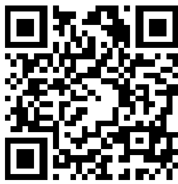

Leicestershire County Council

Meeting: **Local Pension Committee**

Date/Time: **Friday, 26 February 2016 at 9.30 am**

Location: **Guthlaxton Committee Room, County Hall, Glenfield.**

Contact: **Mr. M. Hand (Tel. 0116 305 6038)**

Email: **matthew.hand@leics.gov.uk**

AGENDA

Item		Report By	Marked
1.	Minutes of the meeting held on 22 January 2016		(Pages 5 - 8)
2.	Question Time.		
3.	Questions asked by members under Standing Order 7(3) and 7(5).		
4.	To advise of any other items which the Chairman has decided to take as urgent elsewhere on the agenda.		
5.	Declarations of interest in respect of items on the agenda.		
6.	Presentation by Fund Actuary.	Hymans Robertson	(Pages 9 - 32)
7.	Recommended Method of Deriving Key Actuarial Assumptions For 2016 Actuarial Valuation.	Director of Corporate Resources	(Pages 33 - 42)
8.	Summary Valuation of Pension Fund Investments and Performance of Individual Managers.	Director of Corporate Resources	(Pages 43 - 46)
9.	Performance Assessment of Local Pension Committee and Investment Subcommittee.	Director of Corporate Resources	(Pages 47 - 48)

10.	Funding update as at 31st December 2015.	Hymans Robertson	(Pages 49 - 60)
11.	Market Report.	Kames Capital	(Pages 61 - 74)
12.	Any other items which the Chairman has decided to take as urgent.		

The public are likely to be excluded during consideration of the following items in accordance with Section 100(A)(4) of the Local Government Act 1972 (Exempt Information).

13.	Kames Capital Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
14.	KKR - Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
15.	Kempen Capital Management Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
16.	Kleinwort Benson Investors - Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
17.	Ruffer - Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
18.	Pictet Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
19.	Aviva Investors - Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
20.	Millennium Global - Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
21.	IFM Investors - Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
22.	Legal and General Investment Management - Quarterly Report. (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager
23.	Stafford Timberland - Quarterly Report (Exempt under paragraphs 3 and 10 of Schedule 12A)	Fund Manager

24. Delaware Investments - Quarterly Report. Fund Manager

(Exempt under paragraphs 3 and 10 of Schedule 12A)

25. Ashmore - Quarterly Report. Fund Manager

(Exempt under paragraphs 3 and 10 of Schedule 12A)

26. Aspect Capital - Quarterly Report. Fund Manager

(Exempt under paragraphs 3 and 10 of Schedule 12A)

27. JP Morgan - Quarterly Report. Fund Manager

(Exempt under paragraphs 3 and 10 of Schedule 12A)

TO:

Leicestershire County Council

Mr. G. A. Hart CC (Chairman)
Mr. S. J. Hampson CC
Mr. Max Hunt CC
Mr. K. W. P. Lynch CC
Mr. P. C. Osborne CC

Leicester City Council

Cllr Deepak Bajaj and Cllr. Lynn. Moore

District Council Representatives

Cllr. Malise Graham MBE

University Representative

Mr. J. Shuter

Staff Representatives

Miss. J. Dean
Mr. R. Bone
Mr. N. Booth

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Agenda Item 1

Minutes of a meeting of the Local Pension Committee held at County Hall, Glenfield on Friday, 22 January 2016.

PRESENT:

Leicestershire County Council

Mr. G. A. Hart CC (Chairman)
Mr. S. J. Hampson CC
Mr. Max Hunt CC
Mr. K. W. P. Lynch CC
Mr. P. C. Osborne CC

Leicester City Council

Cllr Deepak Bajaj and Cllr Lynn Moore

District Council Representative

Cllr. Malise Graham MBE

Staff Representatives

Mr. R. Bone
Miss. J. Dean
Mr. N. Booth

Independent Advisers and Managers

Mr. A. Green
Mr. S. Jamieson

388. Minutes of the previous meeting.

The minutes of the meeting held on 14 November were taken as read, confirmed and signed.

389. Question Time.

The Chief Executive reported that no questions had been received under Standing Order 35.

390. Questions asked by members.

The Chief Executive reported that no questions had been received under Standing Order 7(3) and 7(5).

391. Urgent Items.

There were no urgent items for consideration.

392. Declarations of interest.

The Chairman invited members who wished to do so to declare any interest in respect of items on the agenda for the meeting. No declarations were made.

393. Local Government Pension Scheme Investment Reform.

The Committee considered a report by the Director of Corporate Resources concerning a Department for Communities and Local Government (DCLG) initiative to merge Local Government Pension Scheme (LGPS) assets into a small number of pools and a proposed change to LGPS investment regulations. A copy of the report marked '6' is filed with these minutes.

Arising from discussion, the following was noted:

- The DCLG was expected to make a decision on which pools were acceptable by the end of 2016. It was therefore deemed important that the Leicestershire Fund used the opportunity to pick a desired pool to join, rather than being allocated a pool at a later stage;

- County Council officers were continuing discussions with representatives from the LGPS Central Pool concerning the possibility of the Fund becoming part of the investment pool. Having previously worked with six of the eight potential members of the Central Pool on a previous passive investment exercise, officers were confident that it was the best fit for the Leicestershire Fund.

- Once pooling arrangements were introduced, decisions concerning asset allocation would remain with the Committee including the requirement to set the Fund's asset allocation each year. However, the responsibility of selecting the investment managers to manage the various assets would rest with the regional investment pool.

- It was possible that one Infrastructure platform, available to the whole of the LGPS, would be established alongside the regional pools. Whilst the Funds existing infrastructure investments could remain, it would be expected that all future such investments would be made through the platform.

- The Government proposal to introduce new investment regulations would enable the Secretary of State to intervene if a Fund refused to join a regional asset pool. It was not expected that the revised regulations would affect the Leicestershire Fund which had actively engaged in the proposed move to asset pooling.

RESOLVED

a) That a firm commitment is given by the Committee on behalf of the Fund to continue to work with the LGPS Central Pool to put forward a proposal to become one of the six 'British Wealth Funds;

b) That the Director of Finance, following consultation with the Chairman of this Committee, be authorised to:

i. Respond to the Government on its initial proposals for pooling scheme assets, detailing the Funds commitment to pooling and its progress towards formalising arrangements with other authorities to be part of a British Wealth Fund as agreed in recommendations (a) above.

ii. Respond to the government's consultation 'Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulation 2009'.

394. Report of Kames Capital - Market Review.

The Committee received a report by Kames Capital concerning global market conditions. A copy of the report marked '7' is filed with these minutes.

RESOLVED:

That the report be noted.

395. Strategic Investment Benchmark and Portfolio Structure of the Fund.

The Committee received a report by the Director of Corporate Resources, accompanied by an appendix produced by Hymans Robertson, the purpose of which was to recommend changes to the Leicestershire Fund's strategic investment benchmark and portfolio structure.   A copy of the report marked '8' is filed with these minutes.

The Director reported that the recommended changes to the Fund's strategic benchmark were relatively modest and would enable it to continue to have a wide-ranging exposure to markets without being overly diverse.

RESOLVED:

a) That a revised strategic benchmark for the Fund as detailed in the appendix to the report, be approved;

b) That a revised regional equity split for the Fund as shown in paragraph 11 of the report, be approved;

c) That the Investment Subcommittee be asked to review the optimal manner to which an increase the Fund's infrastructure weighting from 3% to 5% can be achieved.

09.30 – 11.15 am   CHAIRMAN
22 January 2016

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HYMANS ROBERTSON

Leicestershire County Council Pension Fund

2016 Formal Valuation

- Barry McKay FFA
- 26 February 2016

PUBLIC SECTOR

Hymans Robertson LLP is authorised and regulated by the Financial Conduct Authority

Overview of a valuation

- Actual cost of a Scheme will depend on the pensions actually paid
- Pensions actually paid depends on benefit structure, inflation and longevity
- A valuation estimates how much money will be needed to pay the pensions
- Estimate is based on assumptions
  - projected amounts of benefit payments
  - projected probability of benefits being paid

How we do a valuation

- We measure the financial position
  - using economic indicators
  - over the long term
  - consistent with the market value of assets

- We manage contributions
  - by modelling economic scenarios
  - over the long term
  - to set stable and affordable costs

HYMANS ROBERTSON

How we do a valuation

2016 valuation

- **Measurement** of the funding level
  - **Current assets**: Market value
  - **Current liabilities**: Prudent investment returns
- **Management** of contribution rates
  - **Future assets**: Probability of better returns
  - **Future liabilities**: Bond yields rise in the future?

Key financial assumptions

- Discount rate – based on future asset returns
- Inflation – long term, based on market yields
- Salary growth – linked to RPI, long term
- Pension increases – CPI

- Longevity – bespoke survival curves from Vita

Assumptions less important for contribution rates

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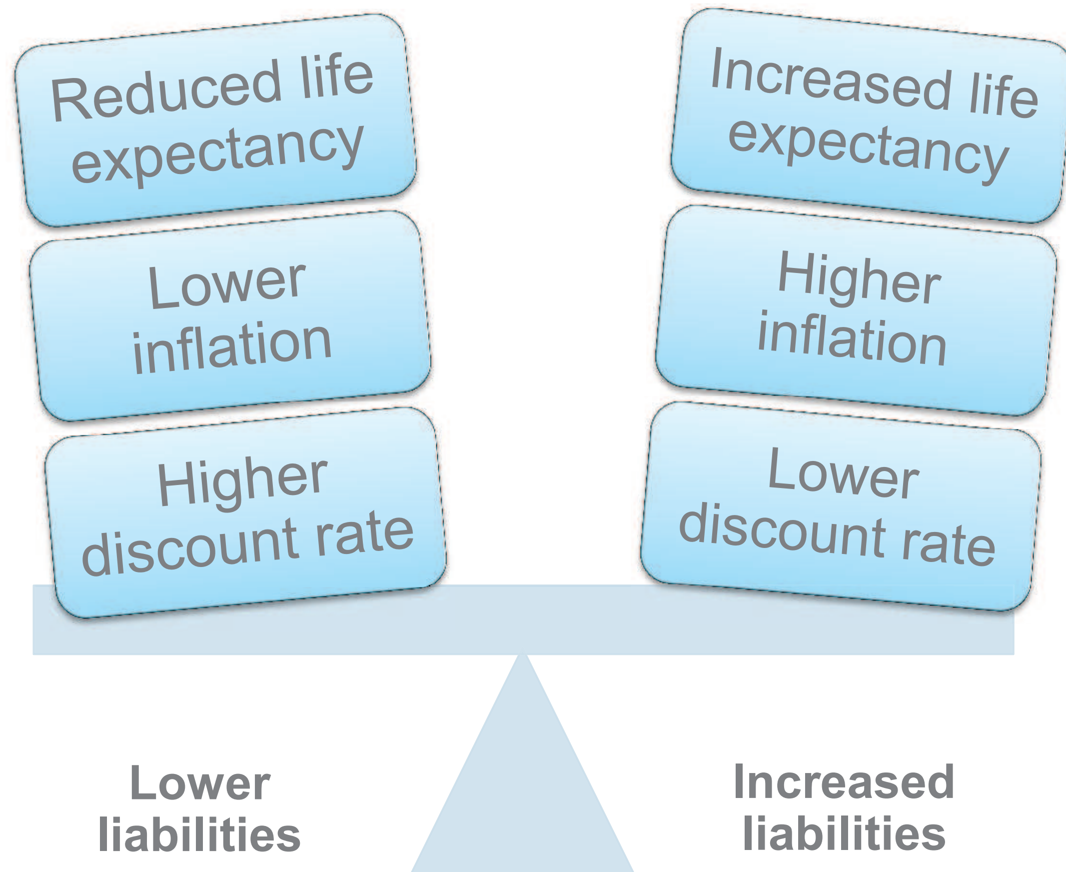
Impact of changes to assumptions



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Market conditions

UK gilt and bond yields since 31 Mar 2013

Discount rate assumption

- Prudent estimate of future investment returns
- Discount rate = gilt yield (long term) + asset outperformance assumption (AOA)
- Why gilt yields? – begin with lowest risk investment return and allow for assets held
- AOA – *prudent* estimate of expected investment return in excess of gilt yields, taking into account Fund's actual asset split

Recommend – Discount rate of gilt yield + 1.8% p.a.

Salary growth assumption

- Decreasing in importance as final salary benefits run off (because only relevant for pre-2014 service)
- No impact on future service cost – CARE scheme
- Typically based on RPI plus a margin (to reflect what has actually happened)
- Promotional salary scale is set separately

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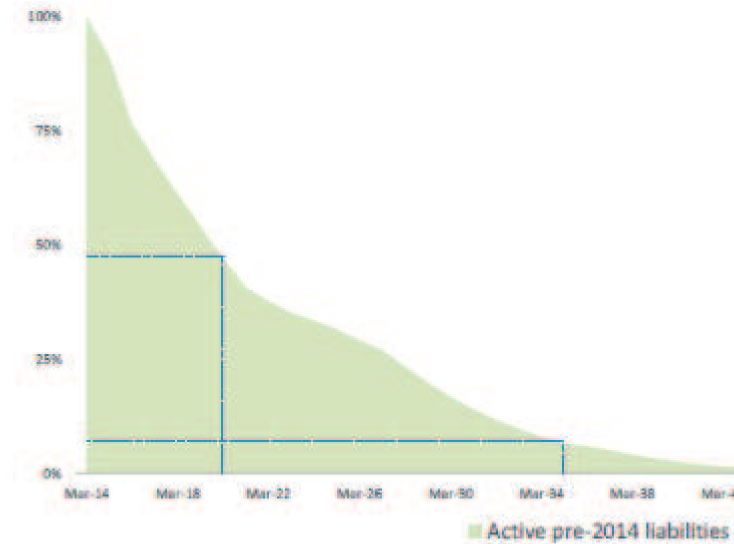
Salary growth analysis

- Final salary benefits run-off
- Public sector pay freeze!



	Scenario
Pay growth (per annum) - Short term (to 31 March 2020) - Long term (from 1 April 2020)	 1% RPI + 1.0% (4.4%)
Single equivalent 2016 valuation assumption - Nominal - Relative to RPI	 3.4% RPI
Reduction in past service deficit	**c.£170m**
Increase in funding level	**c.4%**

Recommend - Salary increases of RPI p.a.

Pension increase assumption

- Pension increases are CPI
- Long term expectations, not current
- No CPI market indicators available
- Based on RPI less a margin
- 1% is the accepted standard

Pension increases of RPI less 1% p.a.

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Differences in longevity

Life expectancy from 65: **12.9 years**		Life expectancy from 65: **21.9 years**
Unhealthy lifestyle postcode	Lifestyle 3.5 years →	Healthy lifestyle postcode
Low affluence	Affluence 3 years →	High affluence
Ill health retirement	Health 2 years →	Normal health retirement
Manual worker	Occupation <1 year →	Non-manual worker

No such thing as a typical member

No such thing as an average scheme or employer

Source: Club Vita's analysis based on membership as at 31 January 2014. Life expectancies shown from age 65, and are based upon Club Vita's baseline longevity calibrated to the period 2010-2012.

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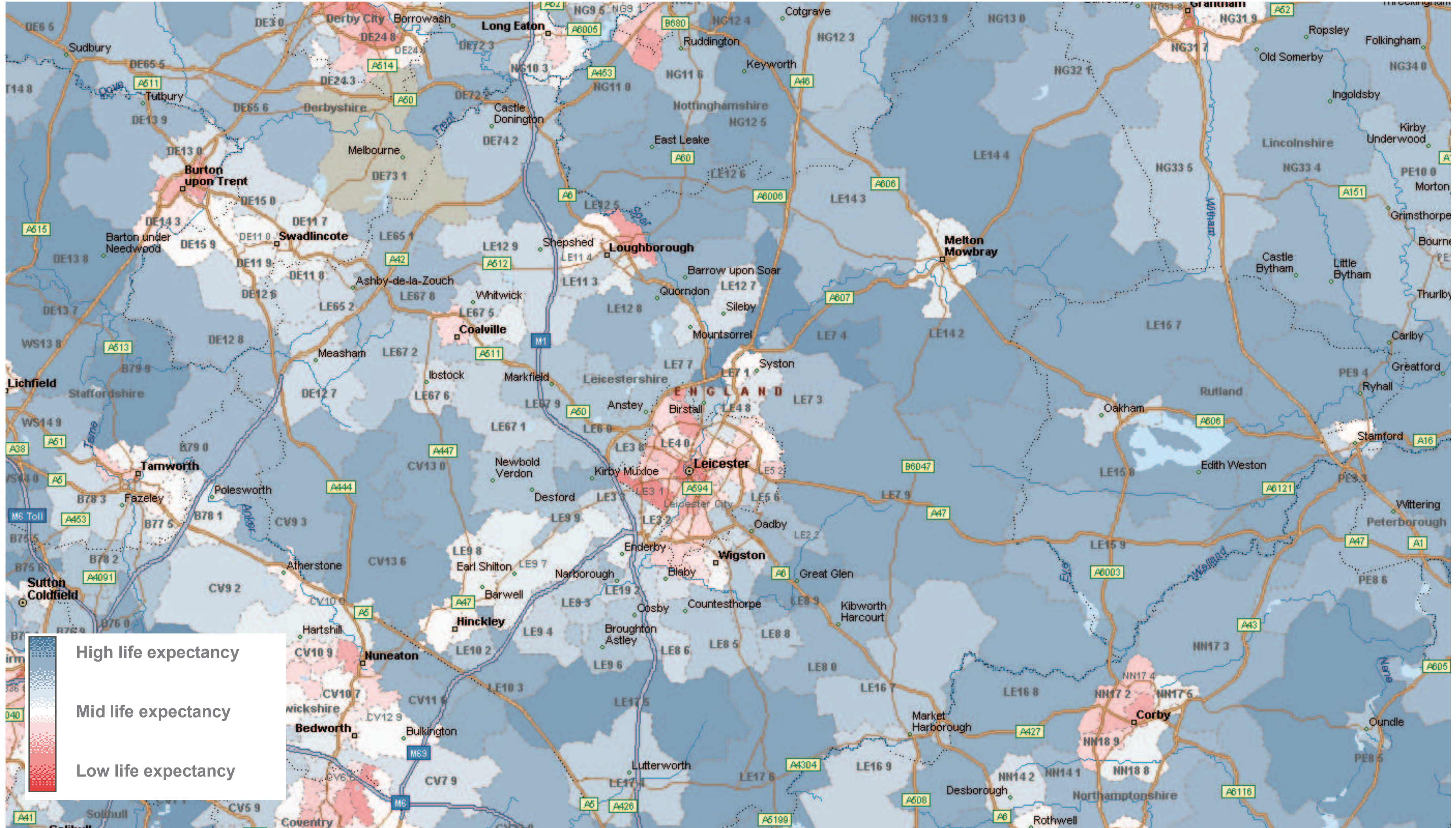
The postcode effect



Source: Club Vita research based on VitaBank as at January 2015

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Measurement - Current funding target

Assumption	2013 approach	2016 approach	Impact on funding level compared with 2013	Impact on funding level - market conditions*
Discount rate	AOA = 1.8%	AOA = 1.8%	No change	Decrease of 13%
Salary growth	RPI + 1%	RPI	Increase of 4%	Increase of 1%
Pension increases (CPI)	RPI - 0.8%	RPI - 1%	Increase of 4%	Increase of 2%

Overall – little change from assumptions

*Based on current market conditions

Beware of heroic assumptions!

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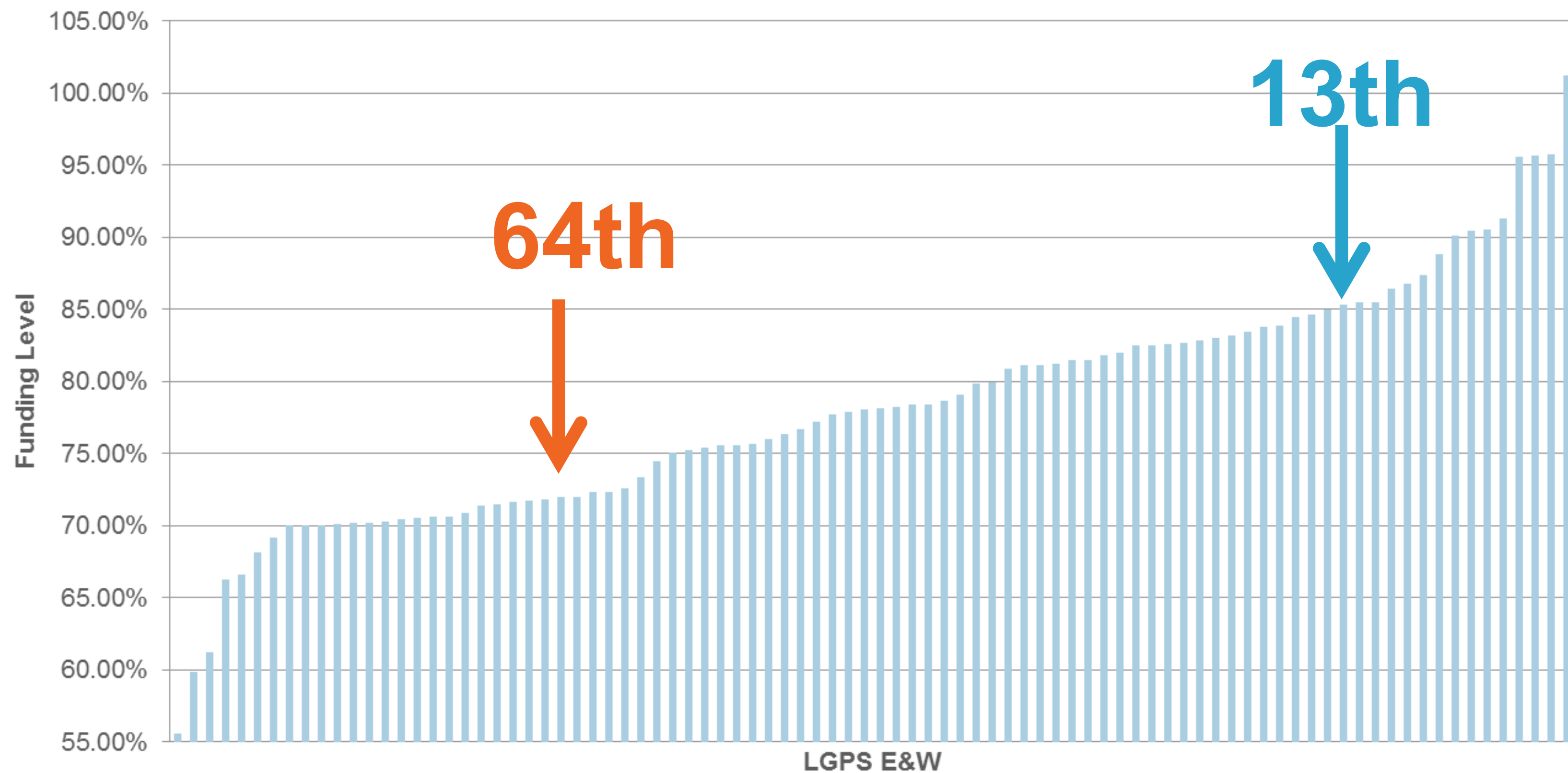
2013 funding levels (published)



Based on local assumptions

Source: All English & Welsh LGPS Funds, values based on 31 March 2013 published valuation data

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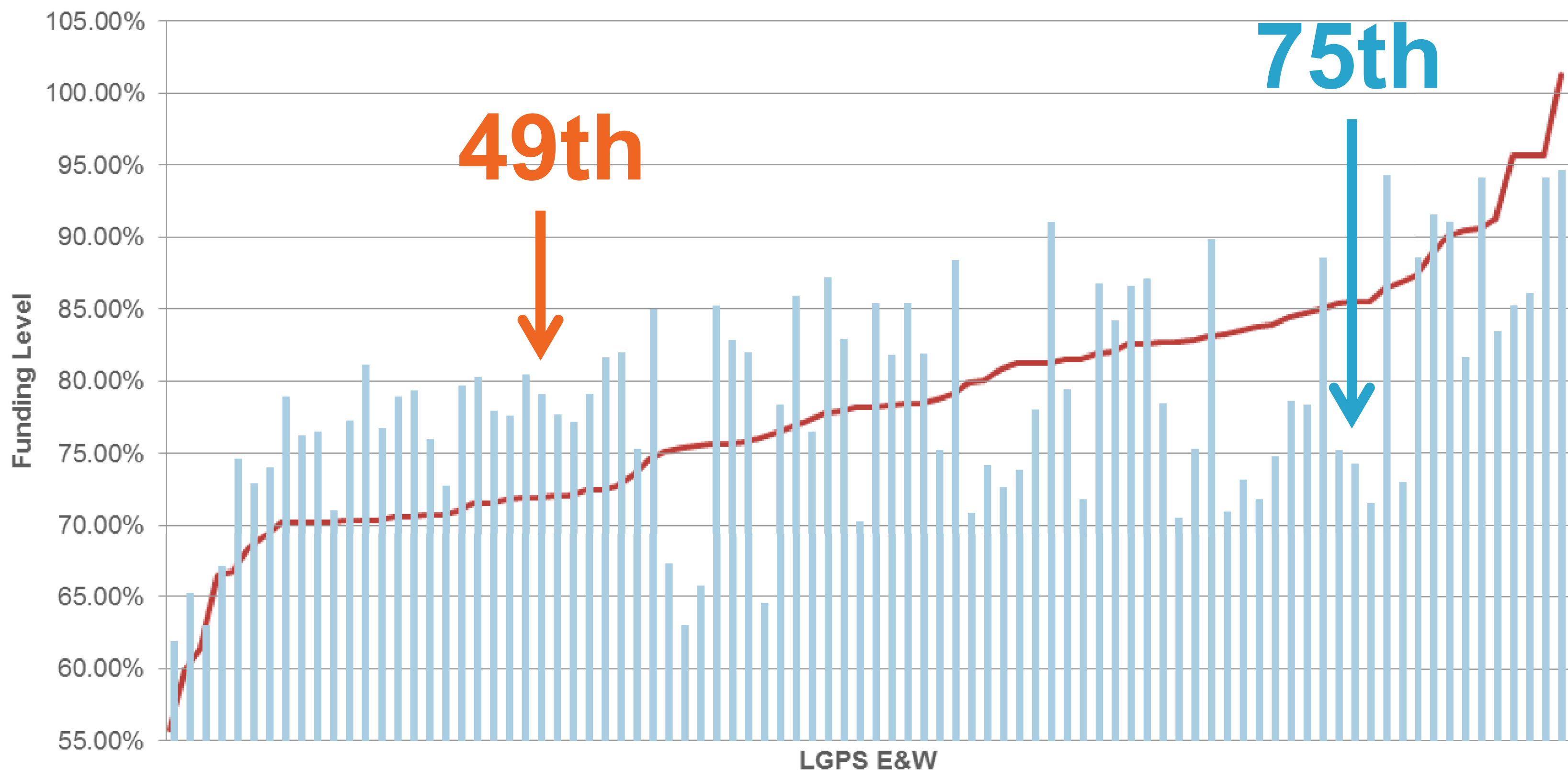
2013 funding levels (same investment return)



Based on standardised assumptions

Source: Hymans Robertson; all English & Welsh LGPS Funds, **estimated** values based on 31 March 2013 published valuation data

Basis: HM Treasury standard basis, Net Discount Rate = 0.25% p.a. pre retirement / 3.0% p.a. post retirement

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Management

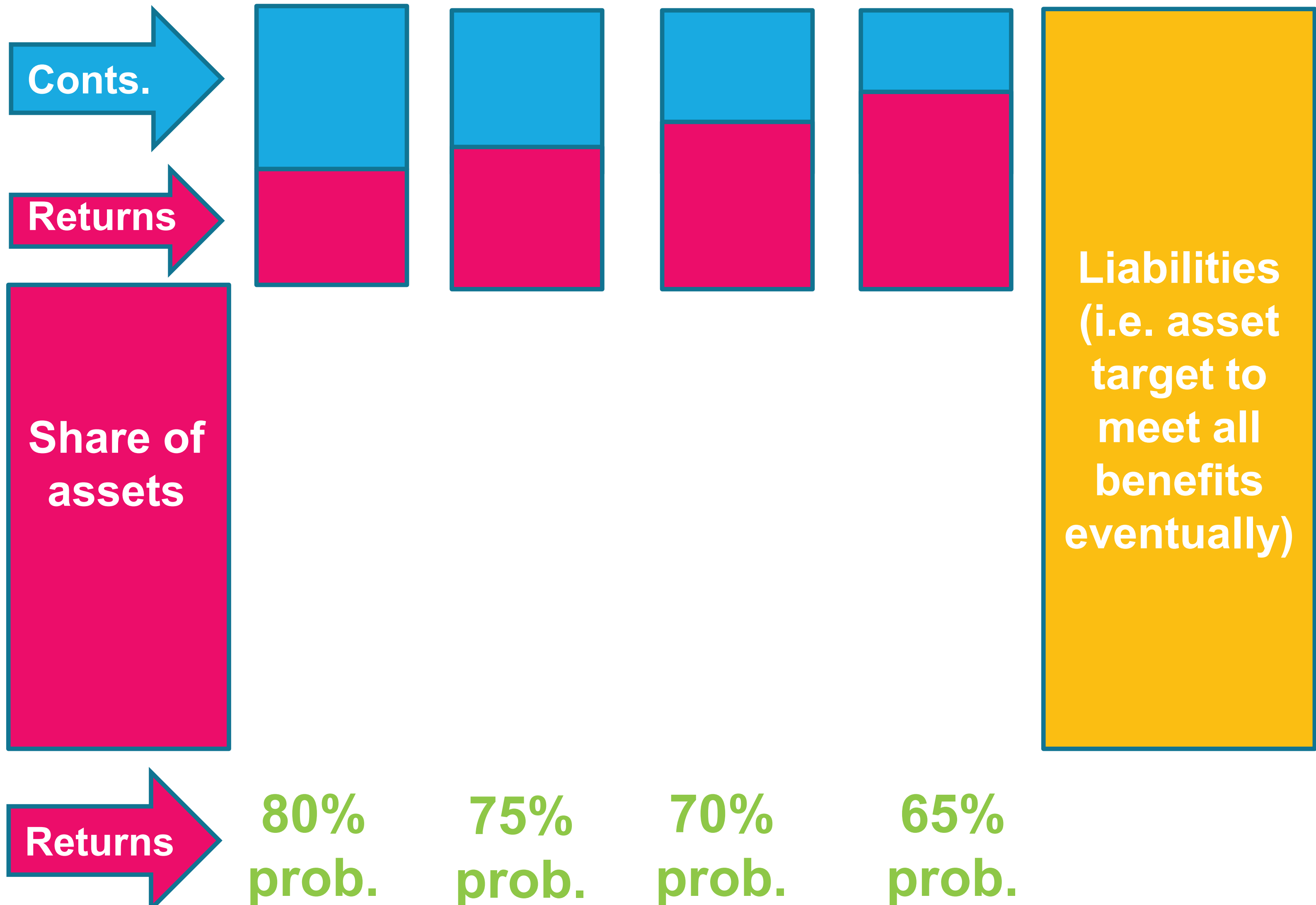
Outputs from a traditional valuation …

- Whole fund results
  - Balance sheet (solvency position)
  - Common contribution rate (no longer required)
- Individual employer results
  - Balance sheet and deficit
  - Calculated contribution rate
- All calculated on a single set of assumptions

Don't base contributions on a single answer

Don’t base contributions on a single answer

- Snapshot is bound to be wrong (we just don’t know in what direction & by how much!)
- Model gives more information to allow better decision making
- Where to strike the balance?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Contributions vs probability
Conts.
Returns
Share of assets
Returns
80% prob.
75% prob.
70% prob.
65% prob.
Liabilities (i.e. asset target to meet all benefits eventually)
21

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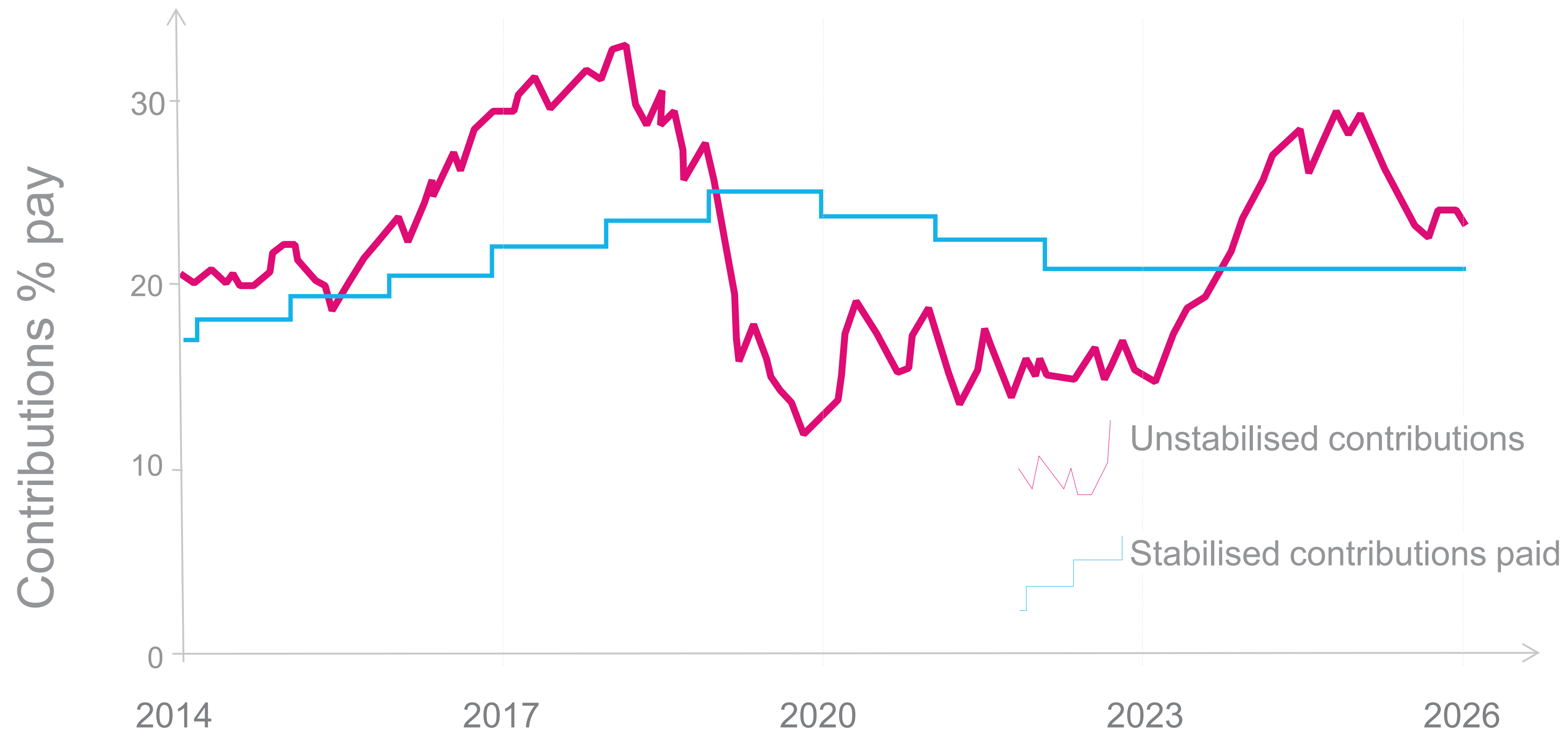
Stabilised contributions



Recognise uncertainty when setting rates

Summary

- Funding level similar to 2013 levels
- Assumptions – market conditions and analysis will inform
- Contributions will remain affordable and stable
- But still in a challenging environment

HYMANS ROBERTSON

Thank you

Any questions?

LOCAL PENSION COMMITTEE – 26TH FEBRUARY 2016

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RECOMMENDED METHOD OF DERIVING KEY ACTUARIAL ASSUMPTIONS FOR 2016 ACTUARIAL VALUATION

Purpose of the Report

1. To recommend to the Committee a method of deriving some of the key assumptions that will be used as part of the actuarial valuation of the Leicestershire Fund based on the position at 31st March 2016.

Background to the actuarial valuation

2. Each Local Government Pension Scheme (LGPS) administering authority has a statutory obligation to have an actuarial valuation carried out every three years, and all Funds in England and Wales need to have a valuation carried out as at 31st March 2016. Leicestershire County Council Pension Fund's actuarial valuation will be carried out by Barry McKay of Hymans Robertson LLP.

3. The major purpose of the actuarial valuation is for the actuary to set employer contributions rates for a three year period that commences one year after the valuation date (i.e. for the period 1st April 2017 to 31st March 2020). In order to set these contribution rates the actuary must take account of a large number of factors, most of which are assumptions of what will happen in the future. In reality these assumptions do not impact onto the ultimate cost of paying benefits, and they impact the pace of funding which in turn impacts the level of contributions set.

4. Throughout the whole actuarial process the actuary has a professional responsibility to certify contribution rates that are considered reasonable. There is also a requirement within the LGPS Regulations that there is an element of prudence built into the actuarial assumptions and that the actuary sets contributions in line with these prudent assumptions but that are also as stable as possible.

Why the assumptions are important

5. One part of an actuarial valuation is an assessment of how the current value of assets held compares to the current value of accrued liabilities – this produces a 'funding level' (i.e. to what extent assets meet accrued liabilities). Whilst the value of assets is a relatively straightforward – it is simply the market value of all assets held by the Fund at the date of the actuarial valuation – the calculation of the liability value is more complex.

6. The value of accrued liabilities could be described as the amount of assets required *on the actuarial valuation date* that would, if all the actuarial assumptions proved to be absolutely accurate, ensure that every benefit was paid with neither a surplus

nor a deficit remaining when the last member dies – in effect, the accrued liabilities are the net present value of future benefit payments. But the assumptions made about the future can have a material impact onto the value calculated for the liabilities that have already accrued.

7. It is often easier to use examples to illustrate the impact that the assumptions have on the accrued liability value:

Future investment return (often referred to as 'discount rate')

Assume that there is a single payment of £1m required 20 years into the future. If the future investment return is assumed to be 4% p.a. a capital sum of £456,400 is required now, because this amount will produce a £1m sum in 20 years' time at a 4% compounded investment return.

If an investment return of 5% is assumed, only £376,900 is required.

If the assets held are valued at £300,000 the funding level is 65.7% at a 4% discount rate, or 79.6% at a 5% discount rate. More importantly, the deficit that needs to be recouped via employers' contribution rates is either £156,400 or £76,900 – a strikingly large difference for a relatively small liability.

Future inflation

If the Fund has a £1m single payment to make in 20 years that must be increased in line with inflation over this period, and if inflation is assumed to be 2.5% p.a., it will become £1,639,000. Assuming a future investment return of 4% p.a. means that £748,000 is required now.

If inflation was 2.0% p.a. the cash sum required in 20 years reduces to £1,486,000. Using the same 4% p.a. investment return means that £678,000 is required now.

Pay growth

Members' benefits pre 1st April 2014 are linked to their salary at retirement. After this date the LGPS moved to a Career Average Revalued Earnings scheme (CARE). Assuming inflation is nil over the next 20 years and that £1m is due at the end of this period. If it is assumed that pay growth will be the same as inflation (i.e. nil), the £1m will not grow as a liability. At a future investment return of 4% p.a., £456,400 is required today to meet the future liability.

Using all the same assumptions but pay growth of 1% p.a. (i.e. 22% over 20 years, due to compounding), the sum required in 20 years will be £1,220,000. At the same 4% p.a. future investment return, £556,800 is required today.

8. The above examples are simplistic and used only as an example of how assumptions impact on the value of accrued liabilities, and hence the funding level and the deficit. In the vast majority of cases liabilities are not met by the payment of a single lump sum – there will usually (but not always) be a lump sum paid as a retirement grant, and this will be followed by many years of monthly pensions payments. These pension payments will be increased annually in line with Consumer Price Inflation, and possibly be followed by a dependant's pension and/or

a death grant. The actuarial valuation takes account of the expected payments and is a far more complicated matter than these examples would suggest.

9. The examples given are also not the only assumptions that are relevant to the outcome of an actuarial valuation. Life expectancy is an important factor, as it is an indication of how long benefits will be payable for. Assumptions about pay growth that is over-and-above the more normal ‘cost of living’ increases will impact on all pre-2014 benefits – in effect an allowance has to be made for what could broadly be described as career progression. Many other factors also have an influence, but it is the assumptions for future investment growth, future inflation and future pay rises that have the biggest influence on the value that is calculated for accrued liabilities.

Impact of assumptions on employers’ contribution rates

10. The reality of an actuarial valuation is that it is not realistically possible to accurately estimate what benefits the Fund will ultimately have to pay, given the many variables that impact on the benefits. But an actuarial valuation is at least an attempt to try to quantify the estimated costs and, importantly, to ensure that contributions paid into the Fund give a high probability that the ultimate objective (to pay every benefit earned by members) can be achieved without any undue surprises somewhere down the line. The actuarial valuation cannot accurately predict how much money the Fund will ultimately need, but it is important in ensuring that the pace of funding these future payments is relatively stable.

11. The assumptions used impact not only on the value of accrued liabilities, and hence on the deficit, but also the amount of money that needs to be paid as part of the employers’ contributions to recoup this deficit over an appropriate length of time. In addition, the assumptions also impact on the cost to employers of paying for future service as it accrues. A higher investment return assumption, for example, means that more of the future cost will be met by investment returns and that employers’ contributions for future service will not be as high as they would be with a lower investment return assumption. Assumptions deliberately designed to give a better outcome (e.g. higher return assumptions, lower inflation assumptions) are doubly-beneficial as they reduce the amount of deficit that needs to be paid via employers’ contribution rates, and also reduce the cost of paying for future service. This places more emphasis on the assets providing higher returns to subsidise the reduced contribution rates set.

12. Employers in the Fund will ultimately have to pay whatever amounts are required to meet their specific liabilities. The Fund has three items of ‘income’ – employee contributions (laid out in the LGPS Regulations), investment returns and employer contributions. It is employer contributions that will pay for what the other two do not meet. Paying lower-than-justified contributions in the short-term will lead to higher-than-needed contributions in the future. Lost investment returns due to having less assets in the Fund will, in effect, have to be met by further employer contributions in the future. Using unreasonably beneficial actuarial assumptions may improve the published funding level, and hence lead to lower employer contribution rates than would otherwise be the case, but this delays the inevitable and makes the future situation worse. What is not paid now will have to be paid in the future, but with interest.

13. Hymans Robertson's presentation on today's agenda gives a very clear example (slides 16 and 17) of how it is possible to use actuarial assumptions to arrive at a more acceptable outcome. There are circumstances in which different assumptions are justified – for example a different asset structure should be expected to produce different assumptions for future investment returns – but there is little doubt that some LGPS Funds have very little prudence within their overall assumptions, and hence no 'buffer' in the event of a disappointing outcome. In an environment of austerity across the public sector, there may be a temptation for some administering authorities to 'massage' the assumptions so as to arrive at employers' contribution rates that are lower than they might otherwise be, thereby freeing-up cash for use in other areas. This is a short-sighted approach, and will simply store up much bigger problems for the future.

14. There have been isolated incidents in recent years of individual employers raising objections/queries about the actuarial assumptions used within the valuation, despite these assumptions having been agreed as appropriate between the administering authority and the actuary. This has never happened within the Leicestershire Fund and there is no expectation that it will, but were it to happen it would take up a sizeable amount of officer and actuary time.

15. In order to engage the Local Pension Committee more fully with the actuarial valuation – an actuarial valuation that will impact onto their own body via the employers' contribution rates that are set – it is considered appropriate to agree how the three key actuarial assumptions (discount rate, inflation, pay growth) will be derived in advance of the actuarial valuation. Doing this will ensure that temptation to adjust the assumptions once the outcome of the valuation is known does not exist and that the decisions made are in the best long-term interests of both the Fund and employing bodies, rather than retaining scope to manipulate the outcome to arrive at a more acceptable outcome for employing bodies.

Pragmatism in setting employers' contribution rates

16. The actuarial valuation will ultimately produce employers' contribution rates for all 200+ employing bodies within the Fund for the period 1st April 2017 to 31st March 2020. These contribution rates will take account of the particular circumstances of each employing body, and the rates will be a combination of the cost of paying for future service as it accrues plus an adjustment for paying off the deficit over an appropriate period of time. The appropriate period of time will vary depending on the nature of the employing body, but for those that are tax-raising bodies or are considered part of the machinery of the public sector it is likely to be 20 years. Other employers, such as transferee admission bodies (i.e. those with outsourced contracts from tax-raising bodies) will have lower deficit spreading periods that are relevant to them (e.g. remaining life of the contract). There may be the odd anomalous employer that actually has a surplus within their sub-fund, and in this case their surplus will be amortised (by reducing their employer contribution rate to below the cost of future service) over an appropriate period of time.

17. Whilst it is difficult for employing bodies to meet high costs of employers' contribution rates, it is volatility (particularly significant increases) that is even more difficult to deal with. Increases in employers' contribution rates from 20% to 25% in one year would inevitably cause a major issue. As a result the Fund and the actuary have introduced a system whereby contribution rates are set in a pragmatic and

risk-assessed way, so that the year-on-year impact of changes in contribution rates is more manageable for employers.

18. At the 2013 actuarial valuation, the majority of employers had contribution rates certified that did not reach, during the three years covered by the rates, the full cost (including deficit repayment amounts) that were calculated as being required. All employing bodies were, however, meeting the cost of future service and making some contribution towards repaying the deficit. This approach was required as a result of financial necessity, but the risks of allowing this approach had been carefully considered. In effect it was almost inevitable that the 2016 actuarial valuation would see further upward movements in employers' contribution rates, unless underlying financial circumstances changed considerably for the better. Circumstances have not got any better over the last three years.

19. Hymans Robertson have a modelling tool which was used in both the 2010 and 2013 actuarial valuation, called comPASS, that can assess contribution rate strategies over the long-term and judge whether they are likely to be sufficient, on the balance of probability, to return the sub-fund of an individual employer to a fully funded position (i.e. enough assets to meet accrued liabilities) within the agreed deficit spreading period. In order to do this the modeller uses thousands of different potential outcomes (investment returns, inflation etc.), thereby giving a very robust result.

20. An example of an input into comPASS from a contribution strategy perspective would be that employer contribution rates do not go up by more than 1% p.a. over the agreed period, but will also never reduce by more than ½% p.a. over the same period. In effect the model is calculating whether an employer that underpays over the next three years (because their rate is below the theoretical rate calculated within the actuarial valuation process) can 'balance off' this underpayment by future overpayments, as they will not see such large future reductions if the costs reduce in the future.

21. In reality comPASS inputs can be rebased at each actuarial valuation, so are adaptable to changing circumstances. If, for example, gilts yields rose by 2% over the next three years and the discount rate went up to such an extent that the value of accrued liabilities reduced substantially, the contribution strategy could be amended accordingly. The contribution rate strategy is not 'set in stone' forever.

Balance between actuarial assumptions and pragmatism in setting contribution rates

22. Using actuarial assumptions that include no prudence (and perhaps even stray into the realms of imprudence) gives an appearance of a stronger financial position for the Fund and potentially lower employer contribution rates than would otherwise be the case. But this undoubtedly stores up considerable problems, and additional cost, for the future. This is not in any employer's long-term financial interest.

23. It is considered much more sensible to use reasonable actuarial assumptions and to use the comPASS modeller to arrive at individual employer contribution rates that have been rigorously assessed as being sufficient to give a high probability of each sub-fund becoming fully funded over an appropriate period.

24. This approach will lead to the Leicestershire Fund looking less well funded than some Funds that use less prudent assumptions, but the Fund should not be concerned about this – what is important is that we take a sensible approach to the issues being faced, and take decisions which do not bring significant future financial risks. The LGPS Scheme Advisory Board will be producing actuarial valuation outcomes on a consistent basis in late 2016 or early 2017, and this will be the truest available measure of scheme solvency. It is highly probable that they will want explanations from those Funds that slip considerably down the league table when the valuations are rebased on a like-for-like basis (like the Fund shown in slides 16 and 17 of Hymans Robertsons' presentation) , and it is highly unlikely that the Leicestershire Fund will be one of these Funds.

25. Manipulation of actuarial assumptions can give a favourable outcome in terms of employers' contribution rates. This simply buys the employers some time. If the assumptions are not borne out in the future this will build up considerable cost pressures for employers in the future. This is not considered a sensible approach to an issue that is long-term in nature and from which the most likely 'escape' is higher employers' contribution rates for many years to come.

Agreement of key actuarial assumptions

26. In his presentation that preceded this report, the actuary provided background information and explained the rationale for his recommendations for the three key actuarial assumptions. This can be broadly summarised as follows:

Discount rate/future investment return

- The starting point is what is known – the guaranteed long-term return on UK government bonds (effectively the 'risk free' return available to the Fund)
- The Fund, however, holds very few of its assets in UK government bonds, so an allowance is made for the expected long-term future investment return *over-and-above the risk free return* on each asset class held by the Fund
- The blended expected long-term future investment return of the Fund, taking into account the Fund's actual investment strategy, is 1.8% p.a. above UK government bond yields

Salary growth assumptions

- Historic salary growth for members that have stayed in the fund from one actuarial valuation to the next has been RPI + 1 p.a.%
- The government have stated that public sector pay growth will be no more than 1% p.a. over the next 4 years (assumed to be until 31st March 2020)
- In the absence of any other information, it is then assumed that pay growth will revert to the historic norm
- As the final salary element of the LGPS will gradually lose its importance over the years (because service after 31st March 2014 is now based on earnings in individual financial years and not on final salary), the amalgamation of the impact of the short-term pay restraint and reversion to the historic norm gives a blended future pay growth assumption of RPI

- The market's assumption of RPI is derived from the difference between yields on index-linked and conventional government bonds at the actuarial valuation date

Pension increase assumptions

- Increases in pensions in payment, increases in the value of deferred benefits that have yet to come into payment and increases in the value of career average-based future pensions are all linked to the Consumer Price Inflation
- It is possible to derive the market's view on future *Retail* Price Inflation from the difference between yields on conventional and index-linked government bonds
- Because of the difference in the methodologies between the calculation of the two inflation measures (including, but not limited to, what is included in the measures and their weightings), it is necessary to make an adjustment to produce a future Consumer Price Inflation figure
- Based on the history of the two measures (CPI has been calculated since 1996), the expectation is that in the future CPI will be 1% p.a. lower than RPI
- The assumption for pension increases will be RPI (derived by taking the difference between yields on conventional and index-linked government bonds) less 1% p.a.

27. The other assumptions that are included in the actuarial valuation will continue to be set by agreement between the actuary and Leicestershire County Council's Director of Finance. These assumptions, in combination, will have an impact onto the outcome of the valuation but their influence is considerably less important than the three key assumptions set out above. Some of these assumptions are likely to be set after the actuarial data has been processed – for example, assumptions on the number of early leavers from the Fund are best set following an assessment of recent experience. Unless there are particularly strong grounds for using alternative assumptions, it is probable that the advice of the actuary will be accepted.

Timeline

28. Although the actuarial valuation is based on the Fund's position as at 31st March 2016, the reality is that validation of the data (on over 87,000 records) is time consuming and is partially reliant on information from employing bodies. It is unlikely that the valuation at a whole Fund level will be available much before the end of October 2016.

29. The whole Fund valuation is, in itself, of limited use. The key outcome is the valuation on an individual employer sub-fund level as this is what is taken into account when setting contribution rate strategy and employer contribution rates. Individual sub-fund valuations on all of the 250-or-so employers are likely to be available until late November. As the contribution rates are a key element of employers' revenue budgets, an employer forum will be held as soon as is possible to present the outcome of the valuation to employing bodies. In previous valuations this employer forum has happened at the end of November or beginning of December, and a similar date is expected this time.

30. Before the actuary can certify the employers' contribution rates, he must have due regard to the Funding Strategy Statement (FSS) of the Fund. It is necessary to consult employers on the contents of the FSS, and also for its contents to be approved by this committee. It is probable that a draft FSS will be brought to the

January 2017 meeting of the Local Pension Committee and although it is hoped that the consultation with employers will have taken place by this time, the timescales are very tight and there is a chance that the consultation may need to take place after the LPC has agreed a draft FSS.

31. As far as is possible the Fund will engage with employing bodies in order to make the valuation process as smooth as possible. The ultimate aim is to try to ensure that there are no surprises for employers when they receive their contribution rates. Even though some employers will no doubt have rates certified that are higher than they would have wished for, it is important that the Fund has given them the opportunity to understand why the rates are necessary and to understand that they are being treated fairly. The Fund has historically enjoyed a good relationship with employers and there is no reason to suggest that this will change, despite the probability of higher employer contribution rates.

Summary

32. The 2016 actuarial valuation of the Fund is likely to be tough, and there is a very high likelihood of increases in contribution rates for the vast majority of employing bodies. The actuarial assumptions used impact directly onto the outcome of the valuation, both in terms of the funding level (i.e. the ratio of assets to liabilities) and the theoretical employers' contribution rates that are set.

33. Employers ultimately need to pay contributions into the Fund to ensure that all of the benefits for which they are responsible are met. The actuarial valuation sets the pace at which these employer contributions are paid, but the actual amount of benefits paid is dependent on a multitude of factors. What employers do not pay now will have to be paid in the future, but will be a higher amount due to the investment returns that have not been earned in the meantime. Using actuarial assumptions that are stretched to the extent that there is little-or-no-prudence in them is not a sensible policy.

34. Using modelling techniques to ensure that employer contribution rates ultimately have a high probability of being sufficient to meet the full cost of benefits is a better option that what would amount to a (probably vain) hope that everything will turn out alright in the end. These modelling techniques will not stop the need for contribution rate increases but they will at least provide a robust and risk-assessed basis of evidence that the actuary is setting contribution rates that are sensible, albeit that these rates will in many instances be below the theoretically required rate calculated within the valuation.

35. Agreement by the Committee of the basis on which the three key actuarial assumptions will be set *before* the actuarial valuation date will show a willingness to deal with the financial position of the Pension Fund in an open manner, and in a way that considers the best long-term financial interest of both employers and the Fund. Given the increased scrutiny that the LGPS is under from both the Scheme Advisory Board and The Pensions Regulator, this level of openness will no doubt be appreciated.

Recommendation

36. The Committee is recommended to approve that the actuarial assumptions to be used in the 2016 actuarial valuation of the Fund for discount rate, salary growth and pension increase are as set out in paragraph 26 of the report.

Equal Opportunities Implications

None specific

Background Papers

None

Officers to Contact

Colin Pratt – telephone (0116) 305 7656
Chris Tambini – telephone (0116) 305 6199

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Agenda Item 8

Leicestershire County Council

LOCAL PENSION COMMITTEE – 26TH FEBRUARY 2016

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

SUMMARY VALUATION OF PENSION FUND INVESTMENTS AND INVESTMENT PERFORMANCE OF INDIVIDUAL MANAGERS

Purpose of Report

1. To present to the Committee a summary valuation of the Fund's investments at 31st December 2015 (attached as an appendix to this report), together with figures showing the performance of individual managers.

Summary Valuation

2. The total market value of investments at 31st December 2015 was £3,079.5m compared to £2,951.7m at 30th September 2015, an increase of £127.8m. In the three month period non-investment related net cash inflows amounting to £4.8m were received. After adjusting for non-investment related cash flows the Fund value increased by £123.0m, or 4.2%, due to changes in the value of investments.

3. The total returns of various indices since 30th September 2015 were as follows:-

	Local Currency %	**Converted to Sterling %**	**Return with 50% hedge %**
UK Gilts	-1.2	-1.2	-1.2
UK Index-Linked	-2.9	-2.9	-2.9
UK Equities	+4.0	+4.0	+4.0
North American Equities	+6.3	+9.0	+7.6
European Equities	+5.8	+6.1	+5.9
Japanese Equities	+9.9	+12.5	+11.2
Pacific (Ex Japan) Equities	+5.4	+10.4	+7.9

4. The current split of investments over sectors is as follows:-

	31st December 2015		**30th September 2015**
	£m	**%**	**%**
UK Equities	370.3	12.0	12.0
Overseas Equities	1,141.9	37.1	35.8
Targeted Return/Credit/Opportunity Pool	781.3	25.4	23.9
Private Equity	118.2	3.8	4.1
Property	288.6	9.4	10.1
Cash	43.4	1.4	0.7
Inflation-Linked Assets	342.1	11.1	11.5
Commodities	0.0	0.0	1.9
Active and Passive Currency	(6.3)	(0.2)	0.0
	3,079.5	**100.0**	**100.0**

5. The investment performance of the individual managers is laid out in the tables below, over various periods. For most managers the benchmark performance quoted is based on indices, for targeted return managers the benchmark is cash + 4% p.a. and for Millennium the benchmark is 1.5% p.a.

3 months

Manager/Portfolio	Actual (%)	B/mark(%)	Relative (%)
Legal & General (passive global equities)	+6.7	+6.7	-
Aviva Investors (property)	+2.8	+2.8	-
Aspect Capital (managed futures)	+2.1	+1.1	+1.0
Delaware (emerging market equities)	+11.0	+3.4	+7.6
Kleinwort Benson (equity dividend)	+7.5	+7.9	-0.4
Kempen (equity dividend)	+5.8	+7.9	-2.1
Ruffer (targeted return)	+1.0	+1.1	-0.1
Pictet (targeted return)	+0.9	+1.1	-0.2
Ashmore (emerging market debt)	-0.0	+0.6	-0.6
Millennium (currency)	+0.4	+0.4	-

Financial year-to-date (9 months)

Manager/Portfolio	Actual (%)	B/mark(%)	Relative (%)
Legal & General (passive global equities)	-4.1	-4.0	+0.1
Aviva Investors (property)	+9.7	+9.4	+0.3
Aspect Capital (managed futures)	+0.5	+3.3	-2.8
Delaware (emerging market equities)	-8.6	-11.9	+3.3
Kleinwort Benson (equity dividend)	-3.4	-3.9	+0.5
Kempen (equity dividend)	-3.8	-3.9	+0.1
Ruffer (targeted return)	-2.4	+3.3	-5.7
Ashmore (emerging market debt)	-4.7	-4.6	-0.1
Millennium (currency)	-0.6	+1.2	-1.8

One year

Manager/Portfolio	Actual (%)	B/mark(%)	Relative (%)
Legal & General (passive global equities)	+2.5	+2.4	+0.1
Aviva Investors (property)	+13.9	+12.5	+1.4
Aspect Capital (managed futures)	+8.8	+4.5	+4.3
Delaware (Emerging market equities)	-8.9	-10.0	+1.1
Kleinwort Benson (equity dividend)	+0.7	+3.3	-2.6
Kempen (equity dividend)	+2.4	+3.3	-0.9
Ruffer (targeted return)	+2.4	+4.5	-2.1
Ashmore (emerging market debt)	-4.6	-5.2	+0.6
Millennium (currency)	+2.0	+1.5	-0.5

Three years (performance per annum)

Manager/Portfolio	Actual (%)	B/mark(%)	Relative (%)
Legal & General (passive global equities)	+10.6	+10.5	+0.1
Aviva Investors (property)	+14.6	+12.9	+1.7
Aspect Capital (managed futures)	+11.3	+4.5	+6.8
Delaware (Emerging market equities)	-0.5	-3.7	+3.2
Ruffer (targeted return)	+7.1	+4.5	+2.6
Kleinwort Benson (equity dividend)	+10.8	+11.3	-0.5
Millennium (currency)	+2.3	+1.5	+0.8

Five years (performance per annum)

Manager/Portfolio	Actual (%)	B/mark(%)	Relative (%)
Legal & General (passive global equities)	+7.3	+7.1	+0.2
Aviva Investors (property)	+10.0	+9.0	+1.0
Ruffer (targeted return)	+5.3	+4.5	+0.8
Millennium (currency)	+1.4	+1.5	-0.1

Equal Opportunities Implications

6. The matters referred to in this report have no identifiable equal opportunities implications.

Recommendation

7. The Local Pension Committee is asked to note the above report.

Officer to Contact

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APPENDIX

PENSION FUND INVESTMENTS AS AT 31ST DECEMBER 2015

	Market Value £	Value %	Benchmark %	Variance %
Equities				
United Kingdom	370,312,840	12.02	11.00	1.02
Overseas:				
Global dividend-focused	238,807,825	7.75	8.00	-0.25
North America	415,490,950	13.49	13.00	0.49
Europe (Ex UK)	198,468,386	6.44	6.50	-0.06
Japan	47,568,817	1.54	1.50	0.04
Pacific (Ex Japan)	96,333,198	3.13	3.00	0.13
Emerging Markets	145,186,393	4.71	5.50	-0.79
Total	1,141,855,569	37.08	37.50	-0.42
Private Equity	118,205,682	3.84	4.00	-0.16
Property				
Direct Holdings*	93,941,000	3.05	4.00	-0.95
Indirect Holdings	194,665,835	6.32	6.00	0.32
Total	288,606,835	9.37	10.00	-0.63
Alternative Investments				
Fauchier	618,889	0.02	0.00	0.02
Pictet	85,238,795	2.77	3.00	-0.23
Ruffer	220,021,367	7.14	7.00	0.14
Credit Opportunities	158,157,920	5.14	5.00	0.14
Aspect	136,653,247	4.44	4.00	0.44
Emerging Market Debt	72,500,569	2.35	2.50	-0.15
Opportunity pool	108,070,430	3.51	3.50	0.01
	781,261,217	25.37	25.00	0.37
Commodities	80,314	0.00	0.00	0.00
Inflation-Linked Assets				
Global Government Index-Linked Bonds	206,883,897	6.72	7.50	-0.78
Infrastructure	80,841,562	2.63	3.00	-0.37
Timberland	54,421,881	1.77	2.00	-0.23
	342,147,340	11.11	12.50	-1.39
Cash on Deposit	43,407,273	1.41	0.00	1.41
Unrealised Profit On Currency				
Active	1,182,868	0.04	0.00	0.04
Passive	-7,530,818	-0.24	0.00	-0.24
Total	-6,347,950	-0.21	0.00	-0.21
TOTAL	**3,079,529,120**	**100.00**	**100.00**	**0.00**

Direct Property Holdings*		
Retail	14,325,000	15.25
Retail Warehouses	19,880,000	21.16
Offices	23,920,000	25.46
Industrials	16,715,000	17.79
Leisure (Hotels/Health Club)	17,690,000	18.83
Farms	1,411,000	1.50
	93,941,000	100.00

Agenda Item 9

LOCAL PENSION COMMITTEE – 26TH FEBRUARY 2016

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PERFORMANCE ASSESSMENT OF LOCAL PENSION COMMITTEE AND INVESTMENT SUBCOMMITTEE

Purpose of the Report

1. To allow the Committee the opportunity to consider its performance over the last year, including the assistance it receives from officers and advisors, the decisions it has taken and whether it feels the structure of both the Committee and the Investment Sub-Committee (ISC) are optimal.

Background

2. One of the areas covered by the revised Myners Principles is that performance of investment managers and other service providers, and also of the Committee itself, should be assessed on a regular basis. The Fund's Statement of Investment Principles states that this self-assessment by the Committee will form part of the Annual Strategy Meeting, although the need to focus on the important matter of investment pooling within the Local Government Pension Scheme (LGPS) at that meeting meant that it was deemed appropriate to postpone the assessment until the next available meeting.

Introduction of Local Pension Board

3. On 1st April 2015 the Local Pension Board came into existence. The purpose of the Board is to secure compliance with the Local Government Pension Scheme Regulations, other legislation relating to governance and administration and any requirements of the Pensions Regulator. The work of the Local Pension Board and the Local Pension Committee do not overlap to any meaningful extent, although the Board does now deal with administration issues that were previously considered by the Committee.

Training

4. The Pensions Regulator (TPR) became responsible for oversight of the LGPS in April 2015 and going forward there will be a much higher degree of scrutiny on the governance of the Fund, including whether members of all Committees/Boards dealing with the Fund have adequate levels of knowledge to discharge their responsibilities properly.

5. It is clear that training for Local Pension Committee members will need to become more formal and better documented than it has been previously. Much of this training will be delivered as part of the normal committee meetings – today's presentation by the actuary, for example, can be viewed as a training item. But members of the Committee must be willing to take personal responsibility for

ensuring that they have the appropriate degree of knowledge and understanding. Part of this responsibility will involve e-learning using the public sector online toolkit that has been developed by TPR.

6. An agenda item concerning training, which will include a 'Training Needs Analysis' self-assessment, will be included at the next meeting of this Committee.

Self-Assessment of Performance over the last twelve months

7. There is no prescribed 'check list' of factors that should be assessed when considering the performance of the Committees. The following is a non-exhaustive list of some of the questions that might be asked by an interested party if the assessment was carried out by them:-

- Does the Committee feel that they are adequately supported by officers and advisors?
- Are the meetings of the Committee and ISC sufficiently regular?
- When making decisions do the Committee feel that they have received sufficient information to assist them?
- With the benefit of hindsight is the Committee comfortable that their decisions have been beneficial to the Fund? If not, are there any lessons that can be learnt to assist with future decisions?
- Are there areas which the Committee feel are overemphasised (or not covered sufficiently) within meetings?
- Is the length of meetings acceptable?
- Do members feel sufficiently 'expert' (individually and as a group) to ensure that effective decisions are made?

8. Of all the above points, it is the last one which is likely to face the greatest external scrutiny. The Fund will need to be able to clearly demonstrate that members (individually and collectively) have sufficient knowledge to make effective decisions, and this undoubtedly increase the emphasis on training.

Recommendation

9. The Committee is asked to note this report.

Equal Opportunities Implications

None specific.

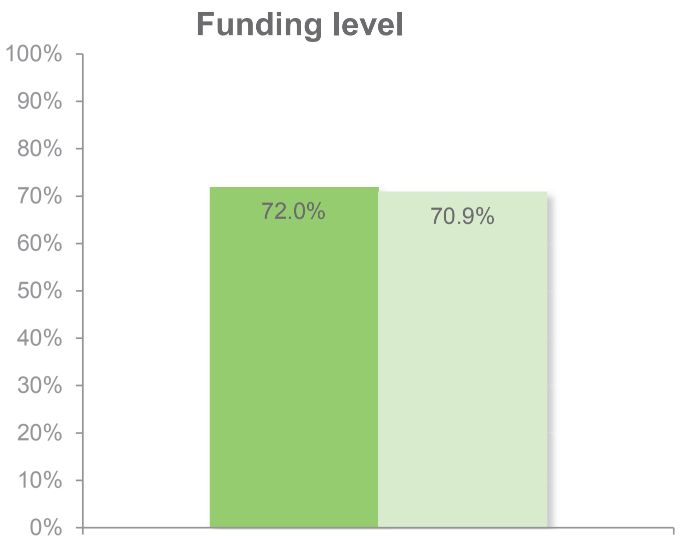
Background Papers

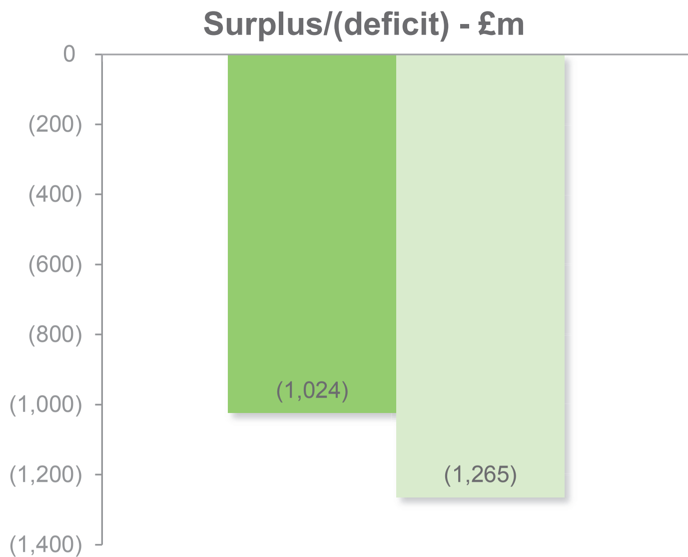
None.

Officers to Contact

Colin Pratt - telephone 0116 305 7656. Email colin.pratt@leics.gov.uk
Chris Tambini - telephone 0116 305 6199. Email chris.tambini@leics.gov.uk

Funding update as at 31 December 2015
Leicestershire County Council Pension Fund





HYMANS ROBERTSON

Summary

This funding update is provided to illustrate the estimated development of the funding position from 31 March 2013 to 31 December 2015, for the Leicestershire County Council Pension Fund ("the Fund"). It is addressed to Leicestershire County Council in its capacity as the Administering Authority of the Leicestershire County Council Pension Fund and has been prepared in my capacity as your actuarial adviser.

The funding level at the latest formal valuation was 72.0%. As at 31 December 2015 the funding level has decreased to 70.9%. This is largely as a result of a decrease in bond yields, and subsequent discount rate, which places a higher value on the Fund's liabilities.

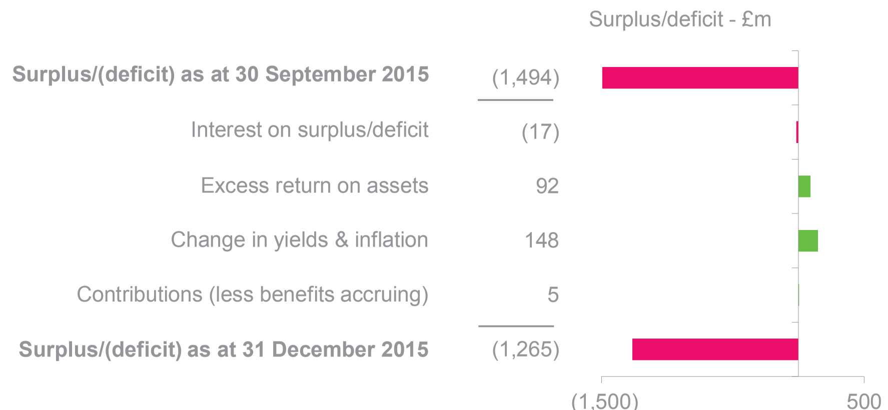
This report has been produced exclusively for the Administering Authority. This report must not be copied to any third party without our prior written consent.

This report looks at the whole fund position and does not allow for the circumstances of individual employers. The results for individual employers can be quite different to the fund as a whole depending on their own experience and the profile of their liabilities. Differences in the relationship between the ratio of accrued liabilities and the payroll can have a large influence on changes in contributions.

Barry McKay
Actuary

What's happened since the last update – ongoing funding basis

	Surplus/deficit - £m
Surplus/(deficit) as at 30 September 2015	(1,494)
Interest on surplus/deficit	(17)
Excess return on assets	92
Change in yields & inflation	148
Contributions (less benefits accruing)	5
Surplus/(deficit) as at 31 December 2015	(1,265)



Differences between this funding update and a full actuarial valuation

The accuracy of this type of funding update calculation is expected to decline over time as the period since the last valuation increases. This is because this funding update does not allow for changes in individual members' data since the last valuation.

Details of the approach used in this funding update are given in the appendix.

The figures in tables throughout this document may not add up due to rounding.

Estimated financial position at 31 December 2015

Ongoing funding basis

£m	31 Mar 2013	30 Sep 2015	31 Dec 2015
Assets	2,628	2,952	3,080
Liabilities	3,652	4,446	4,344
Surplus/(deficit)	**(1,024)**	**(1,494)**	**(1,265)**
Funding level	72.0%	66.4%	70.9%

Gilts funding basis

£m	31 Mar 2013	30 Sep 2015	31 Dec 2015
Assets	2,628	2,952	3,080
Liabilities	5,237	6,432	6,247
Surplus/(deficit)	**(2,609)**	**(3,480)**	**(3,168)**
Funding level	50.2%	45.9%	49.3%

Basis summary

	31 Mar 2013	31 Dec 2015
Pre retirement discount rate		
Nominal	4.8%	4.4%
Real	1.5%	1.1%
Post retirement discount rate		
Nominal	4.8%	4.4%
Real	1.5%	1.1%
Salary increase rate	4.3%	4.3%

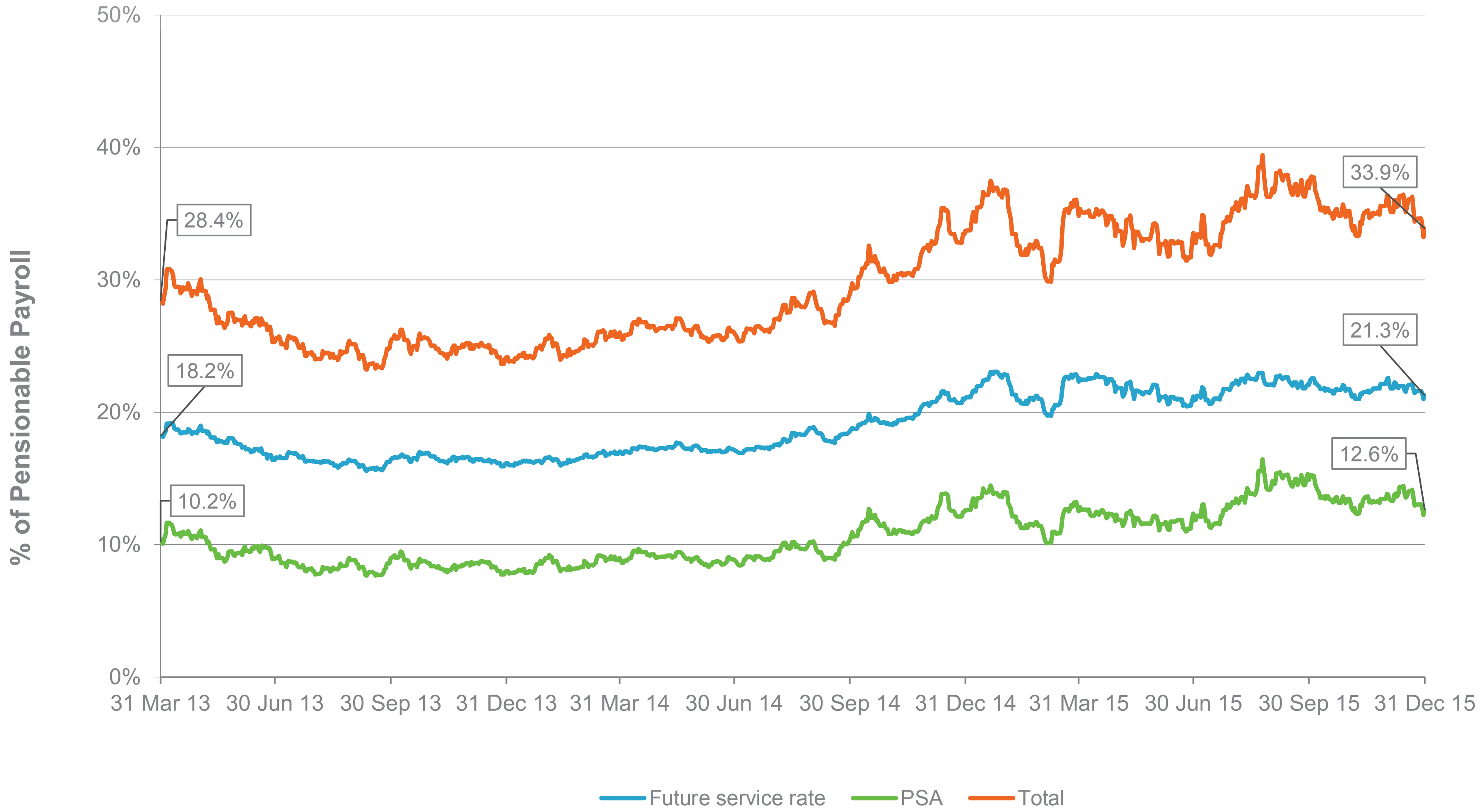
The assumptions underlying the funding bases are set out in the Funding Strategy Statement. They are those set for the 2013 valuation of the Fund updated for market conditions as at the calculation date.

Market indicators

	31 Mar 2013	31 Dec 2015
Market yields (p.a.)		
Fixed interest gilts	3.04%	2.59%
Index linked gilts	-0.27%	-0.71%
Implied inflation (RPI)	3.30%	3.30%
Implied inflation (CPI)	2.50%	2.50%
AA corporate bonds	4.07%	3.68%
AOA	1.80%	1.80%
Price indices		
FTSE All Share	3,381	3,444
FTSE 100	6,412	6,242

Change in funding level since last valuation

Change in contribution rate

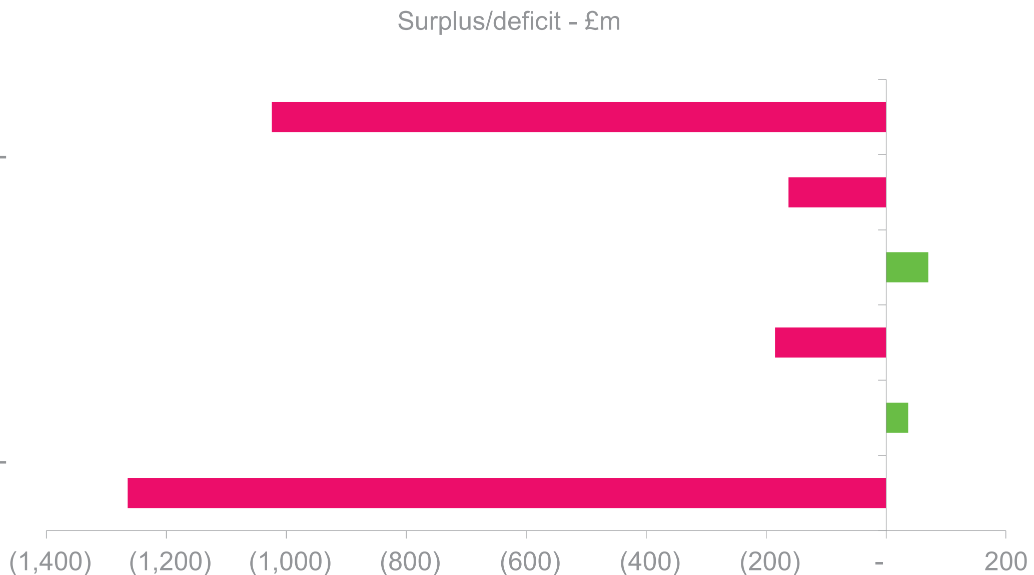


What's happened since last valuation? – ongoing funding basis

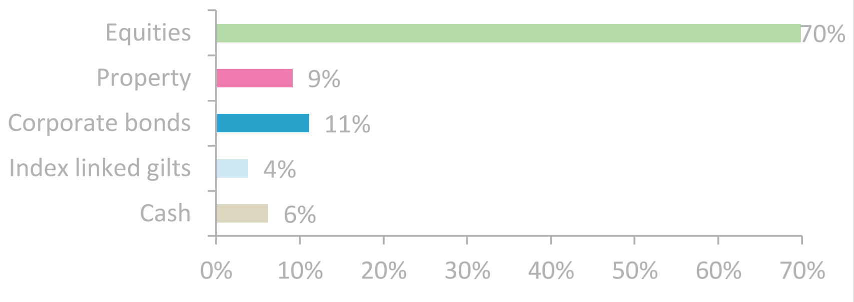
Assets		£m
Asset value as at 31 March 2013	2,628	
Contributions paid in:		365
Benefit payments:		(355)
Expected return on assets:		371
Excess return on assets:		70
Asset value as at 31 December 2015	3,080	

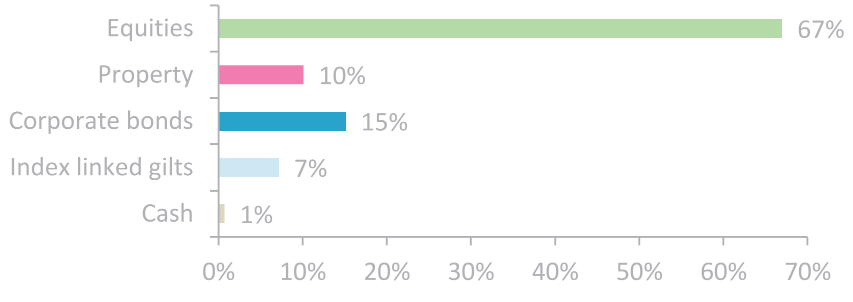
Liabilities		£m
Liability value as at 31 March 2013	3,652	
Cost of benefits accruing:		328
Interest on liabilities:		534
Change in yields & inflation:		185
Benefit payments:		(355)
Liability value as at 31 December 2015	4,344	

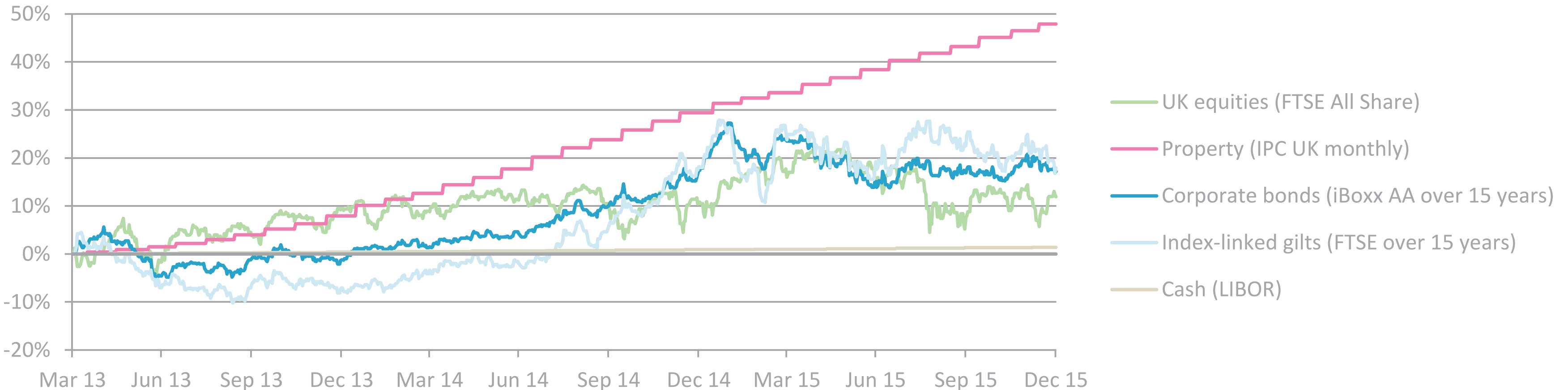
Overall effect



What caused your assets to change?







Sensitivity matrix – ongoing funding basis

Better outcomes →

Bond yields (% p.a.)	4,370	4,994	5,618	6,242	6,867	7,491	8,115
3.20	59.3% (1,579)	65.5% (1,342)	71.6% (1,104)	77.7% (867)	83.8% (630)	89.9% (393)	96.0% (155)
2.99	57.7% (1,704)	63.6% (1,466)	69.5% (1,229)	75.4% (992)	81.3% (754)	87.2% (517)	93.1% (280)
2.79	56.1% (1,836)	61.8% (1,599)	67.4% (1,361)	73.1% (1,124)	78.8% (887)	84.5% (649)	90.1% (412)
2.59	54.5% (1,977)	60.0% (1,739)	65.4% (1,502)	70.9% (1,265)	76.3% (1,027)	81.8% (790)	87.3% (553)
2.38	52.9% (2,126)	58.2% (1,889)	63.4% (1,652)	68.7% (1,415)	73.9% (1,177)	79.2% (940)	84.4% (703)
2.18	51.4% (2,286)	56.4% (2,049)	61.5% (1,811)	66.5% (1,574)	71.6% (1,337)	76.6% (1,100)	81.7% (862)
1.98	49.8% (2,456)	54.7% (2,219)	59.5% (1,982)	64.4% (1,744)	69.2% (1,507)	74.1% (1,270)	78.9% (1,032)

Equity level (using FTSE 100 Price Index as a proxy)

Better outcomes ↑

70.9% (1,265)	Funding level Surplus/(deficit) – £m

Appendix: Scope, methodology, reliances, limitations and market data

Scope

This funding update is provided to Leicestershire County Council as the Administering Authority of the Leicestershire County Council Pension Fund to illustrate the funding position as at 31 December 2015. It should not be used for any other purpose. It should not be released or otherwise disclosed to any third party except with Hymans Robertson LLP's prior written consent, in which case it is to be released in its entirety. Hymans Robertson LLP accepts no liability to any third party unless we have expressly accepted such liability in writing.

Compliance with professional standards

The method and assumptions used to calculate the updated funding position are consistent with those used in the latest formal actuarial valuation, although the financial assumptions have been updated to reflect known changes in market conditions. As such, the advice in this report is consistent with that provided for the last valuation, as set out in the:

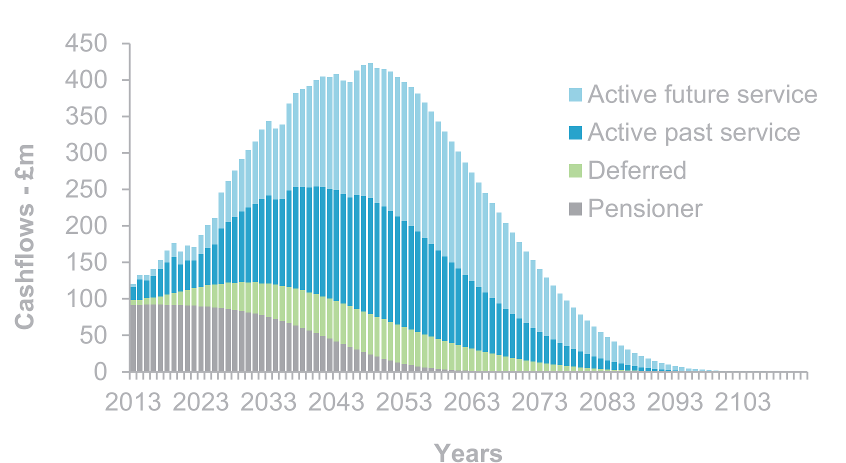
- Valuation Assumptions Briefing Note
- Funding Strategy Statement
- Valuation Report
- Rates and Adjustments Certificate

This update therefore complies with the following Technical Actuarial Standards (TASs):

- Reporting ("TAS R")
- Modelling ("TAS M")
- Data ("TAS D")
- Pensions TAS

How liabilities are calculated

- The future benefits that are payable from the Fund ("cash-flows") were calculated on a specific set of assumptions at the last valuation date.
- These cash-flows (on the ongoing funding basis) are shown below.
- These cash-flows were adjusted using available financial and Fund information to produce estimated cash-flows at post valuation dates.
- The specific information used for this update is set out on the next page.
- Market information is used to produce discount rates at these dates.
- The estimated cash-flows are discounted to produce the estimated liability value at a specific date.



How assets are calculated

Assets are projected from the valuation date allowing for actual or estimated Fund cash-flows, actual quarterly returns (where available) and daily benchmark indices.

The update allows for:

1. Movements in the value of the assets as measured by index returns and data from the administering authority where available.
2. Movements in liabilities as a result of changes in yields and hence inflation and discount rate assumptions.
3. Estimated cash-flows (contributions and benefit payments).
4. Expected accrual of benefits for employee members accrued since the last valuation (based on projected salary roll).
5. Demographic experience in line with assumptions.
6. Variations in liabilities arising from the changes in RPI since the valuation date differing relative to assumptions.
7. Benefit accrual in line with the 2014 scheme.

The update does not allow for:

1. Asset allocations differing from those assumed (other than when asset data is recalibrated based on available information).
2. The asset values as at the date of this report have not been based on audited Fund accounts.
3. Variations in liabilities arising from salary rises differing relative to assumptions.
4. Differences between estimated and actual salary roll of employees.
5. Variation between actual and expected demographic experience (e.g. early retirement or mortality).

Membership data

My calculations are based on the membership data provided for the most recent actuarial valuation. Details on the quality of this data and a data summary can be found in the last formal actuarial valuation report.

Limitations of this model

In the short term, the typical main contributors to funding position volatility are movements in the value of assets held, liability changes due to yield movements, benefit changes and deficit contributions to the Fund.

The accuracy of this type of funding update calculation is expected to decline over time. Differences between the position shown in this report and the position which a valuation would show can be significant; particularly if there have been volatile financial markets or material membership changes (these are more likely to occur in smaller Funds). It is not possible to fully assess the accuracy of this update without carrying out a full actuarial valuation.

Liability calculations are performed on the valuation date, the funding update date, anniversaries of the valuation date and each month-end in between. Interpolation is used for other dates shown in graphs. Some asset classes are not easily tracked by the benchmark indices used in this model which can lead to significant differences between actual and projected asset values.

Indices used to update projected asset values

Some of the following indices have been used to update projected asset values in this funding update.

- FTSE 100
- FTSE 250
- FTSE Small Cap
- FTSE All Share
- FTSE All World Series North America (£)
- FTSE All World Series Japan (£)
- FTSE All World Series Developed Europe (£)
- FTSE All World Series Developed Asia Pacific (£)
- FTSE All World Series All World Developed Ex UK (£)
- FTSE All World Series All World Ex UK (£)
- FTSE All World Series All Emerging (£)
- UK Government Fixed Interest Gilts (Over 15 Years)
- UK Government Index-Linked Gilts (Over 5 Years)
- UK Government Index-Linked Gilts (Over 15 Years)
- iBoxx A rated UK Corporate Bonds (Over 15 Years)
- iBoxx AA rated UK Corporate Bonds (Over 15 Years)
- iBoxx AAA rated UK Corporate Bonds (Over 15 Years)
- iBoxx All Investment Grades rated UK Corporate Bonds (Over 15 Years)
- IPD Property
- Cash Indices LIBOR 1 Month

The indices are a standard list and are not necessarily the same indices that managers have been asked to track or beat. All indices used to estimate projected asset values are total return indices. However, the market indicators quoted in this report are price indices, as these are more widely recognised.

Market information used to update liability values

Some of the following market information has been used to update liabilities values in this funding update.

- FTSE Actuaries UK Fixed Interest Gilts Yields (Over 15 Years)
- FTSE Actuaries Index-Linked Gilts (3% Inflation) Yields (Over 15 Years)
- iBoxx AA rated UK Corporate Bond Yields (Over 15 Years)

Note: Market yields displayed in the market indicators table are on an annual basis.

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Leicestershire County Council Pension Fund Q4 2015 - Market Report

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Historic Returns for World Markets

Index	Q4 (%)	1 Year (%)	3 Years (%)
Citi WGBI Non-GBP TR	1.71	2.12	0.34
FTSE 100 TR	3.71	-1.32	5.66
FTSE 350 TR	3.95	0.69	7.09
FTSE A (Index Linked) British Govt All Stocks TR	-2.89	-0.97	5.80
FTSE A British Govt All Stocks TR	-1.20	0.57	3.22
FTSE A British Govt Over 15 Years TR	-2.42	0.09	5.90
FTSE All-Share TR	3.95	0.98	7.27
FTSE Japan TR	12.50	17.58	14.71
FTSE Small Cap TR	4.07	9.17	13.50
FTSE World Europe ex UK TR GBP	6.07	5.35	9.72
FTSE World ex UK TR GBP	8.57	4.77	13.00
IPD UK All Property Monthly TR	3.09	13.82	14.63
LIBID GBP 7 Day	0.12	0.48	0.48
Markit iBoxx Sterling Non Gilts Overall TR	0.37	0.49	4.38
MSCI EM (Emerging Markets) TR GBP	3.52	-9.65	-3.32
MSCI Pacific ex Japan TR GBP	11.34	-3.04	2.09
S&P 500 TR	10.01	7.25	18.95
Commodities	-10.55	-24.70	-17.34
£ Trade Weighted Index	-0.40	2.73	2.68

Currency	Q4 (%)	1 Year (%)	3 Years (%)
Euro	0.01	-5.03	-3.14
Japanese Yen	2.32	5.44	-7.45
US Dollar	2.77	5.79	3.32

Index returns are reported in GBP to indicate sterling.
Source: Kames Capital as at 31 December 2015. All returns over one year are annualised.

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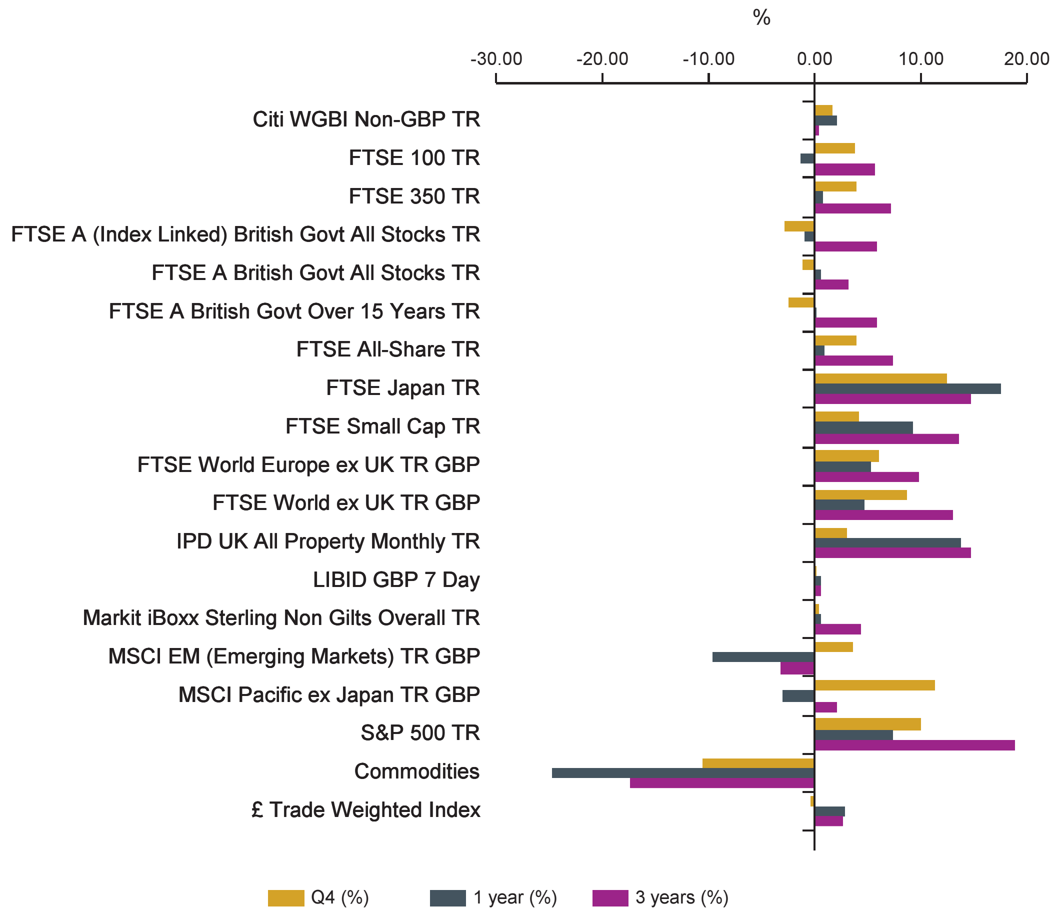
Historic Returns by Market Index

3 months, 1 year and 3 years (annualised)



Index returns are reported in GBP to indicate sterling.
Source: Kames Capital as at 31 December 2015. All returns over one year are annualised.

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Market Review

UK Equities

UK equities climbed over the period, with the FTSE All-Share index returning 3.95%.

Early in the fourth quarter, UK equities were helped by largely positive domestic economic data, with industrial production and retail sales posting relatively good figures while unemployment continued to fall. At the same time, the market had to contend with significant concerns over the health of emerging markets (China in particular) and a steep fall in commodity prices.

Given this turbulent backdrop defensive sectors such as healthcare, telecoms and consumer goods all performed relatively well. Energy related sectors such as oil & gas and basic materials were very weak. Towards the end of the quarter expectations for an increase in base rates were pushed further out after the Bank of England voiced its concerns about the weak global backdrop. This in turn helped domestic sectors, and particularly smaller cap companies to perform well as the quarter came to a close.

US Equities

In the US, the S&P 500 index rose by 10.01% in sterling terms and by 7.04% in dollar terms.

The slow recovery in the US economy continued in the final three months of the year with economic releases generally positive. Non-farm payrolls for October more than doubled their September figures; the addition of 298,000 jobs easily beat expectations of 180,000. This was complemented by a further fall in the unemployment rate, down to 5.0% in October and November from 5.1% in September.

The improved backdrop led the US Federal Reserve to hint that it could raise base rates before the end of the year; the first rate rise since 2006 eventually arrived in December when the Fed raised the rate by 0.25%. At the same time the Fed acknowledged that the pace of future rate increases would be very gradual compared to previous cycles. These dovish comments were welcomed by investors.

In company news, technology stocks had a good quarter; Google's holding company Alphabet moved up on the announcement of a share buyback plan, and Microsoft, LinkedIn and Apple all benefited from positive earnings results. M&A activity remained buoyant with Pfizer and Allergan in the pharma sector agreeing to join forces. In November, Activision Blizzard secured the purchase of King Digital Entertainment, makers of the hugely successful Candy Crush Saga game.

European Equities

The FTSE Europe ex-UK returned 6.07% in sterling terms or 5.80% in euro terms.

Central bank policy was also to the fore in Europe, as markets awaited news on whether the ECB would announce further stimulus measures. Investors' expectations were, however, somewhat unrealistic and the measures announced by the ECB at its December meeting amounted to a modest extension of its existing QE programme, which proved to be a disappointment. Nevertheless, the expectation of further easing was enough to support European equities throughout October and November.

In economic news, some positive data was seen in the form of lowering unemployment (to 10.7% in October from 10.8% in September) and rising industrial and manufacturing production (to 0.6% and 2.2%, respectively, in October). At the same time, retail sales remained weak and consumer confidence levels were dismal.

In the corporate world, the alternative energy, beverage and tobacco sectors were among those to make positive contributions. In November, SABMiller was acquired by AB InBev in a massive £71 billion deal. As in other regions, commodity-related sectors struggled.

Japanese Equities

The FTSE Japan advanced by 12.50% in sterling terms by 9.95% in yen terms.

Despite gains in equity markets, Japanese policymakers lowered growth forecasts for the coming year, which central bank governor Haruhiko Kuroda said was "largely due to the effect of energy price falls". Estimates for GDP growth during the fiscal year to March 2016 were readjusted to 1.2% from 1.7%, and the date at which Japan hopes to reach its 2% inflation-rate target was pushed back by six months.

The Bank of Japan eschewed any changes to policy during its November meeting, as policymakers reiterated their belief that the country's recovery is proceeding as intended. Economic data added some encouragement: the inflation rate was elevated from its zero level, which exceeded expectations, and retail sales for the year to October rose to 1.8%, markedly better than the 0.1% contraction seen in previous readings. The unemployment rate continued to edge down, settling at 3.1% for October when 3.4% had been expected, though it bounced back up to 3.3% in November.

Further positives came in the form of third-quarter GDP growth that exceeded both expectations and initial estimates, as well as an increase in industrial production and an expansion in manufacturing production.

In company news, shares of Japan Post spiked in the wake of its large initial public offering. Retailers had a difficult period; Fast Retailing, for one, registered losses on missed expectations and disappointing profits. The healthcare sector was the most beneficial area over the quarter.

Asia Pacific ex-Japan Equities

Asian markets recovered significantly over the third quarter, with the MSCI AC Asia Pacific ex-Japan index returning 8.13% in sterling terms.

The People's Bank of China (PBoC) continued with easing measures in an effort to balance the economy after the summer's far-reaching market crash. Near the end of the October, the central bank cut the benchmark interest rate to 4.35% and decreased the reserve-requirement ratio demanded of banks by another 50 bps. Third-quarter GDP slipped slightly from the prior quarter but beat expectations, landing at 6.9%. This caused the PBoC to release a statement lowering 2016 growth expectations to 6.8%.

Coinciding closely with their central bank's announcement, Chinese markets reacted positively to the news of rate rises in the US. Indian markets also had a favourable response, offsetting some of the disappointment felt after the ECB failed to deliver significant stimulus increases. Central bank activity in the Pacific region was notably slow after a year of heavy activity: India, Korea, and Australia all kept rates even in December.

Elsewhere in the region, New Zealand experienced record highs in its domestic stock market, buoyed by the ongoing recovery in developed markets. In Australia, business confidence registered a sizeable jump from 1 in August to 6 in September in the wake of Malcolm Turnbull being elected prime minister. The country also received a welcome surprise in the form of falling unemployment, which came in at 5.9% for October; estimates predicted it would remain at 6.2%. The jobless rate then fell to 5.8% for November.

Property

The IPD monthly benchmark showed a 3.1% total return over the quarter ending 31 December. This was driven by both the income return and positive capital growth. The UK commercial property market continues to be buoyant and there is still good demand from investors. A high level of competition has led to falling property yields once again with the IPD monthly index recording a further fall in net initial yields. Investor confidence has again been positive and investors looking for higher returns are taking on increased risk in terms of lease length, location or tenant credit quality. There was more stock on the market during the quarter; however the best assets saw strong competition and competitive bidding.

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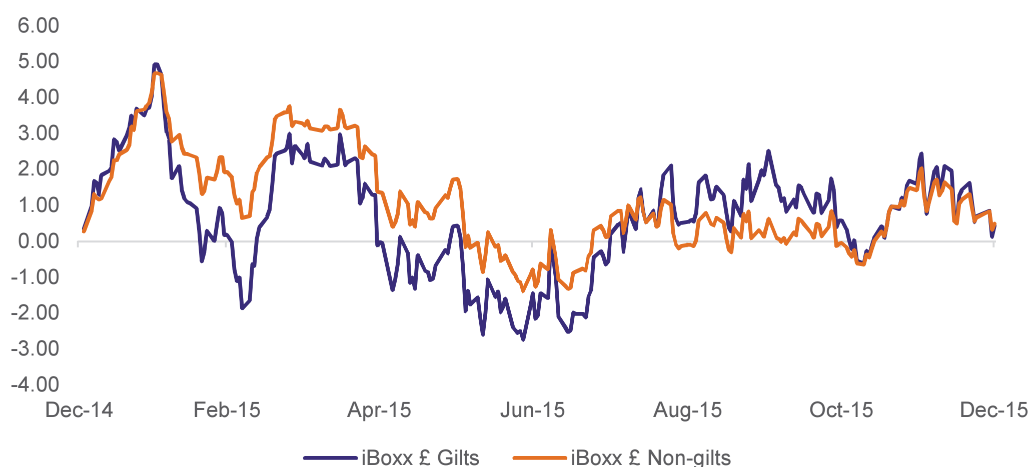
Fixed Income

Government and corporate bond markets both finished in positive territory for 2015, with UK gilts (measured by the iBoxx £ Gilts index) increasing by 0.43% and the UK corporate sector (iboxx £ Non-Gilts) showing a similar rise of 0.49%. It would be easy to conclude from these returns that fixed income assets were relatively subdued in 2015. As the graph below highlights, however, this was not the case; both corporate and government bonds endured a turbulent 12 months with a number of key events dominating markets.

Fixed income volatile in 2015



Source: Markit.com

For most of the year investors focused on the same themes from previous years; the strength of the economic recovery (particularly in the US and UK), Central Bank policy activity (real or inferred) and the search for yield in a low interest rate/low inflation environment. For the period as whole, both the US and UK economies continued to improve although the pace of recovery was again slow. Monetary policy was, as in previous years, to the fore with the market receiving mixed messages about Central Bank intentions. However, we did see some concrete developments in the final quarter of the year.

Government bonds

The fourth quarter began with government bond markets continuing to wrestle with the divergent monetary policy stances from the two largest central banks. In Europe, investors had high expectations that the European Central Bank (ECB) would enhance its quantitative easing (QE) programme, which offered some support to global government bonds. At the same time however, a hawkish comment from the US Fed caused government bonds to sell off somewhat as markets priced-in a year-end rate hike.

At its December meeting, the additional measures announced by the ECB, which amounted to a modest extension of its existing QE programme, proved to be a big disappointment. Markets subsequently reacted negatively with government bond yields moving higher. In contrast, the Fed delivered exactly what was expected of it, with the first rate rise since 2006. Being so well flagged, this had little impact on market prices, but was undoubtedly symbolic nonetheless. The accompanying Fed commentary was pored over by investors, and appeared to suggest a slow but steady rise in rates from here. The end result of all the Central Bank navel-gazing was a shift higher in government bond yields, but still within a well-defined range.

Over the quarter as a whole, the iboxx £ Gilt index fell -1.37%. As the table below shows, yields in most core markets came under some pressure, as they adjusted to Central Bank activity.

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Table 1:10-year yield movements in core and European periphery benchmark bonds

	Core government bonds				Peripheral Europe				
Country	UK	US	Germany	Japan	Spain	Italy	Greece	Ireland	Portugal
Yield at end Sep 2015	1.76	2.04	0.59	0.36	1.89	1.72	8.16	1.24	2.39
Yield at end Dec 2015	1.96	2.27	0.63	0.27	1.77	1.59	8.07	1.15	2.50
Change in yield	0.20	0.23	0.04	-0.09	-0.12	-0.13	-0.09	-0.09	0.11

Source: Bloomberg.

Investment grade

While the investment grade market produced a similar return to its government bond counterpart over 2015 as a whole, it produced a better return in the fourth quarter. The iboxx £ non-Gilts index returned 0.37% for the final three months of the year.

For most of 2015 the corporate sector looked through concerns about potential US interest rate rises and focused on the additional yield available within the asset class. Moreover, the market was not expecting a significant sell-off in the sector, mainly because rate rises will have to be implemented very gradually and the number of increases will be lower than in a 'normal' cycle for fear of bringing the fragile recovery to an abrupt end.

That is not to say the investment grade sector had an easy year or fourth quarter. At various points during the year a robust level of supply, particularly in Europe, weighed heavily on the market. M&A activity, which can be value destructive for bondholders, also remained a key theme and ensured there was a good deal of volatility at an individual bond level. In fact, idiosyncratic issuer risk proved to be a significant source of concern in the fourth quarter. Much of the turbulence was centred on issuers most directly impacted by a quicker-than-expected Chinese economic slowdown, with the large commodity producers the most obvious example.

At the start of the fourth quarter the ECB's suggestion that it might announce an enhancement of its QE programme at its December meeting helped higher-quality euro bonds to outperform their international equivalents. However with the ECB subsequently disappointing investors, the rally seen in the investment grade sector leading up to the meeting unwound, causing European credit to weaken.

High yield

After a reasonably solid start to the year, the second half of 2015 proved a difficult period for risk assets, including high yield. The Barclays Global HY index returned -0.86% over the final three months of the year. US high yield underperformed Europe – the renewed crisis within the US energy sector was a key factor, but it was not helped by outflows around the expectation of a Fed rate hike at the end of the year.

December flows were driven by a combination of renewed weakness in energy after the OPEC meeting, the expected Fed move and year-end tax loss selling. The impact on the market was exacerbated by seasonally

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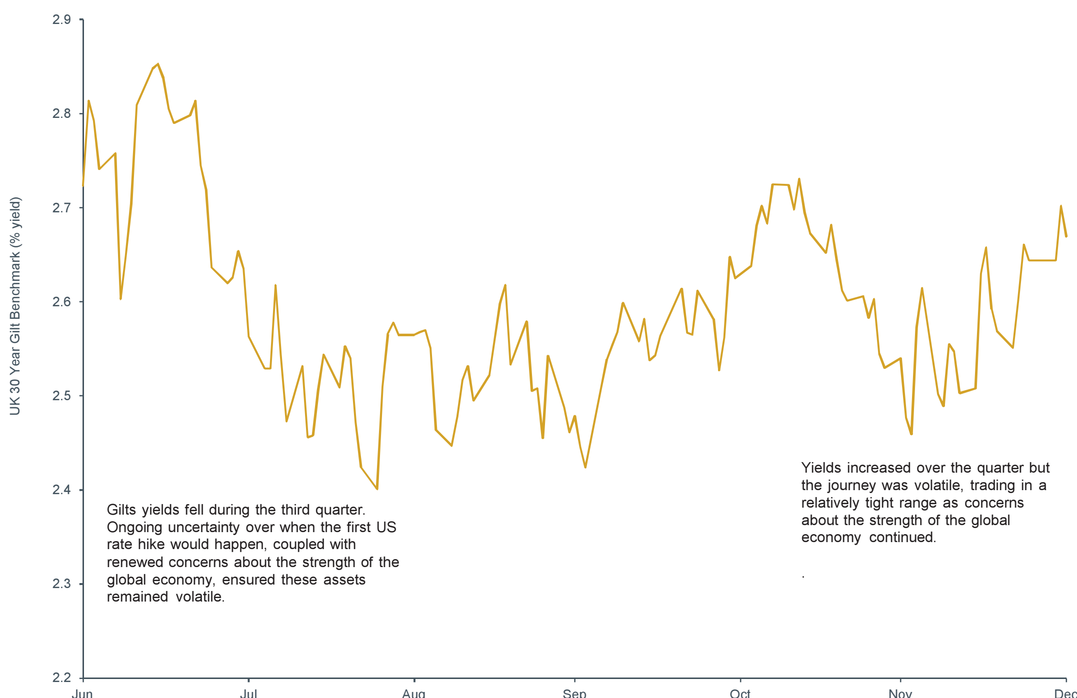
Key Market Movements

The following charts provide a pictorial summary of key market movements during the six-month period to end of December 2015.

Global Equities (FTSE World – Price Index)

Source: Datastream

Long Gilts (War Loans 3.5% Perpetual)



Source: Datastream

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Oil Price (Crude Oil Spot WTI Cushing ($per barrel))

Source: Datastream

UK Sterling (UK Sterling Trade Weighted Index)

Source: Datastream

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Quarterly Thought Piece

The consensus view for 2016 (and beyond) is that the economies of the developed world will grow, not dramatically so but to an extent sufficient to avoid the need for investors to consider how they might react to a recession. At the same time the prospect of the extra-ordinary expansionary monetary policies of recent years generating a pronounced surge in inflation is deemed remote – the collapse of energy prices has seen to that.

In reality the challenge is that the natural stall speed for economies has risen above zero. The reason for this is that the level of impediments to growth has risen substantially since the Great Financial Crisis (GFC). As a result the level of economic growth required before these headwinds begin to determine the economic outlook has risen.

Developments in the energy markets provide a useful illustration of the above. Crude oil prices have slumped (West Texas crude has fallen from $107 per barrel in mid-2014 to below $30 recently) despite global demand for oil increasing (by 2% in 2016 according to the IEA). In short, the level of demand growth required after the recent 'oil rush' in shale etc. in order for the producing companies to just break even has risen beyond that projected for the world. In this there is a metaphor for a raft of situations in the world financial markets e.g. pension funds (despite the good work done by asset markets, improvements in solvency levels have proved elusive).

Headwinds against economic growth include:

- the global debt burden – debt to GDP levels have risen steadily since the GFC as governments (and companies) have exploited ultra-low borrowing costs,
- China – it needs to detach itself further from the strong US$ to rebuild the competitive edge it has had for many years and to arrest the enormous capital outflows of recent quarters,
- energy prices – at current prices the year-on-year adjustments will remain deflationary until H2 and increase the likelihood of a deep contraction across the energy industry (one of the few drivers of corporate capital expenditures in recent years),
- EU worries – centred on the British referendum and the French Presidential election (in 2017) each has the potential to eclipse the problems represented by Greece and raze the EU edifice to the ground,
- policy error – emboldened by their recent success the US Fed tighten too quickly to bring the US expansion to an abrupt halt,
- defaults – developments in the US high yield bond market impact broader markets and encourage investors to reassess credit risks
- emerging markets – the funding problems evident in Brazil and South Africa deepen and spread, and
- the prospect of a highly populist next government in the US – Trump would extend the disturbance (to conventional thought) represented by Corbyn, Le Pen, Bernie Sanders, de Blasio: there's no doubt that there is very deep disillusion with the status quo.

In a sense there is nothing new in this; there are always headwinds. What, arguably, is different is that a material number of each of the challenges listed above have the potential to completely redefine the world economic outlook.

In recent years we have had to face crises surrounding problems of the scale of Greece. Each of the issues listed above has the potential to generate a threat to activity (consumer and corporate confidence) that eclipses the Greek tragedy.

The risk is that this is not fully appreciated by central bankers and that they fail to provide the additional 'adrenalin rush' to which developed economies have become accustomed (addicted). Eventually it will be realised however that monetary policy alone cannot solve the problems we face. A forceful fiscal response will be required – regardless of the impact on debt-to-GDP ratios – 'funded', perhaps, through the overt money approach discussed in the last report.

Beyond all this there is the threat of collective denial. The recent film – the Big Short – presents an account of the practices and build up to the GFC; although a drama, it should be a 'must view' for anyone charged with managing the money of others. Those active in markets at the time will attest all too clearly about the film's accuracy. Beyond the abuse of self-interest, the inability of apparently sensible people to challenge consensus should be the abiding memory.

Today's comfortable consensus of reasonable economic growth and discount rate normalisation stands to be challenged – both by the threats listed above and the self-interested determination that everything will be fine. Things are far from fine in the energy industry; why should they be any more secure elsewhere?

Those charged with investing to support long term liabilities are well advised to retain a defensive investment posture. A number of defensive asset exposures may have lagged the broad markets – what else should have been expected when free money is in infinite supply (QE). The merit of these exposures will come to the fore when market conditions deteriorate.

Scott Jamieson

Head of Multi-Asset Servicing

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