymans Robertson** in accordance with Regulation 34(1) (d) of the Local Government Pension Scheme (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2012/13.

Description of Funding Policy

The funding policy is set out in the Funding Strategy Statement (FSS), effective from 31 March 2010. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the fund and to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- to minimise the degree of short-term change in employer contribution rates;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations:
- to take into account reasonable deficit spreading approaches consistent with the above.

The FSS sets out how the administering authority seeks to balance the conflicting aims of securing the solvency of the fund and keeping employer contributions stable.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008 was as at 31 March 2010. This valuation revealed that the fund's assets, which at 31 March 2010 were valued at £1,869 million, were sufficient to meet 87% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2010 valuation was £272 million.

Individual employers' contributions for the period 1 April 2011 to 31 March 2014 were set in accordance with the fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in my valuation report dated 30 March 2011.

METHOD

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

ASSUMPTIONS

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

The key financial assumptions adopted for the 2010 valuation were as follows:

Financial assumptions	31 March 2010	
	% p.a. Nominal	% p.a. Real
Discount rate	6.1%	2.7%
Pay increases *	5.3%	0.8%
Price inflation/Pension increases	3.3%	-

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 1% p.a. for 2010/11 and 2011/12, reverting to 5.3% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. As a member of Club Vita, the baseline longevity assumptions adopted at this valuation were a bespoke set of VitaCurves that were specifically tailored to fit the membership profile of the fund. Longevity improvements were in line with standard PXA92 year of birth mortality tables; with medium cohort projections and a 1% p.a. underpin effective from 2007. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	21.3 years	23.4 years
Future Pensioners	23.3 years	25.7 years

Copies of the 2010 valuation report and Funding Strategy Statement are available on request from East Sussex County Council, administering authority to the fund.

Experience over the period since April 2010

Experience has been poorer than expected since the last valuation (excluding the effect of any membership movements). The funding level (excluding the effect of any membership movements) has worsened since the 2010 valuation due to falling real bond yields and lower asset returns than expected.

The next actuarial valuation will be carried out as at 31 March 2013. The Funding Strategy Statement will also be reviewed at that time.

19: Actuarial present value of promised retirement benefits

Introduction

CIPFA's Code of Practice on Local Authority Accounting 2012/13 requires administering authorities of LGPS funds that prepare pension fund accounts to disclose what IAS26 refers to as the actuarial present value of promised retirement benefits.

The actuarial present value of promised retirement benefits is to be calculated similarly to the defined benefit obligation under IAS19. There are three options for its disclosure in pension fund accounts:

• showing the figure in the Net Assets Statement, in which case it requires the statement to disclose the resulting surplus or deficit;

• as a note to the accounts; or

• by reference to this information in an accompanying actuarial report.

If an actuarial valuation has not been prepared at the date of the financial statements, IAS26 requires the most recent valuation to be used as a base and the date of the valuation disclosed. The valuation should be carried out using assumptions in line with IAS19 and not the Pension Fund's funding assumptions.

I have been instructed by the Administering Authority to provide the necessary information for the East Sussex Pension Fund, which is in the remainder of this note.

Balance sheet

Year ended	31 Mar 2012 £m	31 Mar 2013 £m
Present value of Promised Retirement Benefits	2,557	3,043

Liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2010. I estimate this liability at 31 March 2013 comprises £1,486m in respect of employee members, £533m in respect of deferred pensioners and £1,024m in respect of pensioners. The approximation involved in the roll forward model means that the split of scheme liabilities between the three classes of member may not be reliable. However, I am satisfied the aggregate liability is a reasonable estimate of the actuarial present value of benefit promises. I have not made any allowance for unfunded benefits.

The above figures include both vested and non-vested benefits, although the latter is assumed to have a negligible value.

It should be noted the above figures are appropriate for the Administering Authority only for preparation of the accounts of the Pension Fund. They should not be used for any other purpose (i.e. comparing against liability measures on a funding basis or a cessation basis).

Assumptions

The assumptions used are those adopted for the Administering Authority's IAS19 report as required by the Code of Practice. These are given below. I estimate that the impact of the change of assumptions to 31 March 2013 is to increase the actuarial present value by £325m.

Financial assumptions

My recommended financial assumptions are summarised below:

Year ended	31 Mar 2012 % p.a.	31 Mar 2013 % p.a.
Inflation / Pension Increase Rate	2.5%	2.8%
Salary Increase rate*	4.8%	5.1%
Discount Rate	4.8%	4.5%

*Salary increases are 1% p.a. nominal for the three years to 31 March 2015 reverting to the long term rate thereafter

Longevity assumption

As discussed in the accompanying report, the life expectancy assumption is based on the Fund's VitaCurves with improvements from 2007 in line with Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

	Males	Females
Current Pensioners	21.3 years	23.4 years
Future Pensioners*	23.3 years	25.7 years

*Future pensioners are assumed to be currently aged 45

This assumption is the same as at 31 March 2012.

Commutation assumption

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2008 service and 75% of the maximum tax-free cash 2008 service.

20: Current assets

31 March 2012 £000		31 March 2013 £000
	Other Investment Balances	
33,667	■ Sales inc Currency	77,874
1,734	■ Investment Income Due	1,645
504	■ Recoverable Taxes	765
-	■ Managers Fee Rebate	-
35,905		**80,284**

31 March 2012 (Restated) £000		31 March 2013 £000
	Current Assets	
7,712	■ Contributions receivable from employers and employees	7,879
1,241	■ Sundry Debtors	1,901
977	■ Cash*	-
9,930		**9,780**

*The prior year comparative figures have been restated to reclassify the cash balance as a current asset rather than an investment balance.

21: Current liabilities

31 March 2012 (Restated) £000		31 March 2013 £000
	Investment Liabilities	
33,711	Purchases including currency	80,034
1,373	Managers Fees	1,595
63	Accrued Dividend Income	-
35,147		**81,629**

31 March 2012 £000		31 March 2013 £000
	Current Liabilities	
1,879	Pension Payments (inc Lump Sums)	1,197
-	Cash	176
25	Professional Fees	60
1,281	Admin/CBOSS Recharge	1,239
1,187	Sundry Creditors	1,619
4,372		**4,291**

22: Additional voluntary contributions

Market value 31 March 2012 £000		Market value 31 March 2013 £000
£15,123	Prudential	£14,948

The Pension Fund Scheme provides an Additional Voluntary Contribution (AVC) facility for scheme members. In 2012/13 some members of the pension scheme paid voluntary contributions and transfers in of £1.528m to Prudential to buy extra pension benefits when they retire. £2.235m was disinvested from the AVC provider in 2012/13 (£2.741m 2011/12). The combined value of the AVC funds at 31 March 2013 was £14.948m (See table above). Contributions and benefits to scheme members are made directly between the scheme member and the AVC provider. The AVC funds are not, therefore, included in the Pension Fund Accounts.

23: Related party transactions

East Sussex County Council

The East Sussex Pension Fund is administered by East Sussex County Council. Consequently there is a strong relationship between the council and the pension fund.

Each member of the pension fund committee is required to declare their interests at each meeting.

The Treasurer of the Pension Fund and members of the County Council and the Investment Panel have no material transactions with the Pension Fund.

The Council incurred costs in administering the fund and charged £1.4m to the fund in 2012/13 (£1.3m in 2011/12). The Council`s contribution to the fund was £40.8m in 2012/13 (£41.6m in 2011/12). All amounts due to the fund were paid in the year. At 31 March 2013 the Pension Fund bank account was overdrawn by (£0.176m). The average invested throughout the year was £1.2m and earned interest of £0.008m in 2012/13 (£0.028m in 2011/12).

Key management personnel

The Chief financial officer of East Sussex County Council holds the key position in the financial management of the East Sussex Pension Fund.

24: Contingent liabilities and contractual commitments

Outstanding capital commitments (investments) at 31 March 2013 totalled £114.2m (31March 2012: £120m).

These commitments relate to outstanding call payments due on unquoted limited partnership funds held in the private equity and infrastructure parts of the portfolio. The amounts 'called' by these funds are irregular in both size and timing, typically over a period of between four and six years from the date of each original commitment.

At 31 March 2013 the unfunded commitment was £109 million for private equity, and £5.2m for infrastructure. The commitments are paid over the investment timeframe of the underlying partnerships. As these partnerships mature they are due to distribute capital back to investors. Commitments are made in US Dollars or Euros and the figures presented here are based on relevant Sterling exchange rates as at 31 March 2013.

Sussex Careers Limited – a Community Admission Body in the Fund until 12 November 2008, supplied careers advisory services on behalf of both East Sussex County Council and Brighton & Hove City Council. Sussex Careers is now in the process of being wound up, and its assets will be distributed to its creditors, including the Fund which is the major creditor. While the distribution to creditors has not been finalised by the Liquidator, the remaining assets are estimated to be approximately £0.5 million. These are not sufficient to meet their deficit of approximately £3.6 million.

The Valuation Tribunal Service – a Scheduled Body in the Fund – ceased on 22 November 2011 on the retirement of their last active member. Discussions are ongoing between the Administering Authority and the Valuation Tribunal Service regarding the payment of the cessation deficit.

25: Contingent assets

Fifteen admitted body employers in the Fund hold insurance bonds to guard against the possibility of their being unable to meet their pension obligations. These bonds are drawn in favour of the pension fund and payment will only be triggered in the event of employer default. In addition to these bonds, pension's obligations in respect of 8 other admitted bodies are covered by:

- 5 guarantees by local authorities participating in the Fund;
- 1 Parent Company Guarantee;
- 2 deposits, equal to the value of the bond required, held by East Sussex County Council.

At 31 March 2013 the Fund has made contractual commitments of £255.3million to private equity funds managed by Adams Street and Harbourvest. The Fund has also committed £14.4 million to the M & G UK Companies Financing fund and £58.1m to the infrastructure funds managed by UBS and M&G.

Following Rulings given by the European Court of Justice, along with a number of other local authority pension funds, the East Sussex Pension Fund is pursuing the recovery of tax paid on certain dividends. If successful this may be of material benefit to the Fund. The amount which may be recoverable is not currently quantifiable.

26: Impairment losses

During 2012/13 the fund has not recognised any impairment losses.

27: East Sussex Pension Fund – Active Participating Employers

East Sussex Pension Fund - Active Participating Employers

Employer	Contribution Rate					
	2011/12		2012/13		2013/14	
	%	Amount	%	Amount	%	Amount
Community Admission Bodies						
Amicus Horizon (1066 Housing) Amicus Horizon (Rother Homes)	17.5%	203,000	17.5%	211,000	17.5%	228,000
Brighton Dome & Festival	24.1%	2,500	24.1%	3,000	24.1%	3,000
Care Quality Commission	20.7%		20.7%		20.8%	
De La Warr Pavilion Charitable Trust	18.7%		19.8%		20.9%	
East Sussex Energy, Infrastructure & Development Ltd (ESEID)	22.9%		22.9%		22.9%	
Hastings Business Operations Limited (HBOL)	15.8%		15.8%		15.8%	
Hove & Portslade CAB	21.5%		21.5%		21.5%	
Sussex Archaelogical Society	21.5%	23,971	21.5%	25,122	21.5%	26,328
Sussex County Sports Partnership	15.8%		15.8%		15.8%	
Sussex Housing & Care	19.3%		19.7%		20.0%	
University of Sussex	24.0%	41,000	24.0%	85,000	24.0%	136,000
Transferee Admission Bodies						
Amey	-		26.8%		26.8%	
Churchill Contract Services Ltd	20.9%		20.9%		20.9%	
ESCC – Churchill	-		18.0%		18.0%	
ESCC _ Keir	-		-		25.2%	
Convex Leisure	18.7%		-		-	
Eastbourne Leisure Trust (Serco)	10.5%		12.0%		13.5%	
Eden Foodservices (Initial)	22.4%		22.4%		22.4%	
European Electronique LTD	21.4%		21.4%		21.4%	
John O'Conner Ltd	-		24.4%		24.4%	
May Gurney Ltd	19.5%		20.2%		20.9%	
Mears Ltd	20.6%		20.6%		20.6%	
MyTime Active Ltd	18.0%		18.0%		18.0%	
Quadron Services Ltd	23.8%		23.8%		-	
Wave Leisure Trust Ltd	14.4%		15.0%		15.6%	
Wealden and Eastbourne Lifeline (WEL)	17.2%		17.8%		18.4%	
Wealden Leisure Ltd	14.9%		15.8%		16.8%	1,200
Wealden Leisure Ltd (trading as Freedom Leisure)	16.6%		16.6%		16.6%	
White Rock Theatre	20.8%	1,676	20.8%	1,760	20.8%	1,848
Town and Parish Councils (pool)						
Battle Town Council	18.9%		19.3%		19.6%	
Camber Parish Council	18.9%		19.3%		19.6%	
Chailey Parish Council	18.9%		19.3%		19.6%	
Chiddingly Parish Council	18.9%		19.3%		19.6%	
Conservators of Ashdown Forest	18.9%		19.3%		19.6%	
Crowborough Parish Council	18.9%		19.3%		19.6%	
East & West Sussex Valuation Tribunal	18.9%		-		-	
Ewhurst Parish Council	18.9%		19.3%		19.6%	
Forest Row Parish Council	18.9%		19.3%		19.6%	
Hailsham Town Council	18.9%		19.3%		19.6%	
Heathfield & Waldron Parish Council	18.9%		19.3%		19.6%	

Hurst Green Parish Council	18.9%		19.3%		19.6%	
Lewes Town Council	18.9%		19.3%		19.6%	
Maresfield Parish Council	18.9%		19.3%		19.6%	
Newick Parish Council	-		19.3%		19.6%	
Newhaven Town Council	18.9%		19.3%		19.6%	
Peacehaven Town Council	18.9%		19.3%		19.6%	
Polegate Town Council	18.9%		19.3%		19.6%	
Ringmer Parish Council	18.9%		19.3%		19.6%	
Rye Town Council	18.9%		19.3%		19.6%	
Seaford Town Council	18.9%		19.3%		19.6%	
Sussex Inshore Fisheries & Conservation Authority	18.9%		19.3%		19.6%	
Telscombe Town Council	18.9%		19.3%		19.6%	
Uckfield Town Council	18.9%		19.3%		19.6%	
Westham Parish Council	-		19.3%		19.6%	
Willingdon & Jevington Parish Council	18.9%		19.3%		19.6%	
Colleges						
Bexhill College	15.8%		16.2%		16.5%	
Brighton, Hove & Sussex Sixth Form College	15.8%		16.2%		16.5%	
City College, Brighton	17.1%		17.5%		17.8%	
Plumpton College	15.8%		16.2%		16.5%	
Sussex Coast College	16.3%		16.7%		17.0%	
Sussex Downs College	14.8%		15.2%		15.5%	
Varndean Sixth Form College	15.8%		16.2%		16.5%	
Scheduled Bodies - Major Authorities						
Brighton and Hove City Council	17.3%		17.7%		18.0%	
East Sussex County Council	18.4%		18.8%		19.1%	
East Sussex Fire & Rescue Service	18.4%		18.4%		18.4%	
Eastbourne Borough Council	21.5%		21.9%		22.2%	
Hastings Borough Council	21.1%		21.5%		21.8%	
Lewes District Council	19.8%		20.2%		20.5%	
Rother District Council	23.0%		23.4%		23.7%	
University of Brighton	16.0%		16.4%		16.7%	
Wealden District Council	17.5%	369,000	17.5%	411,000	17.5%	473,000
Scheduled Bodies - Academies						
Aurora Academies Trust	-		18.7%	16,700	18.7%	17,400
Beacon Academy	-		19.8%		20.1%	
Bexhill Academy	-		24.4%		24.4%	
BHCC Bilingual Primary School	-		22.0%		22.0%	
Brighton Aldridge Community Academy	17.4%		17.4%		17.4%	
Cavendish Academy	-		20.6%	9,300	20.6%	9,800
Eastbourne Academy	18.9%		18.9%		18.9%	
Glyne Academy	-		-		23.7%	
Hailsham Academy	-		20.9%		20.9%	
Hastings Academies Trust	18.1%		18.1%		18.1%	
Portslade Aldridge Community Academy	17.8%		17.8%		17.8%	
Ratton Academy	-		19.8%		20.1%	
Ringmer Academy	18.3%		18.3%		18.3%	
Rye Academy	-		24.5%		24.5%	
Seaford Academy	-		23.8%		23.8%	
Other Scheduled Bodies						
Eastbourne Homes Ltd	17.0%		17.0%		17.0%	
Surrey & Sussex Probation Board	20.0%		20.0%		20.1%	

28: Investment Performance

The County Council uses an independent Investment performance measurement service, provided by the WM Company which measures the performance of the Fund compared with 85 other local authority pension funds. Pension Fund investment is a long term business so as well as showing the annual performance of the Fund, comparison to peers over longer periods is also detailed below.

Performance relative to the Fund's strategic benchmark

	1 year (%)	3 years (%p.a.)	5 years (%p.a.)	10 years (%p.a.)
Fund	**12.7**	**7.1**	**6.2**	**9.4**
Benchmark	**10.8**	**6.0**	**5.6**	**9.3**
Relative	**1.9**	**1.1**	**0.6**	**0.1**

Investment performance relative to peer group

	1 year (%)	3 years (%p.a.)	5 years (%p.a.)	10 years (%p.a.)
Fund	**12.7**	**7.1**	**6.2**	**9.4**
Local Authority Average	**13.8**	**8.1**	**6.5**	**9.4**
Relative	**-1.1**	**-1.0**	**-0.3**	**0.0**

The Fund underperformed the average local authority fund over the year by 1.1%, ranking the East Sussex Fund in the 74th percentile.

Over three years the fund underperformed by 1.0% and was placed in the 87th percentile in the local authority universe. For the longer-term periods of 5 and 10 years the Fund has performed broadly in line with the average local authority fund and was ranked at 54th and 44th percentile respectively.

APPENDIX ONE - PENSION FUND POLICY DOCUMENTS

STATEMENT OF INVESTMENT PRINCIPLES

The Local Government Pension Scheme (LGPS) (Management and Investment of Funds) Amendment Regulations 2009 require administering authorities of pension funds to prepare and review, from time to time, a written statement setting out the investment policy for their Fund. Any material change in investment policy must be included in a revised Statement of Investment Principles (SIP) within six months of the change. This SIP has been written to comply with these regulations. The statement also covers the extent to which social, environmental and ethical considerations (see below) are taken into account in the selection, retention and realisation of investments and a summary of the policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments. The East Sussex Pension Fund statement was first published in May 2000 and updated copies are available from the Acting Chief Finance Officer Business Services Department (01273 481412).

Myners Six Principles – Compliance Statement

The Panel has set out details of the extent to which the Fund complies with the six principles set out in the Chartered Institute of Public Finance and Accountancy's publication, 'investment Decision Making and Disclosure in the Local Government Pension Scheme 2009 – a guide to the application of the 2008 Myners Principles to the management of the LGPS funds'. Administering Authorities are required to report against these six principles on a 'comply or explain' basis. This compliance statement is included in the Fund's Statement of Investment Principles.

SOCIAL, ENVIRONMENTAL AND ETHICAL CONSIDERATIONS

The Panel has considered the issues surrounding socially responsible investment and has adopted an 'Active Shareholder Approach' to encourage companies to adopt best ethical and environmental principles without jeopardizing the investment performance of the Fund. When selecting investments for purchase, retention or sale, Fund Managers are able to invest in all companies, subject to their specific restrictions set out in the Fund's Policy Guidelines in order to achieve their performance targets. However they have been encouraged to engage in constructive dialogue on behalf of the Fund and to use their influence to encourage companies to adopt best practice in all key areas of business. The key areas are:

- Corporate governance
- Employment standards
- Human rights
- Environmental standards

APPENDIX TWO - FUNDING STRATEGY STATEMENT

1. Introduction

This is the Funding Strategy Statement (FSS) of the East Sussex Pension Fund ("the Fund"), which is administered by East Sussex County Council ("the Administering Authority") in accordance with the Local Government Pension Scheme Regulations ("the Regulations").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson and after consultation with the Fund's employers and investment adviser and is effective from 31 March 2011.

1.1 Regulatory Framework

Members' accrued benefits are guaranteed by statute. Members' contributions are fixed in the Regulations at a level which covers only part of the cost of accruing benefits. Employers pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers pay for their own liabilities.

The FSS forms part of a framework which includes:

• the Local Government Pension Scheme (Administration) Regulations 2008 (regulations 35 and 36);
• the Rates and Adjustments Certificate, which can be found appended to the Fund actuary's triennial valuation report;
• actuarial factors for valuing early retirement costs and the cost of buying extra service; and
• the Statement of Investment Principles This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

The key requirements relating to the FSS are that:

• After consultation with all the relevant interested parties involved with the Fund, the administering authority will prepare and publish their funding strategy.
• In preparing the FSS, the administering authority must have regard to:
  - FSS guidance produced by CIPFA
  - Its Statement of Investment Principles published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

• 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. The Fund's actuary must have regard to the FSS as part of the fund valuation process.

1.2 Review of FSS

This is a requirement under Regulation 35 of the Regulations. The FSS is reviewed in detail at least every three years ahead of triennial valuations being carried out, with the next full review due to be started by 31 March 2013 and implemented in April 2014. Set out in Note 27 is the derivation of the target minimum employer contributions rates, agreed phasing and spreading periods, and the resultant increases in relation to 2010/11 contribution rates, for three years 2011/12 through to 2013/14. Note 27 is updated to reflect any changes to employers.
Annex B sets out key roles and responsibilities.

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact:

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1 Purposes

2.1 Purpose of the Funding Strategy Statement

Communities and Local Government (CLG), formerly the Office of the Deputy Prime Minister, has stated that the purpose of the FSS is:

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

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered. The Fund:

- receives contributions, transfer payments and investment income;
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to help meet the long term pension costs and to reduce the variability of those costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarized in Annex B.

2.3 Aims of the Investment Strategy and Funding Policy

The core principles underpinning the Fund's investment policy are as follows:
• to ensure the long-term solvency of the Fund and to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
• to maximize investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk and volatility;
• to minimise the degree of short-term change in employer contribution rates;
• to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations;
• to take into account asset-liability studies when considering asset allocation decisions;
• to take into account reasonable deficit spreading approaches consistent with the above.

3 <u>Employer Contributions and Target Funding Levels</u>

3.1 Derivation of Employer Contributions

Employer contributions are normally made up of two elements:
• the estimated cost of future benefits being accrued, referred to as the *"future service rate"*; plus
• a *'past service adjustment'* for the funding position (at the valuation date) of accrued benefits relative to the Fund's assets. If there is a surplus there may be a contribution reduction; if a deficit a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's actuary is required by the regulations to report the *Common Contribution Rate,* for all employers collectively at each triennial valuation. It combines both items above and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit is currently spread over a period of 20 years.
The Fund's actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to the employer. It is the adjusted contribution rate which employers are actually required to pay. The sorts of peculiar factors which are considered are discussed in Section 3.6.
In effect, the Common Contribution Rate is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific spreading and phasing periods.
For some employers it may be agreed to pool contributions, see Section 3.9.6. Note 27 contains a breakdown of each employer's contributions following the 2010 valuation for the financial years 2011/12, 2012/13 and 2013/14. It identifies which employer's contributions have been pooled with others.

In respect of non-ill health early retirements, those employers classified as 'stabilised employers' have the option to pay an additional 1% of employer contributions per year to meet non-ill health premature retirement costs. For all other employers in the Fund any non-ill health premature retirement costs must be paid as lump sum payments at the time of the employer's decision in addition to the contribution described above (or by installments shortly after the decision). Stabilised employers who choose not to pay the additional 1% must meet the costs via a lump sum payment (or by installments) in the same way as all other 'non stabilised' employers.

Further details about the classification of stabilised employers are given in Section 3.2 below.

3.2 Classification of Employers

As part of the 2010 formal valuation employers have been classified into two distinct groups. These groups are referred to when considering, for example, contribution rate setting, ill-health early retirement options and contribution payment options.

The two groups are:

• 'Stabilised Employers' i.e. Scheduled Bodies, open Community Admission Bodies and open pre-2000 Admission Bodies; and
• 'Non-stabilised' employers i.e. closed Community Admission Bodies, closed pre-2000 Admission Bodies and Transferee Admission Bodies.

3.3 'Stability Overlay' Mechanism

A 'stability overlay' mechanism was applied at the 2010 valuation to derive the minimum employer contribution rates for 'stabilised employers'. This has the effect of dampening down short-term market volatility subject to certain limits. The three year phasing of rate changes still applies (see 3.9.4 and 3.9.5) to 'stabilised employers'.

The table below details how contribution rates are derived under the stability overlay mechanism. Note that the theoretical rate based upon the 2010 valuation, is compared with the current rate as at 2010/11 and the stability overlay is applied depending upon the results of that comparison.

Difference in employer contribution rate Between current 2010/11 and 2010 valuation rate before stability overlay	
A reduction	An increase
• If in deficit: no change from 2010/11 rate; • If in surplus: rate becomes the greater of ($5/6^{ths}$ of the current 2010/11 rate + $1/6^{th}$ of 2010 valuation rate)	Rate becomes the greater of : • 5/6ths of current 2010/11 rate + $1/6^{th}$ of 2010 valuation rate; and • 1% of pay more than the current 2010/11 rate.

The effect of using the mechanism at the 2010 valuation was to restrict the **minimum** contribution rate to an increase of no more than 1% of pensionable pay for stabilised employers.

Employers may opt to pay higher regular contributions than these minimum rates. Where minimum contributions have reduced, employers may prefer not to take such reductions and this would be the strong advice of the Administering Authority.

3.4 Solvency and Target Funding Levels

The Fund's actuary is required to report on the "solvency" of the whole fund at least every three years.

"Solvency" for ongoing employers is defined to be the ratio of the current market value of assets to the value placed on accrued benefits, on the Fund actuary's *ongoing* funding basis. This quantity is known as a funding level.

The ongoing funding basis has traditionally been used for each triennial valuation for all employers in the Fund. The ongoing funding basis assumes employers in the Fund will participate over the longer term as an ongoing concern and is described in the next section.

Where an admission agreement for an admission body that is not a Transferee Admission Body and has no guarantor, is likely to terminate within the next 5 to 10 years or lose its last active member within that timeframe, the Fund reserves the right to set contribution rates by reference to liabilities valued on a gilts basis (i.e. using a discount rate that has no allowance for potential investment outperformance relative to gilts). The target in setting contributions for any employer in these circumstances is to achieve full funding on a gilts basis by the time the agreement terminates or the last active member leaves in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required when a cessation valuation is carried out.

The Fund also reserves the right to adopt the above approach in respect of those admission bodies with no guarantor, where the admission body's financial strength is considered to be weak but there is no immediate expectation that the admission agreement will cease.

The Fund actuary agrees the financial and demographic assumptions to be used for each such valuation with the administering authority. The Fund operates the same target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. The time horizon of the funding target for Community and Transferee Admission bodies will vary depending on the expected duration of their participation in the Fund. Please refer to Section 3.10 for the treatment of departing employers.

3.5 Ongoing Funding Basis

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds advised by the Fund actuary. It is acknowledged that future life expectancy and in particular, the allowance for future improvements in mortality, is uncertain. Employers should be aware that their contributions are likely to increase in future if longevity exceeds the funding assumptions. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed statutory guarantee underpinning members' benefits. The demographic assumptions vary by type of member and so reflect the different profiles of employers.

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes an allowance for anticipated returns from equities in excess of Government bonds. There is, however, no guarantee that equities will out-perform or even match Government bonds. The risk is greater over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

In light of the statutory requirement for the Fund's actuary to consider the stability of employer contributions it is therefore normally appropriate to restrict the degree of change to employers' contributions at triennial valuation dates.

Given the very long-term nature of the liabilities, a long-term view of prospective returns from equities is taken. For the 2010 valuation, it was assumed that the Fund's equity investments will deliver an average real return of 1.6% a year in excess of the return available from investing in index-linked Government bonds at the time of the valuation.

The same financial assumptions are adopted for all ongoing employers. All employers have the same asset allocation.

3.6 Future Service Contribution Rates

The future service element of the employer contribution rate is traditionally calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. The future service rate has been calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. Where it is considered appropriate to do so then the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a gilts basis (most usually for admission bodies that are not a Transferee Admission Body and that have no guarantor in place). The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies that may have the power not to admit automatically all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

3.6.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of employee's contributions) of the benefits which employees earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* with a one year control period. If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the employee profile becomes more 'mature' (i.e. average age increases because, for example, of reduced recruitment of younger employees) the future service rate would rise.

3.6.2 Employers that do not admit new entrants

Certain Admission Bodies who make up a small proportion of all scheme employers have closed the scheme to new entrants. This is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as membership ages. To give more long term stability to such employers' contributions, the *Attained Age Method* is normally adopted. This will limit the degree of future contribution rises by paying higher rates at the outset. Both funding methods are described in the Actuary's report on the valuation. Future service rates calculated under both funding methods will include related administration expenses, to the extent that they are borne by the Fund, and will include an allowance for benefits payable on death in service and ill health and retirement.

3.7 Adjustments for Individual Employers

Adjustments to individual employers' contribution rates are applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

The combined effect of these adjustments for individual employers applied by the Fund actuary relate to:

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

over the period between the 2007 and 2010 valuations and each subsequent triennial valuation period.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

3.8 Asset Share Calculations for Individual Employers

The Administering Authority does not account for each employer's assets separately. The Fund's actuary is required to apportion the assets of the whole fund between the employers at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an established and accepted actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

The Fund actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation, including, but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of more or fewer withdrawals than assumed;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

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

3.9 Stability of Employer Contributions

3.9.1 Stability overlay mechanism

As mentioned earlier, this mechanism was applied at the 2010 valuation and is detailed in Section 3.3. The 2010 valuation rate referred to in the mechanism is the theoretical rate calculated in accordance with Sections 3.9.2. and 3.9.3 below. The effect of the overlay is to dampen changes to contribution rates for employers between successive valuations. The stability mechanism is only available to long term open employers in the Fund which the Administering Authority has classified as 'stabilised employers' (refer to Section 3.2). Contribution rates for 'non-stabilised' employers (refer to Section 3.2) are the 2010 valuation theoretical contribution rates for each employer calculated in accordance with Sections 3.9.2 and 3.9.3 below.

3.9.2 Deficit Recovery Periods

The Administering Authority requests the actuary to adopt specific deficit recovery periods for all employers when calculating their theoretical contributions. The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years but over 15 years for certain classes of employers (depending on the strength of the credit risk/ funding covenant e.g. Council tax covenant is considered the most secure with the smallest credit risk). The table below sets out the maximum deficit recovery period for each type of employer.

Type of Employer	Spreading Period
Statutory Bodies (e.g. tax raising employers, colleges)	20 Years
Community Admission Bodies and pre-2000 Admission Bodies (that are open to new entrants)	15 Years
Community Admission Bodies and pre-2000 Admission Bodies (that are closed to new entrants)	Remaining contract period (where provided), subject to not exceeding Remaining Working Lifetime.
Transferee Admission Bodies	Remaining contract period (where provided), subject to not exceeding Remaining Working Lifetime.

The maximum period is used in calculating each employer's minimum contributions. Employers may opt to pay higher than these minimum contribution rates.

The deficit recovery period starts at the commencement of the revised contribution rate i.e. 1 April 2011 for the 2010 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.9.3 Surplus Spreading Periods

In order to protect the Fund from recent volatile market conditions, contribution rate reductions for any employers deemed to be in surplus (by spreading the surplus element over the minimum period shown above for deficits in calculating their minimum contribution) were not allowed by the Administering Authority at the 2010 valuation. The Administering Authority will review this policy at the 2013 valuation in light of market conditions at that time.

3.9.4 Phasing In of Contribution Rises

The Administering Authority currently permits all employers to phase in contribution rises. This will be in three equal steps over the three years following the triennial valuation i.e. commencing 1 April 2011.

3.9.5 Phasing in of Contribution Reductions

Any contribution reductions will be phased in over three years for all employers.

3.9.6 Pooled Contributions

The Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events – such as ill-health retirements or deaths in service – on their contributions. The actuary is still able to separately identify all the employer's assets. As at the 2010 valuation separate pools are operated for Town and Parish Councils and for certain historic pre-2000 admission bodies. Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not permitted to participate in a pool. Transferee Admission Bodies are also ineligible for pooling.

3.9.7 Payment and Collection of Contributions

Contributions arising from previous valuations were based wholly on a percentage of employees' payroll. However, from April 2011, contributions will be collected via a combination of percentage of payroll (to cover future service benefits) and monetary amounts (to recover deficit relating to past service benefits). This change in approach is designed to protect the Fund from reductions in payroll that may arise over the next few years as economic conditions and spending cuts hit many employers. Stabilised employers, however, will be given the option of paying their contributions either as a combination of percentage of payroll and monetary amounts, or based wholly on a percentage of employees' payroll. The Fund is allowing this since such employers are expected to participate over the long term; this means that any deficit that might not be fully recovered in the short term due to reduced payroll can be collected instead over the longer term at future actuarial valuations. Where monetary amounts are being paid, the monetary amounts may be paid either annually OR monthly. If paid annually, the amounts are due in advance on 1 April 2011, 1 April 2012 and 1 April 2013. If paid monthly, the amounts should be made at the same time as the percentage of payroll monthly contributions are made. In both cases, contributions must be received by no later than the 19th of the month following the due date in order to comply with legislation e.g. April 2011 contributions must be paid to the Fund no later than 19 May 2011.

3.10 Admission Bodies ceasing

Admission Agreements for Transferee Admission Body contractors are assumed to expire at the end of the contract.

Admission Agreements for other employers are generally assumed to be open-ended and to continue until all the benefits have been paid in full. Contributions, expressed as capital payments, can continue to be levied after all the employees have retired. These Admission Agreements can however be terminated at any point subject to the terms of the agreement.

The Fund, however, considers any of the following as triggers for the termination of an admission agreement:

• Last active member ceasing participation in the LGPS;

• The insolvency, winding up or liquidation of the admission body;

• Any breach by the admission body of any of its obligations under the agreement that they have failed to remedy to the satisfaction of the Fund;

• A failure by the admission body to pay any sums due to the Fund within the period required by the Fund; or

• The failure by the admission body to renew or adjust the level of the bond or indemnity or to confirm an appropriate alternative guarantor as required by the Fund.

In addition either party can voluntarily terminate the admission agreement by giving the appropriate period of notice as set out in the admission agreement to the other party (or parties in the case of a Transferee Admission Body).

If an Admission Body's admission agreement is terminated, the Administering Authority instructs the Fund actuary to carry out a special valuation to determine whether there is any deficit.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

a) For Transferee Admission Bodies, the assumptions would be those used for an ongoing valuation to be consistent with the assumptions used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

b) For admission bodies that are not Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or which triggers a cessation event, the Administering Authority must look to protect the interests of other ongoing employers and will require the actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. Where there is a guarantor, the cessation valuation will normally be calculated using an ongoing valuation basis appropriate to the investment strategy. Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis" with no allowance for potential future investment outperformance and with an allowance for further future improvements in life expectancy.

This approach results in a higher value being placed on the liabilities than would be the case under a valuation on the ongoing funding basis and could give rise to significant payments being required.

c) For admission bodies with guarantors, it is possible that any deficit could be transferred to the guarantors in which case it may be possible to simply transfer the assets and liabilities relating to the former admission bodies to the respective guarantors, without needing to crystallise any deficit.

Under (a) and (b), any shortfall would be levied on the departing admission body as a capital payment.

In the event that the Fund is not able to recover the required payment in full directly from the admission body or from any bond or indemnity or guarantor, then:

a) In the case of Transferee Admission Bodies the awarding authority will be liable. At its absolute discretion, the Administering Authority may agree to recover any outstanding amounts via an increase in the awarding authority's contribution rate over an agreed period.

b) In the case of admission bodies that are not Transferee Admission Bodies and have no guarantor, the unpaid amounts fall to be shared amongst all of the employers in the Fund. This will normally be reflected in contribution rates set at the formal valuation following the cessation date.

As an alternative to (b) above where the ceasing admission body is continuing in business, the Fund, at its absolute discretion, reserves the right to enter into an agreement with the ceasing admission body to accept an appropriate alternative security to be held against any funding deficit and to carry out the cessation valuation on an ongoing valuation basis. This approach would be monitored as part of each triennial valuation and the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified.

3.11 Early Retirement Costs

3.11.1 Non Ill Health Retirements

The actuary's funding basis makes an allowance for certain employers for premature retirement except on grounds of ill-health. For other employers they are required to pay additional contributions wherever an employee retires before attaining the age at which the valuation assumes that benefits are payable. The current costs of these are specified in the latest early retirement manual from Hymans Robertson.

Since the introduction of the new LGPS many members now have two tranches of pension - namely that which was accrued before and after 1 April 2008. In theory, these can be paid without reduction from two different retirement ages. In practice, the member can only retire once and so both pensions are paid from a single age. It is assumed that the member will retire at the age when all of the member's pension can be taken without reduction.

The additional costs of premature retirement are calculated by reference to these ages.

For non-stabilised employers in the scheme (refer to Section 3.2) any non-ill health premature retirement costs must be paid as lump sum payments at the time of the employer's decision in addition to the contribution described above (or by installments shortly after the decision).

Stabilised employers (refer to Section 3.2) have the option to pay an additional 1% of employer contributions per year to meet non-ill health premature retirement costs. Stabilised employers who opt to pay the additional contribution of 1% per annum must elect this option prior to 1 April 2011 and are 'locked' into this option for the full 3 year period from 1 April 2011 to 31 March 2014.

3.11.2 Ill Health Monitoring

The Fund monitors each employer's, or pool of employers, ill health experience on an ongoing basis. If the cumulative number of ill health retirements in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis that applies for non-ill health cases.

4. Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice.

4.1 Investment Strategy

The investment strategy currently being pursued is described in the Fund's Statement of Investment Principles.

The investment strategy is set for the long-term, but is reviewed each year at the Annual Strategy meeting of the Investment Panel to ensure that it remains appropriate to the Fund's liability profile. The Administering Authority has adopted a benchmark, which sets the proportion of assets to be invested in key asset classes such as equities, bonds and property. As at 31 March 2010, the proportion held in equities and property was approximately 70% of the total Fund assets.

The investment strategy of lowest risk in terms of volatility of funding – but expected to be the most expensive in terms of employer contributions (given the expected relative out performance of equities) – would be 100% investment in a combination of conventional and index-linked Government bonds. The investment strategy of lowest expected cost in terms of long term employer contribution rates – but the most volatile in terms of actual performance in the short term – is 100% investment in equities and other growth orientated assets. This is the crucial trade off. The greater the investment in equities and other non bonds, the lower the initial employer contributions are likely to be, but the higher the risk of volatility in employer contribution rates (in the absence of stabilisation) and funding levels over the relatively short term period of triennial valuations.

The Fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from Government bonds. The Administering Authority's strategy recognises the 'non-mature' nature of the liabilities of the Fund and the secure nature of most employers' covenants. The same investment strategy is followed for all employers.

4.2 Consistency with Funding Basis

The Fund's investment adviser's current best estimate of the long-term return from equities is around 3% a year in excess of the return available from investing in fixed interest Government bonds.

The funding policy adopts a more prudent approach by anticipating long-term returns of 1.6% per year in excess of the prevailing redemption yield on fixed interest Government bonds. This assumption relates to the future return anticipated on all assets held by the Fund, including corporate bonds and property and other alternative assets in addition to equities.

In this way, the employer contributions anticipate returns from Fund assets where, in the Fund actuary's opinion, there is a better than 50:50 chance of delivering full funding on the ongoing basis over the long-term (measured over periods in excess of 20 years).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 5 will damp down, but not remove, the effect on employers' contributions.

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

4.3 Balance between risk and reward

Prior to implementing its current investment strategy, the Administering Authority considered the balance between risk and reward by altering the level of investment in asset classes with higher expected return, but more volatile, like equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

4.4 Inter-valuation Monitoring of Funding Position

The Administering Authority monitors the funding position, between valuation dates, for changes in core financial factors such as investment returns and liability discount rates. This is reported to all employers on a regular basis. In addition specific inter-valuation for individual employers may be undertaken if considered appropriate.

5. Key Risks and Controls

5.1 Types of Risk

The Administering Authority's has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- Financial;
- Demographic
- Regulatory; and
- Governance

5.2 Financial Risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.	*Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.* *Analyse progress annually and at three yearly valuations for all employers.* *If appropriate Inter-valuation roll-forward of liabilities between formal valuations at individual employer level, provided on an annual basis.*
Inappropriate long-term investment strategy.	*Set Fund-specific benchmark, informed by Asset-Liability modelling.* *This is supplemented with an analysis of absolute returns against those under-pinning the valuation.* *This gives an early warning of contribution rises ahead. In the short term, volatility is damped down by stability measures on contributions. However, if underperformance is sustained over periods over 5 years contributions would rise more.*
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	*Inter-valuation monitoring, as above.* *Some investment in bonds and absolute return funds helps to mitigate this risk.*
Active investment manager under-performance relative to benchmark.	*Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.* *Regular meetings with managers.*
Pay and price inflation significantly more than anticipated	*The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.* *Investment in real assets should help mitigate this risk.*
	Inter-valuation monitoring, as above, gives early warning. *Employers pay for their own salary awards.*
Effect of possible increase in employer's contribution rate on service delivery and admission/ scheduled bodies.	*Seek feedback from employers on scope to absorb short-term contribution rises.* *Mitigate impact through deficit spreading, phasing in of contribution rises and stability overlay mechanism.*

5.3 Demographic Risks

Risk	Summary of Control Mechanisms
Pensioners living longer.	*Set mortality assumptions with some allowance for future increases in life expectancy.* *Fund actuary monitors combined experience of around 50 funds to look for early warnings of lower pension amounts ceasing than assumed in funding.* *Administering Authority encourage any employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.*
Deteriorating patterns of early retirements	*Employers are charged the extra capital cost of non ill health retirements.* *Employer ill health retirement experience is monitored.*
A company admitted to the Fund as an admission body may become financially unviable	*A surety or bond is required to cover the potential risk of the admitted body becoming insolvent and the value of this surety or bond is reviewed regularly to ensure it provides adequate cover for the financial risks involved.*
Ill-health retirements significantly more than anticipated	*Monitoring of each employer's ill-health experience on an ongoing basis. The employer may be charged additional contributions if this exceeds the ill-health assumption built in to the valuation assumptions.*

5.4 Regulatory

Risk	Summary of Control Mechanisms
Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees.	*The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.* *It considers all consultation papers issued by CLG and comments where appropriate.* *The Administering Authority will consult employers where it considers that it is appropriate.* *In all circumstances where it appears that changes may impact on the Fund's solvency the Administrating Authority will consider seeking actuarial advice to mitigate or manage the impact of such changes.*
Changes to national pension requirements and/or HM Revenue and Customs rules e.g. effect of abolition of earnings cap for post 1989 entrants from April 2006, abolition of 85 year rule, new 2008 scheme, tax simplification and budget changes for higher earners.	

5.5 Governance

<table>
<tr><th>Risk</th><th>Summary of Control Mechanisms</th></tr>
<tr><td>Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements).</td><td rowspan="2">The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 78) between triennial valuations.

Deficit contributions are expressed as percentage (see Annex A).</td></tr>
<tr><td>Administering Authority not advised of an employer closing to new entrants.</td></tr>
<tr><td>Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.</td><td>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.

It also operates a diary system to alert it to the forthcoming termination of Best Value Admission Agreements.</td></tr>
<tr><td>An employer ceasing to exist with insufficient funding or adequacy of a bond.</td><td>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.

The risk is mitigated by:
• Seeking a funding guarantee from another scheme employer, or external body, where-ever possible.
• Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.
• Vetting prospective employers before admission.
• Setting a minimum limit of 20 employees for prospective employers.
• Where permitted under the regulations requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.</td></tr>
</table>

Annex B – Responsibilities of Key Parties

The Administering Authority should:-

• collect employer and employee contributions;
• invest surplus monies in accordance with the regulations;
• ensure that cash is available to meet liabilities as and when they fall due;
• manage the valuation process in consultation with the fund's actuary;
• prepare and maintain the FSS and a SIP, both after proper consultation with interested parties; and
• monitor all aspects of the fund's performance and funding and amend FSS/ SIP.

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 authorities 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 FSS; and
• prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

APPENDIX THREE – STATEMENT OF INVESTMENT PRINCIPLES

Contents

STATEMENT OF INVESTMENT PRINCIPLES

1 Overall Responsibility

1.0 East Sussex County Council is the designated statutory body responsible for administering the East Sussex Pension Fund on behalf of the constituent Scheduled and Admitted Bodies. The local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009 require administering authorities of pension funds to prepare and review, from time to time, a written statement setting out the investment policy for their Fund. Any material change in investment policy must be included in a revised Statement of Investment Principles (SIP) within six months of the change.
This SIP has been drafted to comply with these regulations and will be reviewed annually by the Investment Panel.

The Panel has set out the extent to which the Fund complies with the six principles set out in the Chartered Institute of Public Finance and Accountancy's publication, `Investment Decision Making and Disclosure in the Local Government Pension Scheme 2009 – a guide to the application of the 2008 Myners Principles to the management of the LGPS funds`.

1.1 Investments are monitored on a regular basis by the Investment Panel (the Panel) acting on the delegated authority of the County Council. Although the scheme is a statutory one, the role of Panel members is similar to that of "trustees". Day to day operational decisions have been delegated to the Acting Chief Finance Officer Business Services Department and all investments are managed by external investment fund managers.

Investment advice is received as required from the professional Investment Advisers, who are appointed by the Panel.

2 Objectives

2.1 Primary Objective

The primary objective of the Fund is to provide for members' pension and lump sum benefits on their retirement or for their dependants' benefits on death, before or after retirement, on a defined benefits basis.

In order that this primary objective can be achieved, the following funding and investment objectives have been agreed.

2.2 Funding Objectives – Ongoing Basis

To fund the Fund so that, in normal market conditions, the accrued benefits are fully covered by the actuarial value of the assets of the Fund and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary increases.

This funding position will be reviewed at least on each triennial Actuarial Valuation.

3 Investment Objectives

3.1 Funding objectives

The Panel has translated its objectives into a suitable strategic asset allocation benchmark for the Fund (Page 90). The strategic benchmark is reflected in the investment structure adopted by the Panel; this comprises a mix of segregated and pooled, and active and passive, manager mandates. The Fund benchmark is consistent with the Panel's views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking into account of market volatility and risk and the nature of the Fund's liabilities. The Panel monitors investment strategy relative to the agreed asset allocation benchmark.

3.2 Investment Managers

The Investment Managers appointed to manage the Fund's assets are summarised on page 90. The investment managers will be given full discretion over the choice of individual stocks against their respective benchmarks and are expected to maintain a diversified portfolio.

3.3 Kinds of investments to be held

The Fund may invest in quoted and unquoted securities of UK and overseas markets, including equities, fixed interest and index-linked bonds, cash and property (not direct), using pooled funds where agreed.
The Fund may also make use of contracts for differences and other derivates either directly or in pooled funds investing in these products, for the purpose of efficient portfolio management to hedge specific risks.
The current limits are set out in the Policy Guidelines for Investment (Page 91). The strategic asset allocation of the Fund includes a mix of asset types across a range of geographies in order to provide diversification of returns.

3.4 Balance between different kinds of investments

The Panel have agreed an asset allocation benchmark and a performance target based on consideration of the liability profile of the Scheme (see page 89
They reflect the Panel's views on the appropriate balance between maximising the long-term return on investments and minimising short-term volatility and risk. Within each major market the investment managers will hold a diversified portfolio of stocks or will invest in pooled funds to achieve this diversification.

3.5 Risk

The adoption of an asset allocation benchmark (as described above) and the explicit monitoring of performance relative to a performance target, constrains the investment managers from deviating significantly from the intended approach, while permitting flexibility to manage the Fund in such a way as to enhance returns.

The appointment of more than one Investment Manager introduces a meaningful level of diversification of manager risk and provides some protection against one manager producing poor investment returns.

3.6 Expected return on investments

The investment performance achieved by the Fund over the long term is expected to exceed the rate of return assumed by the Actuary in funding the Fund on an ongoing basis.

3.7 Realisation of investments

The majority of assets held by the Fund are quoted on major stock markets and may be realised quickly if required. Property investments, which are relatively illiquid, currently make up a modest proportion of the Fund’s assets and are all invested through property unit trusts or life funds.

3.8 Social, environmental and ethical considerations

The Panel has considered the issues surrounding socially responsible investment and has adopted an ‘Active Shareholder Approach’ to encourage companies to adopt best ethical and environmental principles without jeopardising the investment performance of the Fund. When selecting investments for purchase, retention or sale, Fund Managers are able to invest in all companies, subject to the specific restrictions set out in the Policy Guidelines (page 7.) in order to achieve their performance targets. But they have been encouraged to engage in constructive dialogue on behalf of the Fund and to use their influence to encourage companies to adopt best practice in all key areas of business. The key areas are:

- Corporate governance
- Employment standards
- Human rights and
- Environmental standards

3.9 Exercise of voting rights

The Panel promotes strong Corporate governance and has delegated the exercise of its voting rights to the Fund Managers (subject to the Panel's guidelines) on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The Fund Managers base their corporate governance policies on the Stock Exchange Combined Code and provide the Panel with a copy of their policy from time to time. The Fund Manager(s) is encouraged to vote in line with its guidelines in respect of all resolutions at annual and extraordinary general meetings of companies. Voting actions are reported to the Panel on a regular basis and these actions are reviewed and discussed as appropriate.

3.10 Stock Lending

Within segregated mandates, the Panel has absolute discretion over whether stock lending is permitted. The Panel has considered its approach to stock lending, taking advice from its investment adviser. After consideration of that advice, the Panel has decided not to permit stock lending within any of its segregated investment mandates.

The manager(s) of pooled funds may undertake a certain amount of stock lending on behalf of unit holders in the fund. Where a pooled fund engages in this activity, the extent to which it does is disclosed by the manager. The Panel has no direct control over stock lending in pooled funds; nevertheless, it is comfortable that the extent and nature of this activity is appropriate to the circumstances of the Fund.

3.11 Additional Voluntary Contributions (AVCs)

Members have the opportunity to invest in AVC funds as detailed on page 93.

Investment Managers & Benchmarks

Manager	*Asset Class*	*Actual as at 31/03/12 (%)* [1]	*Target allocation (%)*
L&G	***UK equity***	***15.1***	***15.0***
L&G	***Global equity***	***9.5***	***10.0***
L&G ex Fidelity Assets	***Global equity***	***14.9***	***15.0***
Lazard	***Global equity***	***14.0***	***15.0***
Marathon	***Global equity***	***4.9***	***5.0***
Newton	***Absolute return***	***8.0***	***7.5***
Ruffer	***Absolute return***	***8.1***	***7.5***
Prudential	***Bonds***	***6.9***	***6.5***
Schroder	***Property***	***9.5***	***10.0***
Adams Street / Harbourvest	***Private equity***	***5.3***	***5.0***
UBS / Prudential M&G	***Infrastructure***	***2.5***	***2.0***
Prudential M&G	***Specialist Financing Fund***	***0.6***	***1.5***
Northern Trust	***Cash***	***0.7***	***0.0***

[1] Where valuations weren't available at the valuation date estimates have been used

Policy Guidelines for Investment

1. Statutory Provisions

To act within the powers stipulated from time to time in statutory regulations or enactments. The principal regulations applicable to the Fund are the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998. An amendment to these regulations was introduced in 2003 to give extra flexibility to the prudential limits on certain types of investments.

Investments shall be limited as follows:-

(a) Not more than 10% of the Fund in unlisted securities issued by companies.

(b) Not more than 10% of the Fund in a single holding (excluding Gilts, Bank Deposits, LAMIT and Unit Trusts).

(c) Not more than 10% of the Fund to be deposited with an individual Bank, institute or person.

(d) Not more than 10% of the Fund to be lent internally or deposited with another local authority.

(e) Not more than 25% of the Fund is to be invested in unit trusts managed by a single manager.

(f) The Panel has adopted flexible higher limits within the LGPS regulations to invest in Life insurance contracts. The regulations provide for the maximum amount that can be invested in any single life insurance contract to be raised from 25% to 35%.

(g) Not more than 25% of the Fund may be transferred or agreed to be transferred under stock lending arrangements.

(h) The Panel has adopted flexible higher limits within the LGPS investment regulations to invest in partnership structures. The regulations provide for the maximum amount that can be invested in any single partnership to be raised from 2% to 5% and for investments in total across all partnerships from 5% to 15%.

The Regulations also emphasise that an administering authority shall have regard to the suitability of investments and the need for diversification of investments of fund money and for proper advice to be obtained at reasonable intervals.

2. Cash

The East Sussex Pension Fund's surplus cash is invested with the Fund's Custodian, Northern Trust. Only a minimal working cash balance is held by the Administering Authority to pay pension benefits. Any surplus cash is transferred in the first working week of each month to Northern Trust. The revised LGPS (Management and Investment of Funds) Regulations issued in December 2009, required Administering Authorities to set up a separate bank account from 1 April 2011. The East Sussex Pension Fund Bank Account has been operational since 1st April 2011. The monthly interest rate, earned by the County Council on its treasury cash balances, is used to calculate interest on the daily Pension Fund bank account balance.

3. Property

(a) Investment in property unit trusts may be made only if approved by the Investment Panel.

(b) No direct investment is to be made in property (land or buildings) unless the Investment Panel decides otherwise.

4. Derivatives

Managers may invest in financial futures and traded options in accordance with the limitations contained in guidelines drawn up by the Investment Adviser and approved by the Panel.

5. Underwriting

Managers may seek and enter into underwriting opportunities for the Fund at their discretion.

6. Generally

Between meetings it is open to an individual manager who wishes to invest outside laid down policy to consult with the Acting Chief Finance Officer Business Services Department for her direction.

Voting Guidelines

Issue	***Voting Guideline***
General	Continuing dialogue with companies. Vote on all UK issues. Companies are expected to demonstrate clear compliance with Cadbury and Greenbury principles unless they can show that there are mitigating circumstances.
Uncontroversial issues	Vote with Management.
Executive remuneration - Basic pay - Incentive payments	Must be visible. Market rate. Based on above average returns to shareholders.
Non-Executive Directors	Vote against re-appointment if failed to perform their duties.
Employment Contracts	Vote against contracts exceeding two years unless a longer period can be justified and abstain on those exceeding one year.
Political Donations	Vote against.
Share Incentive Schemes	Each proposal judged on its merits.

AVC Arrangements

The Fund is required to offer members an Additional Voluntary Contribution (AVC) fund in order that members can make additional pension provision. The Investment Panel have considered the available AVC providers and appointed Prudential to manage the AVC arrangement for the Fund in 1988. This appointment has been reviewed on a regular basis, taking account of factors including past investment performance, charges, flexibility, and the quality of administration. This appointment was last reviewed in 2008, confirming the appointment of Prudential

Members may invest in the AVC funds during their employment. The AVC funds are maintained by Prudential, and are separate from the Fund's investments. At retirement, however, members can either take the AVC fund as a lump sum (subject to limits set by HMRC), an additional pension within the Fund, or as an annuity either with the AVC provider, or on the open market.

Investment Choices

Members must select the investment funds that their AVC funds are invested in. They are able to choose from a range of Prudential investment funds, with differing risk ratings, and are able to switch investment funds between the range of funds available. Prudential make no charge in respect of these switches, and there are no restrictions to the number of switches a member may make. Members are charged an Annual Management Charge (AMC) by Prudential, based on the value of their funds in each of the investment fund options they have selected. This charge is calculated on a daily basis, and deducted from the value of the members' funds monthly.

The Investment Panel regularly reviews the investment fund options available to members. The last review was undertaken in 2008, resulting in a change to the investment funds available. The current range of investment funds available to new members are:

Fund Name	**Investment Type**	**Risk Rating**	**AMC (% of fund value)**
Prudential With-Profits Fund (Default Fund)	Full range of investments – including shares, bonds, cash & property – provides smoothed growth through a range of reversionary and terminal bonuses	Lower to Medium	n/a – special charges apply
Prudential Deposit Fund	Cash	Minimal	n/a - Monthly interest rate declared net of charges
Prudential Retirement Protection Fund	UK Government Bonds	Lower	0.65%
Prudential Discretionary Fund	UK & Overseas shares, bonds, property, alternative assets & cash	Medium	0.75%
Prudential Property Fund	UK Commercial property	Medium	0.75%
Prudential Overseas Equity Passive Fund	Company shares in major world markets in proportion to each region's economic importance	Medium to Higher	0.65%
Prudential UK Equity Passive Fund	UK Company shares	Higher	0.65%
Prudentially Socially Responsible Fund	UK Company shares meeting fund's socially responsible criteria	Higher	0.75%

Lifestyle Option

A Lifestyle option is available. This automatically switches investments from higher to lower risk investment funds in the 8 years leading up to the member's Normal Retirement Age (65):

Fund	Years to Retirement								
	8	7	6	5	4	3	2	1	0
Prudential UK Equity (Passive) Fund	100.0%	87.5%	75.0%	62.5%	50.0%	37.5%	25.0%	12.5%	0.0%
Prudential Retirement Protection Fund	0.0%	12.5%	25.0%	37.5%	50.0%	62.5%	75.0%	87.5%	100.0%

Funds closed to new investors

As a result of the 2008 review a number of investment funds were deselected. Rather than require the members invested in these funds to switch funds it was decided that existing contributors to these funds only were able to continue to add contributions. The funds are not, however, available to new investors. These closed funds are:

Fund Name	Investment Type	Risk Rating	AMC (% of fund value)
Prudential Cash Fund	Cash	Minimal	0.75%
Prudential Fixed Interest Fund	British Government Gilts and Sterling Fixed Interest Company Bonds	Lower	0.75%
Prudential Index Linked Fund	British Government Index Linked Gilts	Lower	0.75%
Prudential Global Equity Fund	UK and Overseas Company shares	Medium to Lower	0.75%
Prudential International Equity Fund	Company shares in major overseas equity markets	Medium to Higher	0.75%
Prudential UK Equity (Active) Fund	UK Company Shares managed on a "Fund of Funds" basis	Higher	0.75%

Withdrawal Penalties

Prudential introduced withdrawal penalties in 2012. These apply in respect of new AVC members where their first AVC contribution is received after 18 August 2012, and who take their AVC benefits within 5 years of starting the AVC. The withdrawal penalty operates on a sliding scale, based on the length of time that the member has held the AVC on their withdrawal:

Year of Withdrawal	During Year 1	During Year 2	During Year 3	During Year 4	During Year 5	After 5 Years
Reduction Factor	15%	10%	8%	6%	5%	0%

The withdrawal penalty does not apply in respect of members who die in service, or who are retired with a Tier 1 ill-health pension.

Death in Service

Members are also able to make AVC's to provide additional life cover. These are separate from those contributions made to provide additional pension benefits.

<u>Myners Six Principles – compliance statement.</u>

Introduction

The Local Government Pension Scheme (LGPS) has a deserved reputation for applying and demonstrating the highest standards of governance. All LGPS funds were required from 2002 to comment on the application of and compliance with the original ten Myners Principles.

1. In response to the Treasury report *Updating the Myners Principles: A Response to Consultation* (October 2008) LGPS Administering Authorities will be required to prepare, publish and maintain statements of compliance against a set of six principles for pension fund investment, scheme governance, disclosure and consultation. These principles have been adopted by CLG and replace the ten Myners principles published in 2001.

2. Administering Authorities will be required to report their approach to meeting the principles through the pension fund annual report on a 'comply or explain' basis.

Background

3. In 2000 the UK government commissioned a review of institutional investment in the United Kingdom. The review, published in March 2001, was undertaken by Paul Myners (now Lord Myners). The review was established mainly due to concerns that, by focusing primarily on industry-standard investment patterns, the behaviour of institutional investors, including occupational pension funds, was distorting economic decision making to the detriment of small and medium-sized companies.

4. Myners emphasised the importance of transparency and annual reporting. Consistent with these themes Myners recommended that pension schemes should set out in their statement of investment principles what they were doing to implement his ten 'best practice' principles and, where a given principles had not been adopted, an explanation of that decision.

5. In 2007, six years after the publication of the original investment principles, the government decided to assess the extent to which:

- pension fund trustees or their equivalent had been applying the Myners principles
- scheme governance and the quality of trusteeship had improved
- key gaps identified previously had been addressed

6. It was clear that, in general, progress had not been uniform and that larger schemes had used their additional resources and access to advice to make more progress than the average smaller scheme. However, one area of more general weakness was the lack of willingness of trustees to asses and report on their own performance.

7. Local Authority schemes had made progress. The Government's findings, however, highlighted a greater 'trustee risk' facing local authority schemes, referring to election cycles as shortening the average tenure of a 'trustee' compared with other types of scheme. This raised concerns about a lack of continuity and expertise, which was mitigated to some extent by the professional advice received from officers of the administering authorities.

8. The government concluded that an updated set of principles would be most effective if the government and the pension fund industry developed flexible and overarching voluntary principles, rather than prescribing how pension funds should manage specific aspects of their business. The high-level principles will be the accepted code of practice applying to investment decision making and investment governance in local government pension funds throughout the United Kingdom. Administering Authorities will be required by regulation to report against these on a 'comply or explain' basis.

9. The following pages set out the Fund's response to the six Myners Principles.

PRINCIPLE ONE

1	**Effective decision making** **Administering Authorities should ensure that:** • **Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation;** **And** • **Those persons or organisation have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.**		**Fully Compliant**
Key Issues:			
1.1	Each administering authority should have a designated group of elected members appointed to a Panel to whom responsibility for the management and administration of the pensions fund has been assigned.	The East Sussex Investment Panel has responsibility for the management and administration of the pension fund.	√
1.2	The roles of the officers with responsibility for ensuring the proper running of the administering authority's and the Panel's business should be set out clearly. This should include the Chief Finance Officer and the clerk to the panel. The rules drawn up by the clerk to provide a framework for the Panel's conduct of business should include a process for the declaration of conflicts of interest before each meeting and at other times as appropriate.	Members and officers are invited to make any declaration of personal or prejudicial interests that they may have in relation to items on the agenda at the beginning of each meeting.	√
1.3	Administering authorities are required to prepare, publish and maintain statements of compliance against a set of good practice principles for scheme governance and stewardship.	The administering authority has prepared, published and maintained a Governance Compliance Statement which sets out its compliance against good practice principles.	√
1.4	Guidance issued by CLG required each administering authority to publish a governance compliance statement in regard to each of the funds it controls. This statement shows the extent to which administering authorities comply with nine governance principles. These are set out in the CLG's *Local Government Pensions Scheme Governance Compliance Statutory Guidance.*	The administering authority has prepared, published and maintains a Governance Compliance Statement which sets out its compliance against good practice principles.	√
1.5	Wherever possible, appointments to the Panel should be based on consideration of relevant skill, experience and continuity.	Normal practice (involving independent advice)	√
1.6	The Panel should be governed by specific terms of reference, standing orders and operational procedures that define those responsible for taking investment decisions, including officers of the authority and/or external investment managers.	The Constitution of the County Council explains how we operate, how decisions are made and the procedures which are followed to ensure that these are efficient, transparent and accountable to local people (in addition, Statement of Investment Principle).	√
1.7	It is unlikely that decision on overall strategy and asset allocation can be delegated effectively, whereas day-to-day investment decisions are most likely to be taken by the investment manager, whether internal or external. The process by which such decisions are delegated and authorised should be described in the constitution and record of delegated powers relating to the Panel, as well as in public documents for stakeholders, such as the statement of investment principles.	Statement of Investment Principles and Investment Mandate.	√
1.8	In describing that process, the roles of members, officers (whether as a monitoring control function or as the investment manager), external advisers and managers should be differentiated and specified.	Statement of Investment Principles.	√

1.9	The Panel should ensure that it has appropriate skills, and is run in a way designed to facilitate, effective decision making. It should conduct skills and knowledge audits of its membership at regular intervals in relation to the scope of its work and the pension's issues that are most relevant. A statement should appear in the annual report.	The fund will adopt the knowledge and skills framework as a basis for the training and development of those involved in the pension scheme. The 2010/11 Annual Report will include a statement which discloses the application of the framework and what training has been undertaken.	√
1.10	The Panel should obtain proper advice at reasonable intervals from suitably qualified persons, including officers of the authority and external investment managers. The chief finance officer should assess the need for proper advice and recommend to the Panel when such advice is necessary from an external advisor. The Panel should ensure that it has sufficient internal resources and, where necessary, external resources to carry out its responsibilities effectively.	The Panel's quarterly meetings are attended by the Fund's independent adviser. The Panel is always supported by the Executive Director and his officers. The Panel's training schedule is dictated by their need to carry out its responsibilities effectively.	√
1.11	The Chief Finance Officer should be given responsibility for the provision of the training plan for members to help them to make effective decisions and to ensure that they are fully aware of their statutory and fiduciary responsibilities, and regularly reminded of their stewardship role.	Elected members have legal responsibilities for the prudent and effective stewardship of LGPS pension funds and, in more general terms, have a clear fiduciary duty to participating employers; local tax payers and scheme beneficiaries, in the performance of their functions. This is covered in the Fund's Governance Policy Statement.	√
1.12	Employees appointed as member representatives should be allowed adequate time off from their normal duties to attend meetings and to read the papers.	The employee representative is appointed by Unison and given adequate time off from their normal duties to attend meetings and read the papers.	√
1.13	Papers and related documentation should be clear and comprehensive, and circulated to members of the Panel sufficiently in advance of the meeting to allow them to be read and understood.	Papers are circulated to members at least 7 working days in advance of a meeting.	√
1.14	The chief finance officer should ensure that a medium term business plan is created for the pension fund, which should include the major milestones and issues to be considered by the panel. The business plan should contain financial estimates for the investment and administration of the fund, and include appropriate provision for training. The plan should be submitted to the panel for consideration.	The Panel plans its investment strategy at its Annual Strategy Meeting in June. Effective decision on strategic asset allocation benchmarks for the medium term and sound corresponding manager appointments are the most crucial decisions. This reflects the core business planning activity of the Panel. Budget estimates are prepared and monitored for investment, administration and actuarial costs.	√
1.15	The fund's administration strategy documents should refer to all aspects of the panel's activities relevant to the relationship between the panel and the employing authorities.	Statement of Investment Principles, Annual Accounts, Website, Administrative publications – deal with these matters.	√

PRINCIPLE 2

2.	**Clear objectives** **An overall investment objective(s) should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.**		**Fully Compliant**
Key Issues:			
2.1	The Panel should demonstrate that in setting an overall investment objective for the fund, it has considered: • the fund's liabilities in the context of the expected net contribution inflows; • the adequacy of the fund's assets to meet its liabilities as advised by the actuary; • the maturity profile of the fund's liabilities and its cash flow situation.	The East Sussex Fund's investment strategy is continuously reviewed. Subject to independent advice involving Asset/ Liability Studies as necessary and of course the results of the triennial valuation.	√
2.2	The Panel should also demonstrate that it has sought proper advice, including from specialist, independent advisers where appropriate, as to how this might be expressed in terms of the expected or required annual return on the fund and how it should be measured against stated benchmarks.	The Panel holds quarterly and annual strategy meetings every June, additional to the regular quarterly meetings.	√
2.3	The Panel should consider its own appetite for risk and that of the employers in the fund when considering advice on the mix of asset classes and on active and passive investment mandates. In making asset allocation decisions the Panel should consider all asset classes currently available to investors.	An investment strategy of lowest risk, but not necessarily the most cost effective in the long term, would be 100% investment in index linked government bonds. However, the fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from index-linked bonds. The administering authority's strategy recognises the relatively immature liabilities of the fund and the secure nature of most employers covenants. The same investment strategy is followed for all employers.	√
2.4	The use of peer group benchmarks should be for comparison purposes only and not to define the overall fund objective.	The Fund's performance is measured against its' customised benchmark and that of the WM Local Authorities Universe.	√
2.5	The chief finance officer and the Panel will need to consider the general and strategic impact of the funding levels and employer contribution rates on council tax levels over time. The responsibility of the actuary to keep rates of employer contributions as constant as possible over time is the primary means of achieving this.	The primary objective of investment policy is the maximisation of the Fund's long-term return, consistent with the degree of risk appropriate for a pension fund, in order to minimise the level of employer contributions to the Fund whilst keeping the employer contribution rate as stable as possible.	√
2.6	The Panel should consider the nature of the membership profiles and financial position of the employers in the fund and decide, on the advice of actuaries, whether or not to establish sub-funds with different investment objectives.	Regular dialogue is held with the Actuary. The Funding Strategy Statement (FSS) is reviewed and published in the S.I.P	√

2.7	The Panel should evaluate the split between equities and bonds in the light of the funds forecast liabilities before considering any other asset class. It should state the range of investments it is prepared to include in its asset allocation decision and give the reasons why some asset classes may have been excluded. The Panel should have regard to the diversification and suitability of investments in reaching its asset allocation decisions. Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflect the contribution they can make towards achieving the fund's investment objectives.	Decisions reflect the Fund's own characteristics and consider a full range of investment asset classes, including alternative asset funds. The fund managers have discretion to position the fund around the customised benchmark within agreed control ranges set by the actuary consistent with the performance objectives of the fund	√
2.8	The Panel should take proper advice, including from specialist, independent advisers where appropriate. The Panel should appoint advisors in open competition and should set them clear strategic investment performance objectives. The Panel should state clearly how their advisors' overall performance will be measured and the relevant short, medium and longer term performance measurement framework. All external procurement of advisors, investment managers and other services should be conducted within the EU Procurement Regulations and the administering authority's own procurement rules.	The Panel is supported by an Independent Adviser whose appointment is subject to review. All Pension Fund procurements are run in line with the EU Procurement Regulations.	√
2.9	Understanding transaction-related costs should be a clear consideration in letting and monitoring a contract for investment management and, where appropriate, independent and expert advice should be taken on transaction costs, particularly in relation to transition management.	IMA / NAPF Level 2 Disclosure reports are received half yearly from the Fund's investment managers for monitoring the transaction related costs. Transition management is monitored by Hymans Robertson.	√

PRINCIPLE 3

3.	**Risk and Liabilities** • **In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.** • **These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.**		**Fully Compliant**
Key Issues:			
3.1	The Panel should set out an overall investment objective for the fund that: • represents its best judgement of what is necessary to meet the fund's liabilities given their understanding of the contributions likely to be received from employer(s) and employees • takes account of the Panel's attitude to risk, and specifically its willingness to accept underperformance due to market conditions.	The primary objective of investment policy is the maximisation of the Fund's long-term return, consistent with the degree of risk appropriate for a pension fund, in order to minimise the level of employer contributions to the Fund, as set out in the S.I.P	√
3.2	The Panel should be aware of its willingness to accept underperformance due to market conditions. If performance benchmarks are set against relevant indices, variations in market conditions will be built in, and acceptable tolerances above and below market returns stated explicitly.	Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.	√
3.3	Some benchmarks may also be stated in terms of absolute returns, in which case the Panel must believe that a certain rate of return is acceptable and feasible, regardless of market conditions, from certain classes of asset.	The East Sussex Fund appointed 2 Absolute Return Fund Managers in February 2010.	√
3.4	The fund's Statement of Investment Principles should include a description of the risk assessment framework used for potential and existing investments.	See Risk section 3.5 in the Fund's S.I.P	√
3.5	Objectives for the overall fund should not be expressed in terms which have no relationship to the fund's liabilities, such as performance relative to other pension funds, or to a market index.	The use of the WM Local Authority Average is for information purposes only.	√
3.6	The Panel should state whether a scheme specific benchmark has been considered and established and what level of risk, both active risk and market risk, is acceptable to it.	See S.I.P and Funding Strategy Statement	√
3.7	The Panel should receive a risk assessment in relation to the valuation of its liabilities and assets as part of the triennial valuations. Where there is reasonable doubt about the valuation of liabilities and assets at any stage during the performance monitoring of the fund, the chief finance officer should ensure that a risk assessment is reported to the Panel, with any appropriate recommendations for action to clarify and/or mitigate the risks.	The actuarial valuation is reported to the Investment Panel and the Governance Committee. The triennial valuation is also discussed at the Annual Employers Forum.	√

3.8	The Panel should, at the time of the triennial valuations, analyse factors affecting long-term performance and receive advice on how these impact on the scheme and its liabilities. The Panel should also ask this question of its actuaries and other advisors during discussions on performance.	Regular discussions are held with the Actuary and the Investment advisers.	√
3.9	The Panel should use reports from internal and external auditors to satisfy itself about the standards of internal control applied by the scheme to its administration and investment operations, as well as to the overall governance structure of the Panel and its scheme of delegation. Ensuring effective internal control is an important responsibility of the chief finance officer.	The Panel receives comment from the Fund's internal auditor as to standards of internal control applied by the scheme to its investment and administration operations and its governance structure. Governance Committee receive annual reports from the Fund's external auditor.	√
3.10	The Panel should ensure that its investment strategy is suitable for its objectives and takes account of the ability to pay of the employers in the fund.	Regular discussions take place with the Actuary and an Annual Pension Fund Employers Forum is held each year.	√
3.11	The annual report of a pension fund should include an overall risk assessment in relation to each of its activities and factors expected to have an impact on the financial and reputational health of each fund. This could be done by summarising the contents of a regularly updated risk register. An analysis of the risks should be reported periodically to the Panel, together with necessary actions to mitigate risk and assessment of any residual risk.	Regular monitoring, including the risk assessment of the Fund, is undertaken by Officers in conjunction with the Investment Advisers and the Actuary.	√

PRINCIPLE 4

4.	**Performance assessment** • **Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.** • **Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.**		**Fully Compliant**
Key Issues:			
4.1	The Panel should: • explicitly consider, in consultation with their investment manager(s), whether the index benchmarks it has selected are appropriate, and in particular, whether the construction of the index creates incentives to follow sub-optimal investment strategies • if setting limits on divergence from an index, ensure that they reflect the approximations involved in index construction and selection • consider explicitly for each asset class invested, whether active or passive management would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned • where it believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving the managers the freedom to pursue genuinely active strategies. Note - the term “benchmark” is used to describe the marker against which asset allocation and investment performance will be measured, as set for each portfolio or mandate.	The appropriateness of index benchmarks is discussed with the investment managers and investment advisors. The appropriateness of active v passive management is considered when investment managers are reviewed. The Fund’s managers have discretion to position the fund around the customised benchmark within agreed ranges set by the Panel consistent with the performance objectives of the fund.	√
4.2	The mandate represents the instruction to the manager as to how the investment portfolio is to be managed, covering the objective, asset allocation, benchmark flexibility, risk parameters, performance targets and measurement timescales.	The Agreements with fund managers explicitly state how the portfolio is to be managed, performance targets and measurement timescales.	√
4.3	It is important to recognise that the structure of the benchmark, the control parameters around each element, the risk margins set, and the performance target will all combine to drive the management of the investment portfolio.	See S.I.P	√
4.4	The use of peer group benchmarks (such as the CIPFA/WM Local Authority Pension Fund Investment Statistics) may not be appropriate for directing a mandate of a manager insofar as they infer a common asset liability structure or investment requirement. However, such benchmarks may be used for comparative information in measuring investment performance against other funds, as between managers, or for individual asset classes.	The Fund’s customised benchmark is determined by the Panel. The use of the WM Local Authority Average is for information purposes only.	√
4.5	Where active management is selected, divergence from a benchmark should not be so constrained as to imply index tracking (i.e. passive management) or so wide as to imply unconstrained risk.	The Fund’s managers have discretion to position the fund around the customised benchmark within agreed ranges set by the Panel consistent with the performance objectives of the fund.	√

4.6	Investment activity in relation to a benchmark should be monitored regularly to check divergence and any impact on overall asset allocation strategy.	The asset allocation versus the Fund's benchmark is reported quarterly to the Pensions Panel and the impact of positions is discussed with the Investment Managers. A detailed performance report is presented annually which covers asset and sector allocation and its impact on overall returns.	√
4.7	Investment returns should be measured to enable regular monitoring against bespoke and peer group benchmarks.	Performance is measured and considered by the Panel quarterly.	√
4.8	In addition to the overall fund returns the return achieved in each asset class should be measured so that the impact of different investment choices can be assessed (for example equities by country, fixed interest by country and type, property, private equity etc.)	Stock, sector, geography and asset class returns are considered by the Panel quarterly.	√
4.9	Although returns will be measured on a quarterly basis in accordance with the regulations, a longer time frame (typically three to seven years) should be used in order to: • assess the effectiveness of the fund management arrangements • review the continuing compatibility of the asset/liability profile	On-going reviews and an Annual Strategy Panel Meeting to consider investment strategy.	√
4.10	Returns should be obtained from specialist performance measurement agencies independent of the fund managers.	The Fund's performance is calculated by the WM Company.	√
4.11	Investment manager returns should be measured against their agreed benchmark and variations should be attributed to asset allocation, stock selection, sector selection and currency risk all of which should be provided by an independent performance measurement agency.	Regular monitoring of performance targets by Hymans Robertson, along with annual performance measurement reporting by the WM Company.	√
4.12	When assessing managers and advisers it is necessary to consider the extent to which decisions have been delegated and advice heeded by officers and elected members.	See S.I.P	√
4.13	The Panel should devise a performance framework against which to measure the cost, quality and consistency of advice received from its actuaries. It is advisable to market test the actuarial service periodically.	The cost and quality of the Fund's actuarial advice is reviewed regularly with a full procurement exercise necessary at least every 7 years.	√
4.14	Consultants should be assessed on a number of issues including the appropriateness of asset allocation recommendations (bearing in mind the nature of the liabilities), the quality of advice in choosing benchmarks and any related performance targets and risk profiles, the quality and appropriateness of the investment managers that are recommended, and the extent to which advisers are proactive and consistent in recommending subsequent changes.	Half Yearly Meetings are held with the Consultants and a scorecard system of monitoring performance is incorporated in the management agreement.	√

4.15	The process of self assessment involves both officers and members of the Panel reviewing a range of items, including manager selection, asset allocation decisions, benchmarking decisions, employment of consultants and best value outcomes. The objective of the reviews would be to consider whether outcomes were as anticipated, were appropriate, or could have been improved. This could include expected progress on certain matters, reviews of governance and performance and attendance targets. It should include standards relating to the administration of the Panel's business such as: • attainment of standards set down in CIPFA's knowledge and skills framework • achievement of required training outcomes • achievement of administrative targets such as target dates for issuing agendas and minutes.	Self Assessment forms a key part of the process of the Annual Strategy Meeting	√
4.16	The assessment of business performance should be included in the fund's annual report to its stakeholders.	It is (but will review if it needs to be explained).	√

PRINCIPLE 5

5.	**Responsible Ownership** **Administering authorities should:** • **adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents,** • **include a statement of their policy on responsible ownership in the statement of investment principles** • **report periodically to scheme members on the discharge of such responsibilities**		**Fully Compliant**
Key Issues:			
5.1	Policies regarding responsible ownership must be disclosed in the statement of investment principles which must be contained in the annual report.	A Statement of Investment Principles is published and contained in the annual report.	√
5.2	Responsible ownership should incorporate the Panel's approach to long term responsible investing including their approach to consideration of environmental, social and governance issues.	The fund's statement includes consideration of environmental, social and governance issues.	√
5.3	The Panel should discuss the potential for consideration of environmental, social and governance issues to add value, in accordance with its policies on responsible investing, when selecting investment managers and in discussing their subsequent performance. In addition the Panel should ensure that investment managers have an explicit strategy, setting out the circumstances in which they will intervene in a company that is acceptable within the Panel's policy.	Environmental, social and governance issues are discussed as part of Investment Manager procurement exercises. Managers' engagement and voting records are presented to the Panel quarterly and discussed.	√
5.4	The Panel should ensure that investment consultants adopt the Institutional Shareholders' Committee (ISC) Statement of Practice relating to consultants. (The ISC's Statement of Principles on the responsibilities of shareholders and agents sets out best practice for institutional shareholders and/or agents in relation to their responsibilities in respect of investee companies, in that they will: • set out their policy on how they will discharge their responsibilities, clarifying the priorities attached to particular issues and when they will take action. • monitor the performance of, and establish, where necessary, a regular dialogue with investee companies • intervene where necessary • evaluate the impact of their engagement and report back to clients and beneficial owners)	Hymans Robertson, the Fund's Investment Consultant, is aware of the ISC Statement of Practice relating to Consultants and is supportive of this.	√
5.6	Funds should also be aware of the November 2009 ISC Code on Responsibilities of Institutional Investors. This new code forms part of efforts to help investors become more effective in their dealings with companies in which they invest and sets out best practice with regard to monitoring companies, dialogue with company boards and voting at general meetings.	The Fund is currently appointing a Corporate Governance Overlay Manager in order to implement these principles.	√

5.7	The United Nations Environment Programme Finance Initiative (UNEP FI) has published Principles of Responsible Investment (UNPRI) and has encouraged asset owners and asset managers to sign up and commit to the principles and regularly assess themselves against a comply or explain framework. The six principles can be found at http://www.unpri.org/principles/.	The East Sussex Fund is considering signing up to UNPRI	√
5.8	It is important to ensure through the terms of an explicit strategy that an authority's policies are not overridden, negated or diluted by the general policy of an investment manager or house policy.	Specific policy exists for segregated holdings but has to be recognised that by definition, an individual clients wishes are diluted in a pooled fund. The Fund monitors the Investment Managers voting records and details of action taken are reported quarterly to the Pensions Panel.	√
5.9	Where the exercise of voting action is separated from the investment manager, authorities should ensure that the appropriate investment decision is taken into account by reference to those appointed to manage the investments. Authorities may use the services of external voting agencies and advisers to assist compliance in engagement.	The Investment Managers are responsible for voting.	N/A
5.10	Authorities may wish to consider seeking alliances with either other pension funds in general, or a group of local authority pension funds, to benefit from collective size where there is a common interest to influence a companies to take action on environmental, social and governance issues.	The Council does as appropriate (for example, Royal Dutch Shell Transport).	√

PRINCIPLE 6

6.	**Transparency and reporting.** **Administering authorities should:** • **act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives;** • **provide regular communication to scheme members in the form they consider most appropriate.**		**Fully Compliant**
Key Issues:			
6.1	Transparency is strengthened by a clear and well communicated governance framework. The Panel should ensure that its governance compliance statement is maintained regularly. It should actively challenge any non-compliance and be very clear about for its reasons for this, and be comfortable with the explanations given.	The Fund's Governance Compliance Statement is reviewed annually.	√
6.2	The Fund's Communication statement must set out the administering authority's policy on; • the provision of information and publicity about the scheme to members, representatives of members and employing authorities • the format, frequency and method of distributing such information or publicity • the promotion of the scheme to prospective members and their employing authorities	The Fund's Communication Policy statement covers available information, its format, frequency and distribution method and the promotion of the scheme to prospective members.	√
6.3	The Panel should have a comprehensive view of who its stakeholders are and the nature of the interests they have in the scheme and the fund. There should be a clearly stated policy on the extent to which stakeholders will take a direct part in the Panel's functions and on those matters on which they will be consulted or informed.	The number of stakeholders affected by the local management of the pension scheme is vast and it is accepted that it would be impractical to expect individual committee structures to encompass every group or sector that has an interest in the decisions that fall to be made under the scheme's regulations. It is against this background that the Fund has included representatives from the major employers (District Councils and Scheduled Bodies) on the Pensions Panel, as well as an employee representative. Communication/consultation – extends to Annual Employer meetings, and regular employer and employee briefings.	√
6.4	The Panel should seek examples of good practice from the published reports and communication policies of other pension funds. It should also share examples of its own good practice. The full range of available media should be considered and used as appropriate.	Officer's review published reports and communication policies of other pension funds, and shares examples of its own practice.	√
6.5	The Panel should compare regularly its annual report to the regulations setting out the required content and, if it does not comply fully with the requirements, should ensure that an action plan is produced to achieve compliance as soon as possible. However, the Panel will wish to ensure that the content is, if necessary, extended and presented in the way that is most useful and relevant to its many stakeholders. This may require a thorough review of its data capture and management processes to ensure as efficient an approach to production and use of data as possible.	The Annual Report sets out the regulations relating to the required content and demonstrates compliance against each point. The content of the annual report is reviewed regularly.	√

6.6	The funding strategy statement, the statement of investment principles and the governance compliance statement are core source documents produced by funds to explain their approach to investment and risks. With regard to the first two; It is unlikely that decisions on overall strategy and asset allocation can be delegated effectively whereas day-to-day investment decisions are most likely to be taken by the investment manager, whether internal or external. The process by which such decisions are delegated and authorised should be described. In describing that process, the roles of members, officers (whether as a monitoring control function or as the investment manager), external advisors and managers should be differentiated and specified. The process for monitoring the actions, decisions and performance of external advisers and managers should be clearly stated. The process by which the overall fund asset allocation has been determined should include reference to the assumptions as to future investment returns and to any asset/liability study undertaken. The mandates given to each manager should be described. Fee structures should include the scale of charges in operation, whether ad valorum or fixed, and any performance element built in, stating the implications for risk control. Although there is no requirement to provide copies of the SIP to members, a copy should be made available on request and its availability should be made clear in the publication process.	All set out in the Fund's S.I.P and F.S.S	√
6.7	The governance compliance statement must include information on whether the administering authority delegates the whole or part of its function to a committee, a sub-committee or an officer of the administering authority. If it does delegate functions, the statement must include: • the frequency of any meetings, the terms of reference, structure and operational procedures of the delegation; • whether the committee or sub-committee includes representatives of employing authorities (including non-LGPS employers) or members, and if so, whether those representatives have voting rights.	The Investment Panel is a delegated committee of Governance Committee and has clear terms of reference. This is covered in the Fund's Governance Policy and Governance Compliance Statement.	√
6.8	The governance compliance statement must include details to the extent to which a delegation (or absence of delegation) complies with CLG guidance. Where the statement does not comply with the guidance, the reasons for non-compliance.	Compliance statement forms part of ESPF S.I.P	√
6.9	Where the statement does not comply with the guidance, the reasons for non-compliance.	The statement complies with the guidance.	√
6.10	A copy of the statement (or revised statement) must be sent to CLG.	CLG are kept up to date with the latest Governance Compliance Statement	√

Governance Policy Statement

Introduction

1. This is the Governance Policy Statement of the East Sussex Pension Fund, which is managed by East Sussex County Council, the Administrating Authority on behalf of all the relevant employer bodies in the Fund. All Local Government Pension Scheme (LGPS) Funds in England and Wales are required to publish a governance statement by 1 April 2006, under the LGPS (Amendment) (No 2). Regulations 2005 which came into force on 14 December 2005.

2. As Administering Authority, East Sussex County Council is the designated statutory body responsible for administering the East Sussex Pension Fund of behalf of the constituent Scheduled and Admitted Bodies in the relevant area. The Local Government Pension Scheme Regulations 1997 specify that, in investing the Fund's money, regard must be given to the need for diversification and for proper advice obtained at reasonable intervals.

Governance of East Sussex Pension Fund

3. East Sussex County Council operates a Cabinet style decision-making structure. Under the Constitution, the Governance Committee has delegated authority to exercise the powers of the County Council in respect of the pensions of all employees of the Council (except teachers), including the approval of the pension fund admission agreements. It also has authority for the management of the pension fund. In this latter regard it has delegated the management of the investment funds of the East Sussex Pension Fund to the East Sussex Pension Fund Investment Panel. This panel reports periodically to the Governance Committee.

Responsibilities of the Pension Fund Investment Panel

4. The Pension Fund Investment Panel is required to advise the Governance Committee on the management of the investments of the Pension Fund, investment performance and targets to be achieved by Fund Managers. It is also required to keep under review:

- the Funding Strategy Statement;
- the Statement of Investment Principles; and
- the appointment of an actuary, fund advisers and a custodian.

Frequency of meetings of the Pension Fund Investment Panel.

5. The Pension Fund Investment Panel meets at least 5 times a year. The full term of reference are publicly available as part of the County Council constitution.

Current Operational Procedures of the Pensions Fund Investment Panel.

6. The Pension Fund Investment Panel receives and reviews quarterly reports from all its Investment Fund Managers and the independent Investment Adviser, Hymans Robertson. The Panel is also advised by an additional Independent Advisor. In addition, the Panel is advised by the County Council's Acting Chief Finance Officer Business Services Department (in her capacity as the Council's designated Treasurer). The Panel also receives an annual report from the Fund's independent performance measurement provider which reviews the long-term performance of the Fund and of each of the Investment Fund Managers in relation to their targets. The Panel also holds a separate Annual Strategy Meeting at which its reviews the overall investment strategy of the Fund.

Membership of the Pension Fund Investment Panel

7. East Sussex County Council annually appoints three members to the Pension Fund Investment Panel in accordance with the political balance provisions. Brighton and Hove City Council similarly appoints two members and the Boroughs, between them, appoint one representative. There is a requirement that one of the East Sussex County Council appointments will be the Chairman of the Panel. Each of the above have full voting rights. The Panel also have a Staff Representative, nominated by UNISON, but who does not have voting rights.

8. Day to Day operational decisions have been delegated to the Acting Chief Finance Officer Business Services Department (in her capacity as the Council's County Treasurer) and, other than occasional and temporary short term cash holdings, all investments are managed by external Investment Fund Managers.

Membership of the Governance Committee

9. The County Council annually appoints five members to the Committee in accordance with political balance provisions. All members of the Committee have voting rights. The Committee is advised by the Chief Executive, and the Acting Chief Finance Officer Business Services Department and the Director of Legal and Democratic Services

10. In relation to Pension Matters, the Committee consider directly all issues relating to pension administration, such as changes in benefit regulation, admission agreements etc. (As stated the Pension Fund Investments are handled by the Investment Panel on behalf of the Governance Committee). The Chairman of the Investment Panel is also normally a member of the Governance Committee.

Consultation with Employing Authorities

11. All employing bodies are kept informed of current pension issues, such as proposed changes in the regulations and their implications, by newsletter. They are encouraged to get in touch if they have questions.

12. In addition to these electronic briefings, the East Sussex Fund holds an annual employers forum to which all admitted bodies of the Fund are invited. This annual meeting covers both actuarial and investment issues and always contains a presentation from the Fund's Actuary. The District Councils receive feedback from their representatives on the Investment Panel and are also briefed on pension matters bi-monthly by the Fund's Treasurer at meetings of the East Sussex Financial Officers Association. Update briefings to these meetings are also circulated by email to all other employers in the East Sussex Pension Fund.

13. All employees receive periodic newsletter update on pension issues, especially on any changes affecting benefits. These updates are shared with all employers.

14. More detail on the approach to communication is covered in the separate Pension Fund Communication Statement.

Contact Details

15. As follows:

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Compliance Statement 2008

Part II/A – Structure

a) The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.

b) That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.

c) That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.

d) That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.

	Not Compliant				Fully Compliant
a)					✓
b)					✓
c)					✓
d)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

Item b) a staff representative, nominated by UNISON, is a Member of the Pension Fund Investment Panel but there is no formal representative of ex-members (Pensioners and deferred members).

Part II/B – Representation

a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:

i) employing authorities (including non-scheme employers, e.g. admitted bodies);
ii) scheme members (including deferred and pensioner scheme members),
iii) independent professional observers, and
iv) expert advisors (on an ad-hoc basis).

b) That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.

	Not Compliant				Fully Compliant
a)					✓
b)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

The Staff Representatives, although without voting rights, contributes to all Investment Panel discussions. An Independent Advisor attends the Investment Panel meetings.

Part II/C – Selection and role of lay members.

a) That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.

	Not Compliant				Fully Compliant
a)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

All members of the Investment Panel are aware of their responsibilities. An introductory guidance booklet is sent to new members of the Panel.

Part II/D – Voting

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

	Not Compliant				Fully Compliant
a)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

Part II/E – Training/Facility time/Expenses

a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.

b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.

	Not Compliant				Fully Compliant
a)					✓
b)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

There is no formal documentation on training, but members of the Investment Panel receive training sessions at both the Annual Strategy Meeting and the Quarterly Panel Meetings.

Part II/F – Meetings (frequency/quorum)

a) That an administering authority's main committee or committees meet at least quarterly.

b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.

c) That administering authorities who do not include lay members in their formal governance arrangements, provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.

	Not Compliant				Fully Compliant
a)					✓
b)					✓
c)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

The Investment Panel meets quarterly and also holds an Annual Strategy Meeting. An Annual Employer's Forum is held at County Hall for all employers of the East Sussex Pension Fund.

Part II/G – Access

a) That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.

	Not Compliant				Fully Compliant
a)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

Part II/H – Scope

a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.

	Not Compliant				Fully Compliant
a)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

Part II/I – Publicity

a) That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.

	Not Compliant				Fully Compliant
a)					✓

Reason for non-compliance (Regulation 73A(1)(c)) 1997 Regulations:

Not applicable

Comments on ratings given above:

The Governance Policy Statement is published on the County Council website.

Communications Policy Statement

1. This is the Communications Policy Statement of the East Sussex Pension Fund, which is managed by East Sussex County Council, as the Administering Authority on behalf of all relevant employer bodies in the area.

2. All local government pension schemes are required to publish a statement on the approach of the Pension Fund to communication with members, prospective members and employing authorities.

3. The East Sussex Pension Fund liaises with over 50 employers and approximately 25,000 active and retired members.

Day to Day Responsibilities

4. The executive responsibility for the East Sussex Pension Fund rests with the Acting Chief Finance Officer Business Services Department for East Sussex County Council. For the purposes of the payment and administration of benefits and communication with staff and employers, the day to day responsibilities rests with the County Council Pensions Manager, who reports directly to the Acting Chief Finance Officer Business Services Department

5. The County Council has out-sourced all routine and day to day pension administration functions to its private sector service provider, Serco, but day to day responsibility still rests with the Pensions Manager.

Overview of the Approach to Communication.

6. The East Sussex Pension Fund communicates with a wide variety of stakeholders, each with slightly different needs.

7. The Pension Fund maintains a dedicated web-page on the County Council's website. For the most part routine regular updates, via a periodic newsletter, are communicated electronically to all employers who are encouraged to disseminate to all relevant staff.

8. The Pension Fund also accepts electronic communication, e.g. by email, as well as the more traditional telephone and paper-based communications.

9. All staff and pensioners receive an annual summary report on the performance of the Investment Fund in the previous year as well as notification of any significant scheme benefit changes. In addition, all active/ deferred members receive an annual pension benefit statement showing the accrual of their pension entitlement today and an estimate of the value at their normal eligible retirement age.

10. In addition to regular electronic or paper based updates, there is an annual general meeting for all Employers in the scheme hosted by the Administering Authority.

11. A dedicated customer telephone number, to handle the majority of queries, is maintained by our service provider, Serco.

12. We recognise that individuals may have specific needs in relation to formats or language. We can, and do, respond to this on a request basis. Demand is not high enough, however, to incur the cost of automatically preparing and maintaining such alternative formats etc.

Communication with Deferred and Active Members.

13. The core communication objective is that all active members, within all relevant employer organisations, are kept up to date with any changes in scheme benefits, can access scheme advice and have an awareness of the overall performance of the Investment Fund.

14. This is achieved by the following:

- Dedicated web-page on the County Council's web-site;
- Regular electronic or paper-based newsletters. For other employer bodies, this is dispatched to a lead contact (usually within the HR function) with a request that it is shared with all relevant staff;
- Annual benefit statement posted to the home address;
- Annual summary update on the performance of the Investment Fund dispensed via employers for active members and posted to the home address of deferred members;
- Notification of a dedicated customer query telephone line maintained by the Council's service provider, Serco;
- The running of periodic road shows for employees
- Educational induction and pre-retirement sessions run by most employers;
- Maintenance and publication of Scheme Booklet;
- Advice on request about such matters as estimated retirement benefits etc.

Communication with Pensioners

15. The core communication objective is to ensure that pensioners are aware of the general performance of the fund (recognising this will not impact on pensions in payment) and any specific factors that do affect pensions in payment (e.g. annual pensions increase).

16. This is achieved by the following:

- Summary accounts and performance posted to the home address;
- Notification of pension increase posted to the home address;
- Clear detail on customer query contact routes on payslips posted to the home address;
- Access to the website;
- Access to periodic road shows (advertised in payslips posted to the home address).

Communication with Prospective Members and their Employing Authorities.

17. The core communication objective is to ensure that all employee joiners, to all employers in the East Sussex Pension Fund, are made aware of the benefits of becoming a member of the Local Government Pension Scheme – and are assisted in the subsequent joining arrangements.

18. This is achieved by the following:

- Joiner packs (including scheme booklet and joining instructions), via all relevant employers, distributed to all employee joiners;
- Access to customer query contact details;
- Access to the dedicated web-page;
- Occasional promotional newsletters;
- Receipt of all information and opportunities afforded to existing active members as set out above.

Communication with all Relevant Employer Organisations

19. The core policy communication objective is to ensure that all employers are aware of the performance of the Investment Fund (given its impact on employer contribution rates); any scheme changes impacting on the employer's HR or workforce planning; any key discretions to be exercised by the individual employer; advice on the future valuation outlook; and advice and agreement on key frequent and annual data and financial transaction flows between the administering authority and individual employers. All this is in addition to the general pensions awareness employers will wish to maintain as a 'good employer'.

20. This is achieved by the following:

- Regular employee newsletters shared with all employers;
- Specific newsletters on scheme changes for employers;
- Quarterly summary reports to employers on the Investment Fund performance;
- Annual general meeting with all employers dealing with investment performance, actuarial insights and any scheme changes;
- Routine sharing of employers discretions exercised by ESCC as a preformed to enable other employers to consider their own approach.
- Direct access to the Actuary to the fund if required;
- Periodic road shows/seminars with individual groups of employers;
- Specific employer guide, both paper based and maintained on the website;
- Briefings for groups of senior managers as requested including sharing of key committee papers produced;
- Briefings and sharing of information with union representatives.

Communication with Elected Members individually and in their formal committee roles.

21. The core communication objective is to ensure all elected members are aware of the benefits of joining the LGPS and to ensure the nominated members, in their committee roles, are kept up to date on key investment or scheme issues.

22. This is achieved by the following:

- Tailored induction and joining advice is sent to all members following every election cycle;
- Periodic electronic briefing notes for ESCC members on key issues, but shared with all employers to share with the elected members or equivalent;
- Detailed periodic reports to the appropriate committee to agree, for example, official responses to consultation requests. Again, these are shared with all employees to provide some proforma guidance.
- Detailed and dedicated training for all Members of the Investment Fund.

Communication with other Key Stakeholders

23. These vary from the Administering Authority's service provider (Serco) to the Inland Revenue and the Fund's Actuary. The needs are different. The Administering Authority takes upon itself the responsibility to ensure the most effective and efficient communication processes with these other stakeholders to ensure proper and necessary business is conducted efficiently and effectively. In addition, the Administering Authority will seek to ensure proper and professional response to media queries.

Communication with Council Tax Payers

24. The core communication objective is to ensure that the Council Tax Payer are aware of the pension cost issues as part of the whole range of cost and service dynamics that the Council has to deal with. This is a matter for each individual council.

25. For ESCC, this is achieved by ensuring the pensions cost issues are a transparent part of the Council's wider approach to Reconciling Policy and Resources.

Conclusions and Performance Management

26. ESCC, as Administering Authority, takes its responsibility on behalf of all employees and employers in the scheme very seriously. Communication is vital with all key stakeholders. This is not just to ensure relative needs are recognised and met but to ensure a continued high confidence in the administration of the scheme in East Sussex.

27. Each communication channel will have an obvious performance measure in terms of inputs (e.g. annual pensions meetings are held annually or telephone calls are answered within 30 seconds or post enquiries are responded to within seven days). Most importantly, it is necessary to assess, qualitatively, the perceived quality of the communication. Accordingly (starting in 2006), there will be an annual customer survey of both employers and employees in the scheme in that regard.

Key contacts

28. As follows:

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Funding Strategy Statement

1 Introduction

This is the Funding Strategy Statement (FSS) of the East Sussex Pension Fund ("the Fund"), which is administered by East Sussex County Council ("the Administering Authority") in accordance with the Local Government Pension Scheme Regulations ("the Regulations").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson and after consultation with the Fund's employers and investment adviser and is effective from 31 March 2011.

1.1 Regulatory Framework

Members' accrued benefits are guaranteed by statute. Members' contributions are fixed in the Regulations at a level which covers only part of the cost of accruing benefits. Employers pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers pay for their own liabilities.

The FSS forms part of a framework which includes:

- the Local Government Pension Scheme (Administration)
- Regulations 2008 (regulations 35 and 36);
- the Rates and Adjustments Certificate, which can be found appended to the Fund actuary's triennial valuation report
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Statement of Investment Principles

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

The key requirements relating to the FSS are that:

• After consultation with all the relevant interested parties involved with the Fund, the administering authority will prepare and publish their funding strategy.
• In preparing the FSS, the administering authority must have regard to:
- FSS guidance produced by CIPFA

- Its statement of investment principles published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

1.2 Review of FSS

This is a requirement under Regulation 35 of the Regulations. The FSS is reviewed in detail at least every three years ahead of triennial valuations being carried out, with the next full review due to be started by 31 March 2013 and implemented in April 2014. Set out at Annex A is the derivation of the target minimum employer contributions rates, agreed phasing and spreading periods, and the resultant increases in relation to 2010/11 contribution rates, for three years 20118/12 through to 2013/14. Annex A is updated to reflect any changes to employers. Annex B sets out key roles and responsibilities.

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact:

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2 Purpose

2.1 Purpose of the Funding Strategy Statement

Communities and Local Government (CLG), formerly the Office of the Deputy Prime Minister, has stated that the purpose of the FSS is:

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

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered. The Fund:

- receives contributions, transfer payments and investment income;
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarized in Annex B.

2.3 Aims of the Investment Strategy and Funding Policy

The objectives of the Fund's funding policy include the following:

- to ensure the long-term solvency of the Fund and to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- to maximize investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk and volatility;
- to minimise the degree of short-term change in employer contribution rates
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations;
- to take into account asset-liability studies when considering asset allocation decisions;
- to take into account reasonable deficit spreading approaches consistent with the above.

3 Solvency Issues and Target Funding Levels

3.1 Derivation of Employer Contributions

Employer contributions are normally made up of two elements:

- the estimated cost of future benefits being accrued, referred to as the *"the future service rate"*; plus
- a *"past service adjustment"* for the funding position (at the valuation date) of accrued benefits relative to the Funds Assets. If there is a surplus there may be a contribution reduction; if a deficit a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's actuary is required by the regulations to report the *Common Contribution Rate,* for all employers collectively at each triennial valuation. It combines both items above and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit is currently spread over a period of 20 years.

The Fund's actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to the employer. It is the adjusted contribution rate which employers are actually required to pay. The sorts of peculiar factors which are considered are discussed in Section 3.6.

In effect, the Common Contribution Rate is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific spreading and phasing periods.

For some employers it may be agreed to pool contributions, see Section 3.9.6. Annex A contains a breakdown of each employer's contributions following the 2010 valuation for the financial years 2011/12, 2012/13 and 2013/14. It identifies which employer's contributions have been pooled with others.

In respect of non-ill health early retirements, those employers classified as 'stabilised employers' have the option to pay an additional 1% of employer contributions per year to meet non-ill health premature retirement costs. For all other employers in the Fund any non-ill health premature retirement costs must be paid as lump sum payments at the time of the employer's decision in addition to the contribution described above (or by installments shortly after the decision). Stabilised employers who choose not to pay the additional 1% must meet the costs via a lump sum payment (or by installments) in the same way as all other 'non stabilised' employers.

Further details about the classification of stabilised employers are given in Section 3.2 below.

3.2 Classification of Employers

As part of the 2010 formal valuation employers have been classified into two distinct groups. These groups are referred to when considering, for example, contribution rate setting, Ill-health early retirement options and contribution payment options.

The two groups are:

- Stabilised Employers' i.e. Scheduled Bodies, open Community Admission Bodies and open pre-2000 Admission Bodies; and
- Non-stabilised' employers i.e. closed Community Admission Bodies, closed pre-2000 Admission Bodies and Transferee Admission Bodies.

3.3 'Stability Overlay' Mechanism

A 'stability overlay' mechanism was applied at the 2010 valuation to derive the minimum employer contribution rates for 'stabilised employers'. This has the effect of dampening down short-term market volatility subject to certain limits. The three year phasing of rate changes still applies (see 3.9.4 and 3.9.5) to 'stabilised employers'.

The table below details how contribution rates are derived under the stability overlay mechanism. Note that the theoretical rate based upon the 2010 valuation, is compared with the current rate as at 2010/11 and the stability overlay is applied depending upon the results of that comparison.

Difference in employer contribution rate between current 2010/11 rate and 2010 valuation rate before stability overlay	
A reduction	An increase
• If in deficit: no change from 2010/11 rate; • If in surplus: rate becomes the greater of (5/6^{ths} of current 2010/11 rate + 1/6th of 2010 valuation rate).	Rate becomes the greater of: • 5/6^{ths} of current 2010/11 rate + 1/6th of 2010 valuation rate; and • 1% of pay more than the current 2010/11 rate.

The effect of using the mechanism at the 2010 valuation was to restrict the **minimum** contribution rate to an increase of no more than 1% of pensionable pay for stabilised employers.

Employers may opt to pay higher regular contributions than these minimum rates. Where minimum contributions have reduced, employers may prefer not to take such reductions and this would be the strong advice of the Administering Authority.

3.4 Solvency and Target Funding Levels

The Fund's actuary is required to report on the "solvency" of the whole fund at least every three years.

"Solvency" for ongoing employers is defined to be the ratio of the current market value of assets to the value placed on accrued benefits, on the Fund actuary's *ongoing* funding basis. This quantity is known as a funding level.

The ongoing funding basis has traditionally been used for each triennial valuation for all employers in the Fund. The ongoing funding basis assumes employers in the Fund will participate over the longer term as an ongoing concern and is described in the next section.

Where an admission agreement for an admission body that is not a Transferee Admission Body and has no guarantor, is likely to terminate within the next 5 to 10 years or lose its last active member within that timeframe, the Fund reserves the right to set contribution rates by reference to liabilities valued on a gilts basis (i.e. using a discount rate that has no allowance for potential investment outperformance relative to gilts). The target in setting contributions for any employer in these circumstances is to achieve full funding on a gilts basis by the time the agreement terminates or the last active member leaves in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required when a cessation valuation is carried out.

The Fund also reserves the right to adopt the above approach in respect of those admission bodies with no guarantor, where the admission body's financial strength is considered to be weak but there is no immediate expectation that the admission agreement will cease.

The Fund operates the same target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. The time horizon of the funding target for Community and Transferee Admission bodies will vary depending on the expected duration of their participation in the Fund. Please refer to Section 3.10 for the treatment of departing employers.

3.5 Ongoing Funding Basis

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds advised by the Fund actuary. It is acknowledged that future life expectancy and in particular, the allowance for future improvements in mortality, is uncertain. Employers should be aware that their contributions are likely to increase in future if longevity exceeds the funding assumptions. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed statutory guarantee underpinning members' benefits. The demographic assumptions vary by type of member and so reflect the different profiles of employers.

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes an allowance for anticipated returns from equities in excess of Government bonds. There is, however, no guarantee that equities will out-perform or even match Government bonds. The risk is greater over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

In light of the statutory requirement for the Fund's actuary to consider the stability of employer contributions it is therefore normally appropriate to restrict the degree of change to employers' contributions at triennial valuation dates.

Given the very long-term nature of the liabilities, a long-term view of prospective returns from equities is taken. For the 2010 valuation, it was assumed that the Fund's equity investments will deliver an average real return of 1.6% a year in excess of the return available from investing in index-linked Government bonds at the time of the valuation.

The same financial assumptions are adopted for all ongoing employers. All employers have the same asset allocation.

3.6 Future Service Contribution Rates

The future service element of the employer contribution rate is traditionally calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. The future service rate has been calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. Where it is considered appropriate to do so then the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a gilts basis (most usually for admission bodies that are not a Transferee Admission Body and that have no guarantor in place). The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies that may have the power not to admit automatically all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

3.6.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of employee's contributions) of the benefits which employees earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* with a one year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the employee profile becomes more 'mature' (i.e. average age increases because, for example, of reduced recruitment of younger employees) the future service rate would rise.

3.6.2 Employers that do not admit new entrants

Certain Admission Bodies who make up a small proportion of all scheme employers have closed the scheme to new entrants. This is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as membership ages.

To give more long term stability to such employers' contributions, the *Attained Age Method* is normally adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both funding methods are described in the Actuary's report on the valuation.

Future service rates calculated under both funding methods will include related administration expenses, to the extent that they are borne by the Fund, and will include an allowance for benefits payable on death in service and ill health and retirement.

3.7 Adjustments for Individual Employers

Adjustments to individual employers' contribution rates are applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

The combined effect of these adjustments for individual employers applied by the Fund actuary relate to:

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

over the period between the 2007 and 2010 valuations and each subsequent triennial valuation period.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

3.7 Asset Share Calculations for Individual Employers

The Administering Authority does not account for each employer's assets separately. The Fund's actuary is required to apportion the assets of the whole fund between the employers at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an established and accepted actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

The Fund actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation, including, but not limited to:

• the actual timing of employer contributions within any financial year;
• the effect of more or fewer withdrawals than assumed;
• the effect of the premature payment of any deferred pensions on grounds of incapacity.

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

3.9 Stability of Employer Contributions

3.9.1 Stability overlay mechanism

As mentioned earlier, this mechanism was applied at the 2010 valuation and is detailed in Section 3.2. The 2010 valuation rate referred to in the mechanism is the theoretical rate calculated in accordance with Sections 3.9.2. and 3.9.3 below. The effect of the overlay is to dampen changes to contribution rates for employers between successive valuations.

The stability mechanism is only available to long term open employers in the Fund which the Administering Authority has classified as 'stabilised employers' (refer to Section 3.2). Contribution rates for 'non-stabilised' employers (refer to Section 3.2) are the 2010 valuation theoretical contribution rates for each employer calculated in accordance with Sections 3.9.2. and 3.9.3 below.

3.9.2 Deficit Recovery Periods

The Administering Authority requests the actuary to adopt specific deficit recovery periods for all employers when calculating their theoretical contributions. The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years but over 15 years for certain classes of employers (depending on the strength of the credit risk/ funding covenant e.g. council tax covenant is considered the most secure with the smallest credit risk).
The table below sets out the maximum deficit recovery period for each type of employer.

Type of Employer	Spreading Period
Statutory Bodies (e.g. tax raising employers, colleges)	20 years
Community Admission Bodies and pre-2000 Admission Bodies (that are open to new entrants)	15 years
Community Admission Bodies and pre-2000 Admission Bodies (that are closed to new entrants)	Remaining contract period (where provided), subject to not exceeding Remaining Working Lifetime.
Transferee Admission Bodies	Remaining contract period (where provided), subject to not exceeding Remaining Working Lifetime.

The maximum period is used in calculating each employer's minimum contributions. Employers may opt to pay higher than these minimum contribution rates.

The deficit recovery period starts at the commencement of the revised contribution rate i.e. 1 April 2011 for the 2010 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.9.3 Surplus Spreading Periods

In order to protect the Fund from recent volatile market conditions, contribution rate reductions for any employers deemed to be in surplus (by spreading the surplus element over the minimum period shown above for deficits in calculating their minimum contribution) were not allowed by the Administering Authority at the 2010 valuation. The Administering Authority will review this policy at the 2013 valuation in light of market conditions at that time.

3.9.4 Phasing In of Contribution Rises

The Administering Authority currently permits all employers to phase in contribution rises. This will be in three equal steps over the three years following the triennial valuation i.e. commencing 1 April 2011.

3.9.5 Phasing in of Contribution Reductions

Any contribution reductions will be phased in over three years for all employers.

3.9.6 Pooled Contributions

The Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events – such as ill-health retirements or deaths in service – on their contributions. The actuary is still able to separately identify all the employer's assets.

As at the 2010 valuation separate pools are operated for Town and Parish Councils and for certain historic pre-2000 admission bodies. Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not permitted to participate in a pool. Transferee Admission Bodies are also ineligible for pooling.

3.9.7 Payment and Collection of Contributions

Contributions arising from previous valuations were based wholly on a percentage of employees' payroll. However, from April 2011, contributions will be collected via a combination of percentage of payroll (to cover future service benefits) and monetary amounts (to recover deficit relating to past service benefits). This change in approach is designed to protect the Fund from reductions in payroll that may arise over the next few years as economic conditions and spending cuts hit many employers.

Stabilised employers, however, will be given the option of paying their contributions either as a combination of percentage of payroll and monetary amounts, or based wholly on a percentage of employees' payroll. The Fund is allowing this since such employers are expected to participate over the long term; this means that any deficit that might not be fully recovered in the short term due to reduced payroll can be collected instead over the longer term at future actuarial valuations.

Where monetary amounts are being paid, the monetary amounts may be paid either annually OR monthly. If paid annually, the amounts are due in advance on 1 April 2011, 1 April 2012 and 1 April 2013. If paid monthly, the amounts should be made at the same time as the percentage of payroll monthly contributions are made. In both cases, contributions must be received by no later than the 19th of the month following the due date in order to comply with legislation e.g. April 2011 contributions must be paid to the Fund no later than 19 May 2011.

3.10 Admission Bodies ceasing

Admission Agreements for Transferee Admission Body contractors are assumed to expire at the end of the contract.
Admission Agreements for other employers are generally assumed to be open-ended and to continue until all the benefits have been paid in full. Contributions, expressed as capital payments, can continue to be levied after all the employees have retired. These Admission Agreements can however be terminated at any point subject to the terms of the agreement.

The Fund, however, considers any of the following as triggers for the termination of an admission agreement:
- Last active member ceasing participation in the LGPS;
- The insolvency, winding up or liquidation of the admission body;
- Any breach by the admission body of any of its obligations under the agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the admission body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the admission body to renew or adjust the level of the bond or indemnity or to confirm an appropriate alternative guarantor as required by the Fund.

In addition either party can voluntarily terminate the admission agreement by giving the appropriate period of notice as set out in the admission agreement to the other party (or parties in the case of a Transferee Admission Body).

If an Admission Body's admission agreement is terminated, the Administering Authority instructs the Fund actuary to carry out a special valuation to determine whether there is any deficit.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

a) For Transferee Admission Bodies, the assumptions would be those used for an ongoing valuation to be consistent with the assumptions used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

b) For admission bodies that are not Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or which triggers a cessation event, the Administering Authority must look to protect the interests of other ongoing employers and will require the actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. Where there is a guarantor, the cessation valuation will normally be calculated using an ongoing valuation basis appropriate to the investment strategy. Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis" with no allowance for potential future investment outperformance and with an allowance for further future improvements in life expectancy. This approach results in a higher value being placed on the liabilities than would be the case under a valuation on the ongoing funding basis and could give rise to significant payments being required.

c) For admission bodies with guarantors, it is possible that any deficit could be transferred to the guarantors in which case it may be possible to simply transfer the assets and liabilities relating to the former admission bodies to the respective guarantors, without needing to crystallise any deficit.

Under (a) and (b), any shortfall would be levied on the departing admission body as a capital payment.

In the event that the Fund is not able to recover the required payment in full directly from the admission body or from any bond or indemnity or guarantor, then:

a) In the case of Transferee Admission Bodies the awarding authority will be liable. At its absolute discretion, the Administering Authority may agree to recover any outstanding amounts via an increase in the awarding authority's contribution rate over an agreed period.

b) In the case of admission bodies that are not Transferee Admission Bodies and have no guarantor, the unpaid amounts fall to be shared amongst all of the employers in the Fund. This will normally be reflected in contribution rates set at the formal valuation following the cessation date.

As an alternative to (b) above where the ceasing admission body is continuing in business, the Fund, at its absolute discretion, reserves the right to enter into an agreement with the ceasing admission body to accept an appropriate alternative security to be held against any funding deficit and to carry out the cessation valuation on an ongoing valuation basis. This approach would be monitored as part of each triennial valuation and the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified.

3.11 Early Retirement Costs

3.11.1 Non Ill Health Retirements

The actuary's funding basis makes an allowance for certain employers for premature retirement except on grounds of ill-health. For other employers they are required to pay additional contributions wherever an employee retires before attaining the age at which the valuation assumes that benefits are payable. The current costs of these are specified in the latest early retirement manual from Hymans Robertson.

Since the introduction of the new LGPS many members now have two tranches of pension - namely that which was accrued before and after 1 April 2008. In theory, these can be paid without reduction from two different retirement ages. In practice, the member can only retire once and so both pensions are paid from a single age. It is assumed that the member will retire at the age when all of the member's pension can be taken without reduction.

The additional costs of premature retirement are calculated by reference to these ages.

For non-stabilised employers in the scheme (refer to Section 3.2) any non-ill health premature retirement costs must be paid as lump sum payments at the time of the employer's decision in addition to the contribution described above (or by installments shortly after the decision).

Stabilised employers (refer to Section 3.2) have the option to pay an additional 1% of employer contributions per year to meet non-ill health premature retirement costs. Stabilised employers who opt to pay the additional contribution of 1% per annum must elect this option prior to 1 April 2011 and are 'locked' into this option for the full 3 year period from 1 April 2011 to 31 March 2014.

3.11.2 Ill Health Monitoring

The Fund monitors each employer's, or pool of employers, ill health experience on an ongoing basis. If the cumulative number of ill health retirements in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis that applies for non-ill health cases.

4. Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice.

4.1 Investment Strategy

The investment strategy currently being pursued is described in the Fund's Statement of Investment Principles.

The investment strategy is set for the long-term, but is reviewed each year at the Annual Strategy meeting of the Investment Panel to ensure that it remains appropriate to the Fund's liability profile. The Administering Authority has adopted a benchmark, which sets the proportion of assets to be invested in key asset classes such as equities, bonds and property. As at 31 March 2010, the proportion held in equities and property was approximately 70% of the total Fund assets.

The investment strategy of lowest risk in terms of volatility of funding – but expected to be the most expensive in terms of employer contributions (given the expected relative out performance of equities) – would be 100% investment in a combination of conventional and index-linked Government bonds. The investment strategy of lowest expected cost in terms of long term employer contribution rates – but the most volatile in terms of actual performance in the short term – is 100% investment in equities and other growth orientated assets. This is the crucial trade off. The greater the investment in equities and other non bonds, the lower the initial employer contributions are likely to be, but the higher the risk of volatility in employer contribution rates (in the absence of stabilisation) and funding levels over the relatively short term period of triennial valuations.

The Fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from Government bonds. The Administering Authority's strategy recognises the 'non-mature' nature of the liabilities of the Fund and the secure nature of most employers' covenants. The same investment strategy is followed for all employers

4.2 Consistency with Funding Basis

The Fund's investment adviser's current best estimate of the long-term return from equities is around 3% a year in excess of the return available from investing in fixed interest Government bonds.

The funding policy adopts a more prudent approach by anticipating long-term returns of 1.6% per year in excess of the prevailing redemption yield on fixed interest Government bonds. This assumption relates to the future return anticipated on all assets held by the Fund, including corporate bonds and property and other alternative assets in addition to equities.

In this way, the employer contributions anticipate returns from Fund assets where, in the Fund actuary's opinion, there is a better than 50:50 chance of delivering full funding on the ongoing basis over the long-term (measured over periods in excess of 20 years).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 5 will damp down, but not remove, the effect on employers' contributions.

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

4.3 Balance between risk and reward

Prior to implementing its current investment strategy, the Administering Authority considered the balance between risk and reward by altering the level of investment in asset classes with higher expected return, but more volatile, like equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

4.4 Inter-valuation Monitoring of Funding Position

The Administering Authority monitors the funding position, between valuation dates, for changes in core financial factors such as investment returns and liability discount rates. This is reported to all employers on a regular basis. In addition specific inter-valuation for individual employers may be undertaken if considered appropriate.

5. Key Risks and Controls

5.1 Types of Risk

The Administering Authority's has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- Financial;
- Demographic
- Regulatory; and
- Governance

5.2 Financial Risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.	*Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.* *Analyse progress quarterly, annually and at three yearly valuations for all employers.* *Inter-valuation roll-forward of liabilities between formal valuations at individual employer level, provided on an annual basis.*
Inappropriate long-term investment strategy.	*Set Fund-specific benchmark, informed by Asset-Liability modelling of liabilities.* *This is supplemented with an analysis of absolute returns against those under-pinning the valuation.* *This gives an early warning of contribution rises ahead. In the short term, volatility is damped down by stability measures on contributions. However, if underperformance is sustained over periods over 5 years contributions would rise more.*
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	*Inter-valuation monitoring, as above.* *Some investment in bonds helps to mitigate this risk.*
Active investment manager under-performance relative to benchmark.	*Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.* *Regular meetings with managers.*

Pay and price inflation significantly more than anticipated	*The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.* *Investment in real assets should help mitigate this risk.* *Inter-valuation monitoring, as above, gives early warning.* *Employers pay for their own salary awards.*
Effect of possible increase in employer's contribution rate on service delivery and admission/ scheduled bodies.	*Seek feedback from employers on scope to absorb short-term contribution rises.* *Mitigate impact through deficit spreading, phasing in of contribution rises and stability overlay mechanism.*

5.3 Demographic Risks

Risk	Summary of Control Mechanisms
Pensioners living longer.	*Set mortality assumptions with some allowance for future increases in life expectancy.* *Fund actuary monitors combined experience of around 50 funds to look for early warnings of lower pension amounts ceasing than assumed in funding.* *Administering Authority encourage any employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.*
Deteriorating patterns of early retirements	*Employers are charged the extra capital cost of non ill health retirements following each individual decision.* *Employer ill health retirement experience is monitored.*
A Company admitted to the Fund as an admission body may become financially unviable	*A surety or bond is required to cover the potential risk of the admitted body becoming insolvent and the value of this surety or bond is reviewed regularly to ensure it provides adequate cover for the financial risks involved.*
Ill-health retirements significantly more than anticipated	*Monitoring of each employers ill-health experience on an ongoing basis. The employer may be charged additional contributions if this exceeds the ill-health assumption built into the valuation assumptions.*

5.4 Regulatory

<table>
<tr><th>Risk</th><th>Summary of Control Mechanisms</th></tr>
<tr><td>Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees.</td><td rowspan="2">The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.

It considers all consultation papers issued by CLG and comments where appropriate.

The Administering Authority will consult employers where it considers that it is appropriate.

In all circumstances where it appears that changes may impact on the Funds solvency the Administering Authority will consider seeking actuarial advice to mitigate or manage the impact of such changes.</td></tr>
<tr><td>Changes to national pension requirements and/or HM Revenue and customs rules e.g. effect of abolition of earnings cap for post 1989 entrants from April 2006, abolition of 85 year rule, new 2008 scheme, tax simplification and budget changes for higher earners.</td></tr>
</table>

5.5 Governance

<table>
<tr><th>Risk</th><th>Summary of Control Mechanisms</th></tr>
<tr><td>Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements).</td><td rowspan="2">The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 78) between triennial valuations.

Deficit contributions are expressed as percentage (see Annex A).</td></tr>
<tr><td>Administering Authority not advised of an employer closing to new entrants.</td></tr>
<tr><td>Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.</td><td>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.

It also operates a diary system to alert it to the forthcoming termination of Best Value Admission Agreements.</td></tr>
<tr><td>An employer ceasing to exist with insufficient funding or adequacy of a bond.</td><td>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.

The risk is mitigated by:
• Seeking a funding guarantee from another scheme employer, or external body, where-ever possible.
• Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.
• Vetting prospective employers before admission.
• Setting a minimum limit of 20 employees for prospective employers.
• Where permitted under the regulations requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.</td></tr>
</table>

Responsibilities of Key Parties

The Administering Authority should:-

- collect employer and employee contributions;
- invest surplus monies in accordance with the regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the fund's actuary;
- prepare and maintain the FSS and a SIP, both after proper consultation with interested parties; and
- monitor all aspects of the fund's performance and funding and amend FSS/ SIP.

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 authorities 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 FSS; and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

APPENDIX FOUR

Independent auditor's report to the Members of East Sussex County Council

Opinion on the pension fund financial statements

We have audited the pension fund financial statements of East Sussex County Council for the year ended 31 March 2013 under the Audit Commission Act 1998. The pension fund financial statements comprise the Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

This report is made solely to the members of East Sussex County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council and the Council's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Acting Chief Financial Officer and auditors

As explained more fully in the Statement of Responsibilities for the Statement of Accounts, the Acting Chief Financial Officer is responsible for the preparation of the Statement of Accounts, which includes the pension fund financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Acting Chief Financial Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the pension fund's financial statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2013 and the amount and disposition of the fund's assets and liabilities as at 31 March 2013, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- have been properly prepared in accordance with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

Opinion on other matters

In our opinion, the information given in the annual report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we report by exception

We report to you if, in our opinion the governance compliance statement does not reflect compliance with the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance. We have nothing to report in this respect.

Leigh Lloyd-Thomas
For and on behalf of BDO LLP, Appointed Auditor
London, UK

30 September 2013

Produced by:

Business Services Department
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P.O. Box 3
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East Sussex BN7 1UE

Printed on 100% recycled paper

September 2013

Further information can also be obtained from our website eastsussex.gov.uk or by writing to the Chief Finance Officer at the address left or by email to finance@eastsussex.gov.uk

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