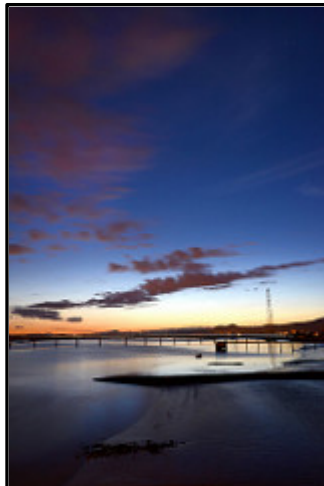


# Falkirk Council Pension Fund Annual Report and Accounts 2015/16

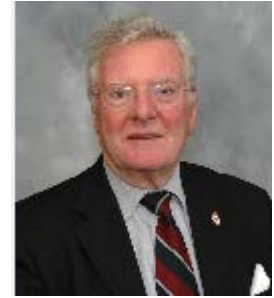


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## Foreword from the Chair of the Pensions Committee



As Chair of the Pensions Committee with responsibility for overseeing the investment management and administration of the Falkirk Council Pension Fund, I am pleased to introduce the 2015/16 Annual Report and Statement of Accounts.

The past year has been one of ongoing evolution for both the Local Government Pension Scheme and the Falkirk Council Pension Fund, with the reforms ushered in by the Hutton Commission and the Public Service Pensions Act 2013 now well and truly in place.

The year has seen the introduction of the Career Average version of the Scheme with its emphasis on sharing the burden of scheme cost more equitably between members, employers and Council tax payers. New governance arrangements in the shape of a national Scheme Advisory Board and local Pension Board have also been established and, for the first time, the Scheme has been brought within the responsibility of the Pensions Regulator to ensure adequacy of administration standards and acceptable levels of “Trustee” knowledge and understanding.

The Scheme Advisory Board, which consists of an equal number of Employer and Trade Union representatives, exists to advise Scottish Ministers on Scheme policy matters. Significant items on the Board’s current agenda include a review of the structure of the Scheme in Scotland and guidance on fiduciary duty.

The topic of fiduciary duty is particularly relevant to local authorities in the light of requests from pressure groups to disinvest from particular sectors such as oil, mining and tobacco. In keeping with around 70 other UK Funds, the Falkirk Fund is a member of the Local Authority Pension Fund Forum (LAPFF), an umbrella group which seeks to improve standards of corporate behaviour. The LAPFF approach, which is currently endorsed by the Falkirk Fund, is that Funds should not disinvest but should maintain their interests in such assets and use their collective influence as a force for change.

2015/16 saw the completion of a review of Fund Investment Strategy. The key decisions, consistent with the Fund’s aim to gradually de-risk, were to increase the proportion of Fund assets allocated to infrastructure and property, and to undertake a “Smart Beta” investment (i.e. where assets track an index of shares but the asset allocation within the index is based on qualitative factors rather than price).

Our Investment Managers generally performed satisfactorily in a challenging environment. However, one manager - Aberdeen Asset Management – did disappoint and continues to be monitored closely. The Fund's initiative to collaborate with the Lothian Pension Fund in making UK infrastructure investments has been progressing well and it has been heartening to see several investments made within the Scottish renewables sector.

Mention of collaboration and infrastructure reminds me that a major asset pooling exercise is underway in England and Wales designed to reduce investment costs and create conditions in which Funds are more disposed to invest in larger scale infrastructure projects. It remains to be seen what influence this will have in Scotland, however, the very laudable aim of upgrading the UK's infrastructure should not obscure the fact that Funds can only commit capital if risk and return profiles are acceptable.

Other Government initiatives such as Auto-Enrolment, Freedom and Choice and - from April this year - the new Single State Pension continue to impact on the work of the Pensions Section, as does the financial climate in which local authorities are operating which means that high numbers of retirements and retirement estimates are prevalent.

During 2015/16, a new pensions administration system was installed to address the complexities of members having both career average and final salary benefits. This roll out of the new system is continuing and work to upgrade the Pensioner Payroll and improve online Member Information is scheduled for 2016/17.

Despite the many changes that have been made to the Scheme and the many other initiatives which are afoot, I am pleased to note that the Scheme remains an important part of employees' reward package offering stability and security of income to members and pensioners both now and in the future.

Once again, can I take this opportunity to thank my colleagues on the Pensions Committee, Pension Board, the staff and our advisors for their commitment and support over the past year.



Councillor John Patrick  
Chair of Falkirk Council Pensions Committee

## Contact Us

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Post: Pensions Section

PO Box 14882

Falkirk Council

Municipal Buildings

Falkirk

FK1 5ZF

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The Pension Section Administration Team is available to help with all aspects of scheme membership including benefits for active, deferred and pensioner members.

General Enquiries: 01324 506329

Retirement/Death Enquiries: 01324 506325

Strategic and Policy matters: 01324 506333

Accounting and Investment matters: 01324 506338

Opening hours: Monday to Friday, 9.00am – 5.00pm

Websites: [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org)  
[www.scotlgps2015.org](http://www.scotlgps2015.org)

Email: [pensions@falkirk.gov.uk](mailto:pensions@falkirk.gov.uk)  
[investments@falkirk.gov.uk](mailto:investments@falkirk.gov.uk)

**Reference is made in this report to a number of online documents. If you are unable to access any of these, or would like a hard copy, please don't hesitate to contact us using the above General Enquiries telephone number.**

# Management Structure

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|  |  |
|--|--|
| <b>Administering Authority:</b>        | Falkirk Council<br>Municipal Buildings<br>West Bridge Street<br>Falkirk<br>FK1 5RS   |
| <b>Fund Officers:</b>                  | Bryan Smail, Chief Finance Officer<br>Alastair McGirr, Pensions Manager  |
| <b>Legal Advisors:</b>                 | Falkirk Council – Legal Services<br>McLay, Murray and Spens  |
| <b>Fund Custodian:</b>                 | The Northern Trust Company   |
| <b>Performance Measurement:</b>        | The Northern Trust Company   |
| <b>Actuary and Investment Advisor:</b> | Hymans Robertson LLP   |
| <b>Fund Managers:</b>                  | Schroder Investment Managers<br>Newton Investment Managers<br>Aberdeen Asset Management<br>Baillie Gifford<br>Legal and General<br>SL Capital Partners<br>Wilshire Associates<br>Grosvenor Capital<br>Hearthstone Investments<br>M & G Investments<br>Ancala Partners<br>Dalmore Capital<br>FIM Services Ltd |
| <b>Bankers:</b>                        | Clydesdale Bank  |
| <b>AVC Providers:</b>                  | Prudential and Standard Life   |
| <b>Independent Auditor:</b>            | The Auditor appointed by the Accounts Commission for Scotland for the purpose of auditing the annual report and accounts is Audit Scotland, 4 <sup>th</sup> Floor, South Suite, The Athenaeum Building, 8 Nelson Mandela Place, Glasgow, G2 1BT.   |

# Management Commentary

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## Introduction

The Local Authority Accounts (Scotland) Regulations 2014 and accompanying guidance require the Annual Report and Accounts to contain a Management Commentary including:

- an overview of Fund business
- a description of the Fund business model and Fund risks
- a review of financial performance and key strategies
- an analysis of trends
- a review of policies affecting Social, Community and Human Rights issues
- an analysis of staffing resources by gender

## Overview of Fund Business

Under the statutory provisions of the Local Government Pension Scheme, Falkirk Council is designated as an “Administering Authority” and is required to operate and maintain a pension fund - the Falkirk Council Pension Fund (“the Fund”).

The Fund is used to pay pensions, lump sum benefits and other entitlements to scheme members and their dependants. Contributions to the Fund are made by employee members and by participating employers. The Fund also receives income from its investments, which include equities, property and bonds.

The Fund operates under the terms of the Local Government Pension Scheme, which is a public sector pension arrangement. Scheme membership is made up of active, deferred and pensioner members. To join the scheme, a person must be employed by a local authority or designated body and not be eligible to join another public sector scheme.

Employers who participate in the Fund are either Scheduled Bodies – in which case they are required to offer the Scheme to their employees, or Admission Bodies – in which case the body has applied to participate in the Fund and their application has been accepted.

The larger Fund employers are Clackmannanshire, Falkirk and Stirling Councils, the Scottish Environment Protection Agency (SEPA), the Scottish Children’s Reporter Administration (SCRA) and Scottish Autism. Other employers include several non-profit making charitable bodies located in Central Scotland, as well as two contractors (Amey and Forth and Oban Ltd) to whom school facilities maintenance has been transferred.

In addition to Fund employers, key partners include local authorities, actuaries, banks, government agencies, fund managers, legal advisers, communications specialists, corporate governance and litigation specialists, and various other financial institutions.

## Business Model and Risk

Falkirk Council Pension Fund is managed and administered from the Municipal Buildings in Falkirk.

The majority of the Fund's activities are managed in-house by the Council's Pensions Section, which is accountable to the Pensions Committee, the Pension Board, Fund Employers and Scheme Members.

The in-house team is committed to providing a quality service to meet the needs of the Fund's diverse stakeholders and to delivering high standards of customer care.

Pension Fund activity can be split into the following categories:

- Membership and Benefits Administration
- Investment Management
- Governance
- Funding and Accounting
- Communications

**Membership and Benefits Administration** is undertaken internally by the Council's Pensions Section. For more detailed information on this activity, turn to the Administration Section on Page 24.

**Investment Management** of the Fund's assets is undertaken by external fund managers and overseen by the Pensions Section with the support of Hymans Robertson, the Fund's Investment Advisor. A review of Investment activity is provided on Page 31.

Additional support is provided via a Shared Service resourcing agreement with the Lothian Pension Fund.

**Governance** is undertaken by the Pensions Committee to whom Fund business has been delegated by Falkirk Council. This includes the appointment and monitoring of investment managers. The Committee is supported by a Pension Board to ensure that its decisions are made within the terms of the Scheme rules and in accordance with good practice. More information on the Governance process can be found in the Governance Section on Page 19.

**Funding and Accounting** matters are undertaken internally by the Pensions Section with the assistance of Hymans Robertson, the Fund Actuary.

**Communication** is delivered via a dedicated Pension Fund website ([www.falkirkpensionfund.org](http://www.falkirkpensionfund.org)), through members mailshots, or by messaging pensioners through regular pension advice slips.



Awareness of risk and risk mitigation is a key facet of the Fund's strategic and operational activities. Whilst it is not possible to eliminate risk entirely, the Fund has taken steps to evaluate risk and put strategies in place to minimise its adverse effects.

A risk register is maintained and can be viewed at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications section. An update on risk is a standing item at quarterly Pensions Committee meetings. More information on Risk can be found at Page 29 of this report.

The Pensions Section also provides a calculation and payments service for Fund employers in respect of Compensatory Added Years awarded under the Local Government (Discretionary Payments and Injury Benefits)(Scotland) Regulations 1998. These payments are met in full by the former employer on a pay as you go basis and do not form part of Falkirk Council Pension Fund's liabilities.

## Financial Performance

2015/16 has been a challenging year for the Fund's investments. A return of 1.5% was achieved over the year which was 1.2% above the Fund benchmark of 0.3%. Whilst the 1.5% was ahead of the return that could have been achieved by investing solely in cash, it was behind the Fund's long term strategic funding requirement of 6% per annum.

One year is however a very short period over which to assess performance with 3 and 5 year returns being a more realistic timeframe. 3 year and 5 year performance returns are 7.2% and 8.2% respectively. Other performance information is available on Page 33.

Fund assets at 31 March 2016 were slightly in excess of £1.8 billion, a modest increase of £38m over the year, reflecting the variable market conditions for investors.

Fund liabilities also increased and were estimated to have risen from £2.2bn at 31 March 2015 to £2.4bn at 31 March 2016 mainly as a result of the continuing trend of falling gilt yields. The liabilities have been estimated by the Fund Actuary rolling forward cash flows and investment returns from the 2014 triennial valuation. The £2.4bn does not appear in the financial statements as the statements do not take account of the Fund's obligations to pay pensions after the 31 March 2016.

The net increase in liabilities means that the deficit increased from £283m at the 2014 valuation to £550m. Despite the increase, the Fund has a robust funding strategy in place and regular funding reviews are undertaken to ensure that the Fund's deficit remains manageable.

On the benefits side, contributions increased by £1.3m due to the fact that most employers were scheduled to pay a higher contribution rate in 2015/16 in keeping with their funding schedules. Transfers in and contribution refunds were down from 2014/15 reflecting a slowdown in member turnover, attributable to recruitment restraints within the public sector.

## Actuarial Valuation as at 31 March 2014

An actuarial valuation of the Fund takes place every three years and acts as an independent financial health check to determine how much money needs to be paid into the Fund by employers so that it can continue to pay benefits both now and in the future.

The most recent valuation of the Fund took place at 31 March 2014 and set the contribution rates to be paid by Fund employers for the 3 years between 1 April 2015 and 31 March 2018. The valuation showed that the Fund was 85% funded, meaning that it had 85% of the monies needed to pay the benefits of scheme members based on the rights they had accumulated to that date.

The key results from the 2014 valuation were as follows:

|                                 | Valuation at<br>31/03/2014 |
|---------------------------------|----------------------------|
| <b>Past Service Liabilities</b> | £1,860m                    |
| <b>Assets</b>                   | £1,577m                    |
| <b>Funding Deficit</b>          | £283m                      |
| <b>Funding Level</b>            | 84.8%                      |

|                                    |              |
|------------------------------------|--------------|
| <b>Future Service Cost</b>         | 17.9% of pay |
| <b>Past Service Cost</b>           | 5.5% of pay  |
| <b>Total Employer Contribution</b> | 23.4% of pay |

The valuation disclosed that asset performance over the 3 years to March 2014 had been significantly better than the return targeted by the Actuary (28% return against a target of 19%). However, this had been outstripped by an increase in fund liabilities arising from the sharp decline in the yield on government bonds – the yardstick used to measure fund liabilities. As a result, the deficit at March 2014 was £283m. (£194m at March 2011)

As part of the Fund's risk management process, the Pensions Manager and the Actuary met individually with fund employers to discuss the valuation results and each employer's funding position.

Since March, 2014, the continuing fall in gilt yields and the less than expected return on assets during 2015/16 has resulted in the funding level falling to an estimated 77% at 31 March 2016. Whilst this represents a worsening of the funding position from the 2014 valuation, it remains within the range of acceptable outcomes as prescribed in the Funding policy.

A statement by the Actuary on the current Fund actuarial position is set out at Appendix 1.

## Funding Strategy Statement

The **Funding Strategy Statement** is the formal record of how the Fund intends to meet its obligations to pay benefits.

The Fund's funding policy is to achieve a fully funded status over a 20 year period whilst keeping contribution rates as constant as possible.

A stability mechanism within the strategy helps employers budget for their short term contributions and smooth out volatility from what could be significant changes in the employer contribution rate.

The Funding Strategy Statement was last reviewed during 2014/15, the main changes being to provide greater clarity around the setting of employer contribution rates and options available should admission bodies be seeking to withdraw from the Fund.

The Pensions Committee considers that the valuation assumptions agreed with the Actuary, including an assumed investment return of gilts plus 1.6%, result in the Fund having a realistic and credible funding plan.

The Funding Strategy Statement can also be found at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications section.

## Investment Strategy

The Investment Strategy of the Fund is to invest monies in a prudent and diversified manner, in accordance with the Scheme regulations and in recognition of the risks that accompany investment in various asset classes. The strategy is set out in the **Statement of Investment Principles** and can be viewed at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) under Forms and Publications.

The Fund's longer term strategy is to reduce its exposure to more volatile asset classes to a point where there is parity between the growth-seeking and defensive assets. The reduction in growth seeking assets will however only take place when market conditions are attractive and the Fund is ahead of schedule in repairing its funding deficit which, at the 2014 valuation, was assessed at £283m.

The investment strategy also requires that asset allocation be sufficiently prudent so as give the Fund a reasonable chance of being fully funded over 20 years but also minimise the chance of the Fund finding itself in a poor funding position. These aims are expressed through the following funding objectives:

### Short Term Objective

- The probability of the funding level being below 70% at the 2017 valuation should be less than 20%.

## Long Term Objectives

- The probability of the funding level being under 60% in 2035 should be less than 20%.
- The probability of being fully funded by 2035 (measuring liabilities on a gilts plus 1.6% basis) should be more than 75%.

A review of asset allocation and manager performance was undertaken during 2015/16 by a subgroup comprising Committee members, officers and advisors. The sub group met on 5 separate occasions with members of the Board also attending in an observer capacity. The key recommendations adopted by the Committee were to increase the proportion of Fund assets allocated to infrastructure and property, and to undertake a “Smart Beta” investment.

## Performance Standards

The Fund measures its performance against a number of pre-determined standards with performance information being supplied to both CIPFA and the Scottish Government as part of an annual review across all Councils.

The performance of the Pensions Section against key standards in 2015/16 was as follows:

| Membership and Benefits Administration Cost to be less than £25 pa per member |                            |
|---|----------------------------|
| Not Achieved  | Per member cost was £29.08 |

| Meet deadlines for accounts, benefit payments, statistical returns and remittances |   |
|--|---|
| Achieved in Full   | All of the above were made within statutory time limits |

| Fund to achieve its benchmark return |  |
|--------------------------------------|--|
| Achieved in Full                     | Fund returned 1.5% against a benchmark of 0.3% |

| Fund Managers to achieve their individual benchmark returns |  |
|---|--|
| Achieved in Part  | Benchmark was exceeded in 4 out of 8 mandates – but all managers delivered positive absolute returns |

- Member costs rose in 2015/16 as a result of the on-going implementation of the new Career Average compliant pensions administration system, and the loss of income from the sponsors of Police and Fire Pension Schemes as a result of these schemes now being administered nationally.
- The installation of the new system, preparations for LGPS 2015, freedom of information requests and the strong flow of severance estimates continue to place a pressure on turnaround times for non statutory transactions.
- The Fund has now outperformed its benchmark in each of the past 5 years.

Fund Manager performance is reviewed on a quarterly basis by the Pensions Committee and by the in-house team. Whilst Manager scrutiny is a key aspect of fund stewardship, it is the strategic asset allocation that will have a greater impact on Fund returns than the ability of individual managers to deliver performance ahead of their benchmarks.

The Pensions Section prepares an Annual Budget which is reviewed and approved by the Pensions Committee. Details of the budget for 2016/17 and costs for 2015/16 are provided on Page 26 of the Annual Report and on Page 62 in Note 11 in the Accounts Section of this report.

## **Trends and Influences - Administration**

- The introduction of the Career Average version of the Local Government Pension Scheme from April, 2015 continues to be the single most significant factor affecting the activities of the administration team.
- To enable compliance with the new arrangements, a new administration system – *Altair* - was introduced in March, 2015. The system was procured using a national framework agreement and is supported and maintained by Pension Consultants, Heywood. It is the system used by the majority of UK local authority funds.
- Further strands of the Altair project are scheduled to be rolled out over the next 18 months, including the transfer of the pensioner payroll to Altair and the introduction of Self Service facilities.
- The UK Government's pension initiatives - freedom and choice, auto enrolment and the abolition of contracting out – mean that the tempo of pensions reform remains brisk with challenges on a variety of fronts. The sudden announcement of a change in the discount rate for public service pension schemes has also meant a moratorium on certain inter scheme transfers.
- The additional scrutiny of administration activities by the Pension Regulator and the Scheme Advisory Board may require Funds to review their staffing complements.
- The pressures on public spending mean that a high volume of member and employer retirement estimates can be expected. These same pressures may prompt some employers to explore leaving the scheme. The Fund will work with employers to ensure that any exits are carefully managed in order to minimise the impact on remaining employers.

## **Trends and Influences - Investment**

- The continuing environment of low interest rates and relaxed monetary policy has led to high equity valuations and low yields on fixed interest securities. Against this backdrop, investment managers are likely to face the same challenges to find risk adjusted returns in 2016/17 that have been encountered in 2015/16, including stuttering global growth, sluggish demand in China and depressed oil and commodity prices.
- Markets are expected to remain volatile in the face of the EU referendum, the migrant crisis, the pending US Presidential election and uncertainty surrounding the timing of further US interest rate rises.
- 2016/17 is expected to see the further deployment of capital in relation to the Fund's Social and Affordable Housing mandate and the UK Infrastructure mandate, the latter being undertaken in collaboration with the Lothian Pension Fund.
- An initiative by the UK Government to improve investment manager selection, reduce costs and create a platform from which greater infrastructure investment may be made is currently underway in England and Wales. The Scottish Scheme Advisory Board Review is likely to consider whether a similar "pooling" initiative should be recommended in Scotland.
- A more detailed review of global market conditions in 2015/16 can be found on Page 37.

## **Trends and Influences – Governance**

- A review of the workings of Pension Boards in Scottish Public Service Schemes, including the LGPS, is expected during 2016/17.
- Training arrangements for Committee and Board members will continue to be a priority to enable appropriate knowledge and understanding obligations to be met. However, the complexion of Committee and Board may be affected by the Scottish local government elections which will be taking place in 2017.

## Social, Community and Corporate Governance Responsibilities

### Statement of Investment Principles

The Fund's approach to Environmental, Social and Corporate Governance (ESG) matters is set out in its **Statement of Investment Principles** (SIP) which can be found at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications Section. This emphasizes the Fund's commitment to key issues such as human rights and the environment.

The Fund generally does not impose any ethical restrictions on Fund Managers' capacity to invest. However, managers must take cognisance of the **Statement of Investment Principles** when constructing portfolios and are required to account for their actions and report on the extent of their corporate engagement. All managers have confirmed their commitment to advancing the principles of the UK Stewardship Code.

### Pensions and Research Consultants Ltd

To support its ESG commitments, the Fund has engaged the Pensions and Investment Research Consultants (PIRC) to provide advice and research information on all matters pertaining to corporate governance and to act as voting agents for the Fund. Motions where PIRC have consistently lodged "oppose" votes in 2015/16 include those involving governance arrangements, executive remuneration, share buy backs and auditor rotation.

### Local Authority Pension Funds Forum

The Fund considers that an effective way to exert influence on ESG matters is through membership of the Local Authority Pension Funds Forum (LAPFF). LAPFF acts for around 70 UK pension funds and seeks to promote high corporate standards amongst investee companies. Recent LAPFF campaigns to change corporate behaviour have included Executive Remuneration, Gender Equality in Boardrooms and Fossil Fuel emissions.

More information about the work of the LAPFF can be found at [www.lapfforum.org](http://www.lapfforum.org). More information about Corporate Governance matters can be found on Page 40 of this report.

### Impact Investment

In recognition of the lack of affordable housing in the UK, the Pensions Committee has investigated the possibility of making an investment in social and affordable property. Following a tendering process and consultation with the Investment Advisor in 2014, Hearthstone Investments were appointed to manage a £30m commitment.

The initiative, which has the support of the Scottish Government, is aiming to deliver a return of 7% p.a. over a 10 year period and will help secure the construction of around 190 social housing units in the Clackmannanshire, Falkirk and Stirling areas as well as additional units of affordable housing in Scotland.

The Fund is also investing in the UK economy through a £60m commitment to UK infrastructure. Thus far, investments have been made in hydro, solar and wind projects.

## Staffing Resources

The Pension Section's staffing compliment at 31/03/16 was as follows:-

### Senior Officers

|                  | No. of Males | No. of Females |
|------------------|--------------|----------------|
| Pensions Manager | 1            | 0              |

### Administration Officers

|                         | No. of Males | No. of Females |
|-------------------------|--------------|----------------|
| Pension Officers        | 1            | 1              |
| Pension Support Officer | 0            | 1              |
| Trainee Pension Officer | 0            | 1              |
| Pension Assistants      | 2            | 4              |
| Clerical Assistant      | 0            | 0.5            |

### Investment and Accounting Officers

|                      | No. of Males | No. of Females |
|----------------------|--------------|----------------|
| Fund Accountant      | 0            | 1              |
| Accounting Assistant | 0            | 0.5            |

The above resource is supplemented by a shared service Resourcing Agreement between the Fund and the City of Edinburgh Council/Lothian Pension Fund to provide additional investment and accounting expertise.

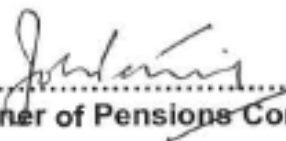
In view of current financial pressures, it is Council policy that new appointments, including appointments to the Pension Fund, are made on a temporary basis.



## Director's Report

In respect of the Fund's senior officers, the Pensions Manager was absent through ill health for 3 months in Autumn 2015. No personal data incidents or other material absences were recorded during 2015/16.

There is no need for the Pension Fund to produce a remuneration report, as the Fund does not directly employ any staff. All staff are employed by Falkirk Council, and their costs reimbursed by the Fund. However, details of the remuneration of senior management can be found at Note 24 of the Accounts.

  
.....  
**Convener of Pensions Committee**

**Date** ..... 22 / 9 / 16 .....

  
.....  
**Chief Executive**

**Date** ..... 22/9/16 .....

  
.....  
**Chief Finance Officer**

**Date** ..... 22/9/16 .....

# The Local Government Pension Scheme

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The Local Government Pension Scheme (Scotland) is a statutory pension scheme. This means that it is very secure as its benefits are defined and set out in law. Under Regulation 55 of The Local Government Pension Scheme (Scotland) Regulations 2014, all LGPS Funds are required to publish an Annual Report.

This document is the Annual Report of the Falkirk Council Pension Fund for 2015/16.

## The Local Government Pension Scheme (LGPS)

- The Local Government Pension Scheme is a nationwide pension arrangement for persons working in local government and is one of the largest public sector pension schemes in the UK with over 4 million members.
- Local Authorities and certain other public bodies are required by law to operate the Scheme. Other organisations such as charities, non-profit making entities and contractors may apply to join the Scheme.
- The Local Government Pension Scheme (Scotland) is the version of the Scheme which applies to local authorities in Scotland. Similar but separate versions of the Scheme apply in England and Wales and in Northern Ireland.
- The Scheme consists of around 100 regional pension funds across the UK – one of which is the Falkirk Council Pension Fund.
- Unlike other public sector schemes, the LGPS is a funded scheme, which means that monies have been set aside to pay for future benefits as they fall due. This helps to reduce the potential costs falling on future generations of tax payers.
- The Scheme provides a range of high quality inflation linked benefits based on members' salaries and their years' of scheme membership. Unlike other forms of pension provision, benefits do not depend on investment performance.
- Prior to 1 April, 2015, benefits in LGPS (Scotland) were calculated on a "Final Salary" basis. From 1 April, 2015, scheme benefits are being calculated on a "Career Average" basis with pre-April 2015 rights being fully protected on the final salary basis. For more information about LGPS 2015, please visit [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) or [www.scotlgps2015.org](http://www.scotlgps2015.org).



# Governance

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## Overview

Falkirk Council is the **Administering Authority** of the Falkirk Council Pension Fund and is responsible for ensuring that pension fund business is conducted in accordance with the law and proper standards, and that monies originating from scheme members and from the public purse are safeguarded and properly accounted for.

Governance arrangements are prescribed by legislation and underpinned by the **Annual Governance Statement** and the **Governance Compliance Statement**. Details of the Fund's approach to Governance can be found in the Fund's Governance Policy document at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications section. Governance arrangements are periodically reviewed and subject to consultation with stakeholders to ensure they remain relevant and effective.

Falkirk Council has delegated its pensions function to the Pensions Committee, with certain operational activities being delegated to the Chief Finance Officer. From 1 April, 2015 under the terms of the Public Service Pensions Act 2013, the activities of local authority pension funds require to be overseen by a local Pension Board. Arrangements for establishing the Fund's Pension Board were approved by Falkirk Council at its meeting on 17 December 2014. The Committee is required to meet on not less than a quarterly basis. During 2015/16, the Committee held four joint meetings, all of which were joint meetings with the Pension Board.

## Annual Governance Statement

The Local Authority Accounts (Scotland) Regulations 2014 require that all Councils conduct a review, at least once in each financial year, of the effectiveness of the system of internal control and that an Annual Governance Statement is included in the Annual Accounts. Falkirk Council has complied with both of these requirements voluntarily for some years now, underlining a commitment to openness and transparency.

The Annual Governance Statement in respect of 2015/16 is set out in full on page 88.

## Governance Compliance Statement

Regulation 53 of the Local Government Pension Scheme (Scotland) Regulations 2014 requires the Fund to publish and maintain a Governance Compliance Statement, setting out how Fund business is conducted and how stakeholders are represented in the decision making process.

The Fund's Governance Compliance Statement is set out in full on page 92.

## Pensions Committee

The **Pensions Committee** is responsible for the strategic management of the Fund's assets and the administration of members' benefits.

The Committee consists of nine members – six elected members from Falkirk Council and three members representing employer, employee and pensioner interests. The three co-opted members have full voting rights and full access to papers. The Committee meets on a quarterly basis with meetings being held mainly in public session. Members of the Committee are as follows:

|                                    |   |  |
|------------------------------------|---|--|
| Councillor John Patrick (Convener) | - | Elected Member (Falkirk Council)           |
| Councillor Jim Blackwood           | - | Elected Member (Falkirk Council)           |
| Councillor Thomas Coleman          | - | Elected Member (Falkirk Council)           |
| Councillor Steve Carleschi         | - | Elected Member (Falkirk Council)           |
| Councillor Craig Martin            | - | Elected Member (Falkirk Council)           |
| Councillor Dr Craig R Martin       | - | Elected Member (Falkirk Council)           |
| Councillor Callum Campbell         | - | Employer Representative (Stirling Council) |
| Mr Ian McLean                      | - | Pensioner Representative                   |
| Mr Andy Douglas                    | - | Trade Union Representative                 |

The Committee's key responsibilities are:-

- to oversee the administration of the Fund
- to manage the investments of the Fund
- to establish and review investment strategy
- to ensure the suitability and adequate diversification of investments
- to take proper advice in relation to investment matters
- to set the strategic asset allocation and individual manager benchmarks and targets
- to review the performance of investment managers on a regular basis
- to select and appoint investment managers and custodians as required
- to formulate and monitor a funding policy for the Fund
- to ensure the Fund is subject to actuarial valuations as required
- to agree a Pension Fund Budget and monitor performance against outturn
- to approve the Annual Report and Accounts

(Councillors Blackwood, Carleschi, Dr CR Martin and Mr Douglas were active members of the Scheme during 2015/16. Councillor Patrick and Mr McLean are pensioner members of the Scheme).

The Committee is supported at its meetings by officers and professional advisers. External Auditors were also in regular attendance at the 2015/16 meetings.

## Pension Board

The Public Service Pensions Act 2013 requires that a local Pension Board is established from 1 April 2015 to assist the Scheme Manager (i.e. in this case Falkirk Council) in securing compliance with the scheme rules and with the Pension Regulator's Codes of Practice.

Prior to the establishment of a Pension Board, member and employer representation was provided through an advisory Pensions Panel. With the coming into effect of the new governance arrangements, and following consultation with stakeholders, the decision was taken to wind up the Pensions Panel.

The Pension Board comprises eight members - four Trades Union and four employer representatives. This meets the requirements of both the Public Service Pensions Act 2013 and the Local Government Pension Scheme (Scotland)(Governance) Regulations 2014. The Board generally meets in conjunction with the Pensions Committee but can choose to meet on its own.

The Trades Union members are drawn from the four main Unions representing Scheme members, namely Unison, Unite, GMB and UCATT. The four employer representatives are drawn from the largest Fund employers not already represented on the Pensions Committee.

Board Members during 2015/16 were as follows:

|                                    |   |  |
|------------------------------------|---|--|
| Councillor Archie Drummond (Chair) | - | Employer Rep. (Clackmannanshire Council) |
| Mr Gordon Laidlaw                  | - | Employer Rep. (Scottish Autism)          |
| Mr Ed Morrison                     | - | Employer Rep. (SCRA)                     |
| Mrs Jennifer Welsh                 | - | Employer Rep. (SEPA)                     |
| Mrs Susan Crook                    | - | Union Representative                     |
| Mr Sandy Harrower                  | - | Union Representative                     |
| Mr Tommy Murphy                    | - | Union Representative                     |
| Mr Herbie Schroder                 | - | Union Representative                     |

Mr Schroder and Councillor Drummond have recently resigned from the Board for reasons other than Pension Board business. Replacements are in the process of being appointed.

## **Training for those with Governance Responsibilities**

The Fund's training policy recognises that those persons involved in the governance of the Fund should have the necessary level of skills and knowledge to allow them to carry out their duties effectively.

Various seminars, conferences and in-house training events have been made available for Committee and Board members to attend. During 2015/16, these have included:

19/04/2015 – Annual Conference, Callendar House, Falkirk

19/10/2015 – Training for Pension Board members

03/03/2016 – Training Session on Investment Strategy

Further educational insight has been provided during the year through the visits of Fund Managers and Pensions Specialists to attend Committee and Board meetings.

Training arrangements for 2016/17 will continue to be broad based in order to support member decision making.

## **Conflict of interests**

A conflict of interest occurs where there is the existence of a financial or other interest which is likely to prejudice the way a person exercises their functions as a member of the Committee or Board but does not include a financial or other interest arising merely by virtue of being a member of the scheme.

There is a standing agenda item at each Pensions Committee or Board meeting for Members to declare any such interests. Any declarations are minuted.

## **Accountability and Transparency**

Pensions Committee agendas, reports and minutes are published on the Falkirk Council website at <https://www.falkirk.gov.uk/coins/default.asp>.

Pensions Committee meetings are open to members of the public (with the exception of commercially sensitive private items).

## **Data Security**

Falkirk Council Pension Fund is responsible for a lot of personal data and sensitive information. We aim to comply with the Information Security Policy adopted by Falkirk Council and in doing so, have the following arrangements in place to safeguard this data:

- All staff are regularly reminded of their obligations in respect of Confidentiality, Data Protection and Information Security

- New staff have these responsibilities and policies explained to them as part of their induction and their understanding is checked
- Where paper records are being converted to electronic images, paper records are securely destroyed
- Encrypted laptops are provided to staff who work away from the office, as part of their regular role or as part of our business continuity plan
- Where data has to be transferred off site we use either secure FTP, VPN, or password protection
- Our administration system complies with the standards contained in ISO/IEC 27001 information security management
- We have Data Processing Agreements in place with our third party processors
- We aim to have Data Sharing Agreements in place with our constituent employers within the next two years

## Communications

Communication with stakeholder groups is achieved through emails, publication of committee minutes, newsletters, payslip messaging and the pension fund website. The range of topics covered includes actuarial matters, benefits and regulatory changes, investment performance and investment manager/adviser presentations.

The following documents can be viewed or downloaded from the Falkirk Council Pension Fund website at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org):

- Annual Report and Accounts
- Member Newsletters
- Funding Strategy Statement
- Governance Framework Document
- Statement of Investment Principles
- Valuation Reports

## More Information

Copies of the **Statement of Investment Principles**, the **Funding Strategy Statement** and the **Governance Policy** document are available from the Chief Finance Officer, Falkirk Council, Municipal Buildings, West Bridge Street, Falkirk FK1 5RS or at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org).

# Scheme Administration

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## Outline

The aim of the Pensions Section is to provide an efficient and cost effective administration service that meets stakeholders' needs.

The Section consists of 12 full-time equivalent staff and is headed by the Pensions Manager, who reports directly to the Chief Finance Officer. In addition to benefits administration, some staff members undertake governance, accounting, and investment related activities.

The Section is made up as follows:

| Role                     | Nos. | Average Years of Pensions Service | Pensions/Financial Qualification |
|--------------------------|------|-----------------------------------|----------------------------------|
| Pensions Manager         | 1    | 33 years                          | Yes                              |
| Fund Accountant          | 1    | 1 year                            | Yes                              |
| Pensions Officers        | 2    | 30 years                          | Yes (1)                          |
| Pensions Support Officer | 1    | 25 years                          | No                               |
| Accountancy Assistant    | 0.5  | 12 years                          | No                               |
| Trainee Pensions Officer | 1    | 2 years                           | Yes                              |
| Pensions Assistants      | 6    | 8 years                           | No                               |
| Clerical Assistant       | 0.5  | 2 years                           | No                               |
| Total                    | 13   |                                   |                                  |

The principal activities of the Pensions Section are:

- to set the strategic direction for all aspects of the service
- to support the Pensions Committee and Pensions Board
- to implement the Fund's investment strategy
- to manage and oversee the investment of Fund monies
- to implement the Fund's funding strategy
- to prepare and maintain Pension Fund Accounts
- to undertake all Fund administration obligations, including the collection of contributions and the payment of benefits
- to provide information, guidance and communications material to Fund stakeholders

## Service Planning

The Section operates within a three-year Service Development Plan which is linked to the Council's overall Service Plan.



## Professional Development

The members of staff who work for us are the Fund's greatest assets and are valued accordingly.

We invest in the continuing professional development of staff, for the benefit of our stakeholders and the Fund overall.

The Council holds Investors in People accreditation.

## Equality and Diversity

It is the policy of Falkirk Council to ensure that all its employees are selected, trained and promoted on the basis of their ability, the requirements of the job and other similar non-discriminatory criteria. All employment decisions are based purely on relevant and objective criteria.

We aim to deliver accessible, high-quality and value for money services to all our customers, without discrimination on grounds of group memberships; for example sex, race, disability, sexual orientation, religion, belief or age.

## Systems

All Pensions Section staff have access to up to date computer hardware and operating systems. In addition to normal desktop software, the range of services provided by the Section requires it to have access to the following systems:

| System  | Database  | Purpose                      |
|---|-----------|------------------------------|
| External Pensions Administration System (Heywood) | Web Based | Pensions Administration      |
| Resourcelink (Northgate)                          | Oracle    | Pensioner Payroll            |
| Integra   | Oracle    | Financial Information System |
| Passport (Northern Trust)                         | Web Based | Custodian Information        |
| Clydesdale Bank                                   | Web Based | Fund Banking Information     |

During Spring 2015, records were migrated from the in-house administration system to an externally hosted system. This process was undertaken in consultation with the Council's Internal Audit team.

Asset valuations are available to the Pensions Section via the Passport application of Fund Custodian, Northern Trust. This is complemented by the web based applications of the Fund's investment managers allowing up to date valuations and reports to be obtained.

## Pension Section Budget

A summary of the Pension Section's administrative expenditure for 2015/16, together with the approved budget for 2016/17, is shown in the table below.

The budget focuses on controllable expenditures and thus excludes benefit payments and transfers of pensions from the Fund. Similarly, income does not include contributions receivable and pension transfers to the Fund.

| Pension Fund                          | Budget<br>15/16  | Actuals<br>15/16 | Variance<br>15/16 | Budget<br>16/17  |
|---------------------------------------|------------------|------------------|-------------------|------------------|
| <b>Benefits Administration</b>        |                  |                  |                   |                  |
| Employee Expenses                     | 321,460          | 332,166          | 10,706            | 325,460          |
| Pensions Administration System        | 400,000          | 392,932          | (7,068)           | 250,000          |
| Other                                 | 75,950           | 129,970          | 54,020            | 77,670           |
| <b>Total</b>                          | <b>797,410</b>   | <b>855,068</b>   | <b>57,658</b>     | <b>653,130</b>   |
| <b>Oversight and Governance Costs</b> |                  |                  |                   |                  |
| Shared Services-Lothian               | 120,000          | 157,615          | 37,615            | 120,000          |
| Actuarial Fees                        | 40,000           | 26,105           | (13,895)          | 90,000           |
| Tax Advice and Legal fees             | 60,000           | 75,128           | 15,128            | 100,000          |
| Employee Expenses                     | 96,020           | 96,394           | 374               | 97,210           |
| Investment Advisory                   | 80,000           | 91,101           | 11,101            | 90,000           |
| Other                                 | 59,710           | 81,066           | 21,356            | 61,620           |
| <b>Total</b>                          | <b>455,730</b>   | <b>527,409</b>   | <b>71,679</b>     | <b>558,830</b>   |
| <b>Investment Management</b>          |                  |                  |                   |                  |
| Managers Fees                         | 5,040,280        | 5,022,887        | (17,393)          | 5,655,000        |
| Custodian Costs                       | 120,000          | 117,119          | (2,881)           | 120,000          |
| Aborted Deal Costs                    | 0                | 0                | 0                 | 150,000          |
| <b>Total</b>                          | <b>5,160,280</b> | <b>5,140,006</b> | <b>(20,274)</b>   | <b>5,925,000</b> |
| <b>Pension Fund Total</b>             | <b>6,413,420</b> | <b>6,522,483</b> | <b>109,063</b>    | <b>7,136,960</b> |

The main variance between budgeted and actual amounts related to:

- Shared Services costs arising from due diligence on infrastructure investments
- Loss of income from administration recharges to Police and Fire Services
- Savings from fund managers fees (arising from fee discount negotiated with Aberdeen Asset Management)

Allowances have been made in the 2016/17 budget for:

- Reduction in Pension Administration System costs
- Increase in actuarial fees, as we are approaching a valuation year
- Increase in tax and legal fees in anticipation of further infrastructure investments

The budget for Investment Management Expenses in 2016/17 has been set at £5.9m and reflects the average level of fees over the past three years.

## Review of 2015/16 Administration

### LGPS 2015

2015/16 has been dominated by the introduction of the Career Average version of the Scheme and the establishment of the new Pension Boards.

To ensure compliance with the new benefit structure, a replacement pension administration system was procured during 2014/15. The new system was bedded in successfully during 2015/16 and, although further development is being undertaken in 2016/17, the new system has enabled essential calculations such as employer estimates and retirement and death benefits to be maintained during the year.

A series of on-site training sessions were provided to staff during the year to ensure their familiarity and competency with the new administration system.

### Other Miscellaneous

- Letters informing members about the abolition of contracting out and the latest reductions in the Lifetime and Annual Allowances were issued to all members.
- Initial work relating to the reconciliation of contracting out records was undertaken.
- The Fund operates an Internal Dispute Resolution Procedure (IDRP) which is defined by statute. This is used where a member disagrees with the benefits awarded or a decision made by their employer which affected their benefits. The majority of IDRP appeals during 2015/16 related to potential ill-health retirement claims. Details of the IDRP process can be found in the forms and publications area of our website at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org).

### Online services

We have our own website at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org). The website is split into areas for active, deferred and retired scheme members, as well as containing forms, scheme guides and information about a range of scheme features.

The screenshot shows the homepage of the Falkirk Council Pension Fund website. At the top right, there are links for 'Forms and Publications | Topping-up | LGPS 2015 | Employers Site'. The main header features the Falkirk Council logo and the text 'Falkirk Council Pension Fund'. Below this is a navigation menu with links: 'Home', 'Paying in', 'No longer paying in', 'Pensioners', 'Joining', 'Understanding pensions', 'About us', and 'News'. The main content area has a large 'Welcome' banner with a background image of a building. Below the banner are four columns of links: 'I am an active member' (Currently working and paying into the Pension Scheme), 'I am a deferred member' (No longer paying into the Pension Scheme but not yet retired), 'I am a pensioner' (Getting a pension from the Pension Scheme), and 'I am being auto-enrolled' (Find out more about automatic enrolment and what it means for you).

## Analysis of Membership

Membership numbers are most commonly affected by persons joining or leaving the Scheme as part of normal staff turnover. From time to time, however, there can be more significant membership movements resulting from factors such as economic circumstances, staff transfers, and Government initiatives.

The balance of membership between non-pensioners and pensioners is an important indicator of the maturity of the Fund in terms of whether the Fund can continue to pay benefits from its regular contribution inflow or whether it may be forced to sell assets in order to pay on-going benefits.

Recent membership movements show that:

- Active membership has remained broadly stable during 2015/16, whilst deferred and pensioner numbers have risen in line with the challenging financial environment and persistence of early retirement initiatives across fund employers.
- The influx of new active members which occurred with the introduction of auto enrolment has levelled off. This combined with the net increase in pensioner members has led to a slight but not yet significant maturing of the Fund's membership profile.

### Split of Membership between Actives, Deferreds and Pensioners

|                  | 2011/12       | 2012/13       | 2013/14       | 2014/15       | 2015/16       |
|------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Active</b>    | <b>12,668</b> | <b>12,880</b> | <b>14,690</b> | <b>14,589</b> | <b>14,595</b> |
| <b>Deferred</b>  | <b>5,085</b>  | <b>5,204</b>  | <b>5,320</b>  | <b>5,405</b>  | <b>5,430</b>  |
| <b>Pensioner</b> | <b>8,119</b>  | <b>8,372</b>  | <b>8,693</b>  | <b>8,995</b>  | <b>9,374</b>  |
| <b>Total</b>     | <b>25,872</b> | <b>26,456</b> | <b>28,703</b> | <b>28,989</b> | <b>29,399</b> |

|  |               |               |               |               |
|--|---------------|---------------|---------------|---------------|
| <b>Maturity Level</b><br>(% of Deferred & Pensioner<br>Members to Total Members) | <b>51.32%</b> | <b>48.82%</b> | <b>49.67%</b> | <b>50.36%</b> |
|--|---------------|---------------|---------------|---------------|

### Split of Membership between Scheduled and Admission Bodies

|                  | 2011/12       | 2012/13       | 2013/14       | 2014/15       | 2015/16       |
|------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Scheduled</b> | <b>23,583</b> | <b>24,045</b> | <b>26,055</b> | <b>26,160</b> | <b>26,311</b> |
| <b>Admission</b> | <b>2,289</b>  | <b>2,411</b>  | <b>2,648</b>  | <b>2,829</b>  | <b>3,088</b>  |
| <b>Total</b>     | <b>25,872</b> | <b>26,456</b> | <b>28,703</b> | <b>28,989</b> | <b>29,399</b> |

# Risk Management

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## Overview

Pension fund management is not immune from risk. This may be the risk faced by the Fund as an investor through Fund Manager ineptitude or corporate malpractice, or it may be related to the Fund's administrative functions in which case the risks may relate to systems failures or regulatory breaches. Whilst it is not possible to eliminate risk completely from day to day activity, the nature of risk has been evaluated and strategies put in place to minimise the adverse effects. These are set out in the following documents:

- the Pension Fund Risk Register
- the Fund's Statement of Investment Principles
- the Operational Risk Management Action Plan
- the Finance Business Continuity Plan

## Risk Register

The Pension Fund Risk Register identifies risks related to the Fund's administrative and investment functions. Other Risk Plans describe the more detailed actions that would be taken in the event of emergency situations occurring.

The Pension Fund Risk Register is a standing item at the quarterly meetings of the Pensions Committee and Pension Board. Individual risks and proposed mitigations are identified by the Chief Finance Officer and Pensions Manager with the support of fund advisers. The areas of greatest risk identified during 2015/16 are set out below:

- Funding position affected by falling asset values or falling bonds yields
- Investment Strategy may be inappropriate
- Failure to meet statutory deadlines
- Members' confidential data is lost or made public
- Investment Managers may not have appropriate control framework in place
- Committee and Board members have inadequate knowledge and understanding
- Staff unable to perform duties due to systems failure

The current risk register, including mitigations, can be viewed on the Fund website at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications section.

## Investment Risk

The various types of investment risk to which the Fund is exposed is set out in the **Statement of Investment Principles**. These risks include price risk, currency risk, counterparty risk, interest rate risk and inflation risk. **The Statement of Investment Principles** is updated whenever there is a material change in investment strategy.

The decisions taken as a result of the recent investment strategy review will shortly be reflected in an updated version of the Statement of Investment Principles.

A key risk faced by the Fund is ensuring the responsible stewardship of its monies by each of its external Fund managers. Reassurance is sought through regular meetings with the managers, through dialogue with the Fund's investment advisor and through the procurement of the managers' audited compliance and control reports.

Details of the control reports (or equivalent) obtained in 2015/16 are as follows:

| Fund manager                         | Type of assurance       | Control Framework    | Compliance with controls | Reporting accountant |
|--------------------------------------|-------------------------|----------------------|--------------------------|----------------------|
| Aberdeen Asset Management            | AAF 01/06               | Reasonable assurance | Reasonable assurance     | PWC LLP              |
| GCM Customised Fund Investment Group | SSAE16 (AT Section 801) | Reasonable assurance | Reasonable assurance     | EY LLP               |
| Legal & Genaral                      | AAF 01/06/ISAE3402      | Reasonable assurance | Reasonable assurance     | PWC LLP              |
| M&G                                  | ISAE 3402               | Reasonable assurance | Reasonable assurance     | EY LLP               |
| Newton Investment Management         | ISAE3402/SSAE16         | Reasonable assurance | Reasonable assurance     | KPMG LLP             |
| Schroder Investment Management       | ISAE 3402/AAF 01/06     | Reasonable assurance | Reasonable assurance     | PWC LLP              |
| SL Investments                       | ISAE 3402/AAF 01/06     | Reasonable assurance | Reasonable assurance     | PWC LLP              |
| Baillie Gifford                      | ISAE 3402/AAF 01/06     | Reasonable assurance | Reasonable assurance     | KPMG LLP             |
| IPES (fund administrator for Ancala) | ISAE 3402               | Reasonable assurance | Reasonable assurance     | EY LLP               |

Investment risk is also referred to in the Notes to the Financial Statements and as a consequence, Committee and Board are alerted to these matters at least twice annually when considering the unaudited and audited accounts. This information can be found in Note 17 on Page 73.

The Fund also complies with the six revised Myners' principles. A summary of the level of compliance is included in the **Statement of Investment Principles** which can be viewed on the Fund website at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org).

# Investment Policy and Performance

## Investment Overview

The Administering Authority invests the Fund in compliance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2010. The Fund's investment advisor is Hymans Robertson LLP.

The Fund's investment policy is set out in its **Statement of Investment Principles**, which can be found on the Fund website under Forms and Publications at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org).

During 2015-16, the following investment managers managed the Fund's assets:

| Manager                        | Mandate                          |
|--------------------------------|----------------------------------|
| Aberdeen Asset Management      | Global Equities – Active         |
| Legal & General (L&G)          | Global Equities - Passive        |
| Newton Investment Management   | Global Equities – Active         |
| Schroder Investment Management | UK Equities                      |
| Baillie Gifford                | Global Fixed Income - Active     |
| Baillie Gifford                | Diversified Growth               |
| Ancala Partners                | UK Infrastructure                |
| Dalmore Capital                | UK Infrastructure                |
| FIM                            | UK Infrastructure                |
| Grosvenor Capital              | Global Infrastructure            |
| Hearthstone Investments        | UK Social and Affordable Housing |
| Schroder Investment Management | UK & European Property           |
| M&G                            | UK Private Debt                  |
| SL Capital Partners            | UK & European Private Equity     |
| Wilshire Associates            | Global Private Equity            |

Manager returns are measured against various benchmarks, the main ones being:

| Manager                            | Mandate                                |
|------------------------------------|--|
| Aberdeen Asset Management          | MSCI All Countries World Index         |
| Baillie Gifford Bonds              | Customised UK Fixed Interest Benchmark |
| Baillie Gifford Diversified Growth | UK Bank of England Base Rate           |
| Legal & General (L&G)              | Customised Global Equities Benchmark   |
| Newton Investment Management       | MSCI All Countries World Index         |
| Schroder UK Equities               | FTSE All Share Index                   |
| Schroder Property                  | AREF/IPD UK Quarterly Property         |



## Investment Strategy

The Fund's investment objective is to hold a broad range of assets, balancing risk and reward, and managing the assets prudently and effectively in order to minimise the burden of costs falling on employers and tax payers.

The current investment strategy began in 2012 when it was agreed that the Fund should begin to reduce its strategic allocation to traditional investments such as Equities and Bonds and increase its exposure to Alternative Assets, including Diversified Growth and Infrastructure.

This restructuring led to the appointment of Baillie Gifford to manage a Diversified Growth mandate and Credit Suisse (now Grosvenor Capital) to manage a Global Infrastructure mandate.

Throughout 2015/16 the Fund has continued to build upon this strategy of alternatives diversification, making a further \$80m commitment to Global Infrastructure and a further £30m commitment to UK Infrastructure, the latter in collaboration with the Lothian Pension Fund.

In spite of the significant allocation to alternatives, the Fund's actual equity allocation continues to exceed its strategic allocation due to the performance of global equity markets compared to other assets over the past four years.

A comparison of the strategic allocation of Fund Assets with the actual allocation at 31 March 2016 is set out below:

| <b>Asset Class</b>               | <b>Strategic Allocation</b> | <b>Actual Allocation at 31/3/2016</b> |
|----------------------------------|-----------------------------|---------------------------------------|
| <b>Equities</b>                  | 60%                         | 62%                                   |
| <b>Bonds</b>                     | 10%                         | 9%                                    |
| <b>Property</b>                  | 10%                         | 8%                                    |
| <b>Diversified Growth</b>        | 10%                         | 11%                                   |
| <b>Social/Affordable Housing</b> | 1%                          | 1%                                    |
| <b>Other Alternatives</b>        | 9%                          | 9%                                    |
| <b>Totals</b>                    | <b>100%</b>                 | <b>100%</b>                           |

Within "Other Alternatives", the Fund is holding a 1.8% allocation to cash in anticipation of making imminent investments in Social and Affordable Housing and Infrastructure.

A review of investment strategy has taken place during 2015/16. The review took cognisance of actuarial evidence which indicated that the Fund could continue to reduce its exposure to riskier assets without compromising its prospects of reaching fully funded status in the medium to long term.



The key recommendations emerging from the review are as follows:

- to reduce the equity allocation
- to increase the infrastructure and property allocations
- to undertake a “Smart Beta” investment
- to refrain from further private equity investments

## Investment Monitoring

Regulation 10 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) 2010 (SSI 2010/233) requires the regular monitoring and review of investment managers’ performance.

The Pensions Committee meets on a quarterly basis to review manager actions and performance. Two managers invariably present at the quarterly meeting with Committee members and advisers having the opportunity to hold managers to account for their activities.

The in-house team also has regular meetings with fund managers to discuss performance, process and strategy. This helps to ensure that appropriate oversight and control is being exercised by the Fund. A Resourcing Agreement is in place with the Lothian Pension Fund to provide additional support in the areas of manager monitoring and performance.

## Investment Performance

The Fund’s total returns over the short, medium and long term are set out below.

|                         | 2015/16<br>% | 3 years<br>% per<br>annum | 5 years<br>% per<br>Annum | Inception<br>% per<br>annum |
|-------------------------|--------------|---------------------------|---------------------------|-----------------------------|
| <b>Fund Return</b>      | 1.5%         | 7.2%                      | 8.2%                      | 7.2%                        |
| <b>Benchmark Return</b> | 0.3%         | 6.0%                      | 6.4%                      | 6.8%                        |
| <b>Excess</b>           | 1.2%         | 1.2%                      | 1.8%                      | 0.4%                        |

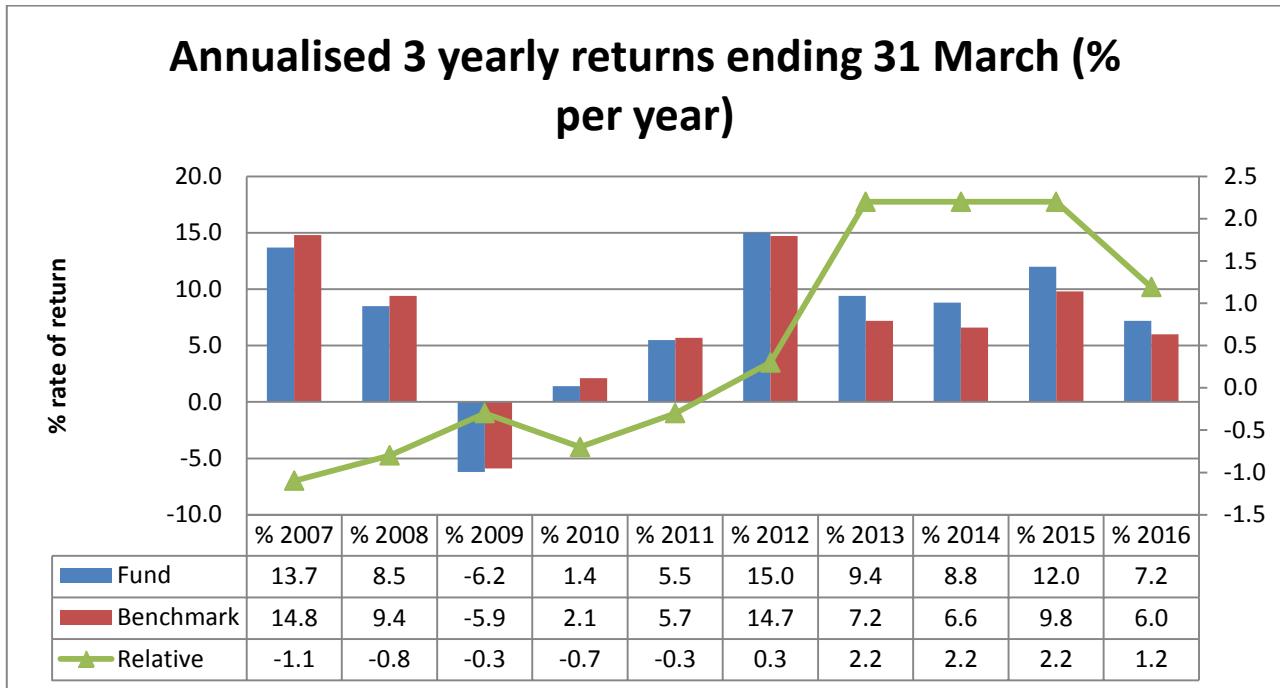
“Inception” records performance from 2001 when the current custodian appointment was made.

The Fund’s performance remains ahead of benchmark across all time periods. The table below compares Fund returns with an indicator of inflation.

|                                  | 2015/16<br>% | 3 years<br>% per<br>annum | 5 years<br>% per<br>annum | Inception<br>% per<br>annum |
|----------------------------------|--------------|---------------------------|---------------------------|-----------------------------|
| <b>Fund Return</b>               | 1.5%         | 7.2%                      | 8.2%                      | 7.2%                        |
| <b>Retail Price Index</b>        | 1.6%         | 1.7%                      | 2.4%                      | 2.8%                        |
| <b>Consumer Price Index</b>      | 0.5%         | 0.7%                      | 1.7%                      | 2.2%                        |
| <b>National Average Earnings</b> | 1.9%         | 2.5%                      | 1.6%                      | 2.9%                        |

\* Inception date 30/09/2001

The Fund's historic performance is further illustrated by the following graphic which sets out the 3 year rolling average returns over the past 10 years. The chart shows that there has been significant volatility of returns over the past decade covering in particular the global financial crisis of 2008/09 and subsequent resurgence in asset values.



**Annualised 3 yearly returns ending 31 March (% per year)**

|                  | Mar-07 % | Mar-08 % | Mar-09 % | Mar-10 % | Mar-11 % | Mar-12 % | Mar-13 % | Mar-14 % | Mar-15 % | Mar-16 % |
|------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| <b>Fund</b>      | 13.7     | 8.5      | -6.2     | 1.4      | 5.5      | 15.0     | 9.4      | 8.8      | 12.0     | 7.2      |
| <b>Benchmark</b> | 14.8     | 9.4      | -5.9     | 2.1      | 5.7      | 14.7     | 7.2      | 6.6      | 9.8      | 6.0      |
| <b>Relative</b>  | -1.1     | -0.8     | -0.3     | -0.7     | -0.3     | 0.3      | 2.2      | 2.2      | 2.2      | 1.2      |

## Manager Returns

The Fund's investment managers had the following performance against benchmark over 2015/16:

| Fund Manager                 | Mandate                       | 1 Year % | Benchmark % | Excess % |
|------------------------------|-------------------------------|----------|-------------|----------|
| Aberdeen Asset Management    | Global Equities – Active      | -4.9     | -0.7        | -4.2     |
| Baillie Gifford              | Fixed Interest                | 0.6      | 1.6         | -1.0     |
| Baillie Gifford              | Diversified Growth            | -0.9     | 0.5         | -1.4     |
| Legal & General              | Global Equities – Passive     | -1.6     | -1.7        | +0.1     |
| Newton Inv. Management Ltd   | Global Equities – Active      | 8.9      | -0.8        | +9.7     |
| Schroder Inv. Management Ltd | UK Equities – Active          | -4.8     | -3.9        | -0.9     |
| Schroder Inv. Management Ltd | Property                      | 11.2     | 10.6        | +0.6     |
| Alternatives                 | Private Equity/Infrastructure | 13.2     | 0.4         | +12.8    |

n.b. The Hearthstone Social/Affordable Housing mandate has been running less than one year and is therefore not listed above

## Comments on 2015/16 Manager Performance

- It was a mixed year for a number of the Fund's managers with the benefits of diversification being to the fore as Property and Alternatives compensated for poorer returns from equity managers and the Diversified Growth mandate.
- Whilst 2015/16 was a challenging one for equity managers, Newton's performance in global equities was a strong one returning almost 9% against a benchmark of -0.8%. Outperformance has been driven by Newton's overweight positions in North America and Europe. The manager continues to have concerns about the levels of global debt and holds a significant level of cash as a defensive measure.
- Returns from Legal and General were in line with their benchmark.
- Aberdeen's performance continued to disappoint and they remain behind their benchmark across all relevant time periods. The Pensions Committee have agreed to retain Aberdeen at present noting that terminating the mandate would result in a crystallisation of losses. Some tentative signs of recovery have emerged in the first quarter of 2016 and Aberdeen remains committed to its philosophy of sourcing investments in strong cash generative companies undervalued by markets.
- The Schroder UK Equities mandate remains ahead of benchmark across all time periods. The returns in 2015/16 fell short of the stellar returns (18%) in 2014/15, however, this is not surprising given the manager's value approach where investment is made in companies perceived to be undervalued and unloved by markets.
- The Schroder property mandate has benefited from an improving UK economy and a rising tide of commercial property values. After much repositioning of the portfolio,

Schroder outperformed the benchmark but failed to meet the objective set for them, again largely due to the performance of the Continental European part of the portfolio.

- Baillie Gifford’s fixed interest mandate generated a small positive return for the Fund, but lagged its benchmark over the year. Attribution analysis showed that stock selection was the main detractor from performance and that none of the underlying funds managed to achieve their benchmark return. The Fund also invests in Baillie Gifford’s Diversified Growth Fund, whose objective is to produce returns 3.5% per annum above the UK base rate over rolling three year periods. It aims to achieve equity-like returns but with lower-than-equity levels of volatility. The mandate has certainly achieved its volatility target, but it has a high correlation with equity markets, which resulted in a slightly negative return over the last year.
- The Fund’s alternatives programme continued to mature as an increasing number of underlying private equity funds reached the “harvesting” stage of their evolution and delivered a strong flow of cash returns from investments made earlier in the programme. A number of new investments were made in UK infrastructure using the in-house investment team with a view to minimising fee drag and achieving better alignment with fund objectives.

### Key Investment Holdings

The Fund’s 10 largest equity holdings at 31/03/2016 are as listed below:

| Name of Stock            | Market Value as at 31/03/2016 | Sector                     |
|--------------------------|-------------------------------|----------------------------|
| CENTRICA                 | £15,515,890                   | Utilities                  |
| ROYAL DUTCH SHELL        | £14,994,629                   | Energy                     |
| BRITISH AMERICAN TOBACCO | £14,007,432                   | Consumer Staples           |
| VODAFONE GROUP           | £13,999,914                   | Telecommunication Services |
| JAPAN TOBACCO            | £13,963,889                   | Consumer Staples           |
| GLAXOSMITHKLINE          | £13,173,872                   | Health Care                |
| NOVARTIS                 | £12,055,090                   | Health Care                |
| NESTLE                   | £11,565,017                   | Consumer Staples           |
| BP                       | £11,554,425                   | Energy                     |
| ROYAL BANK OF SCOTLAND   | £11,255,797                   | Financials                 |

The scheme rules specify that the maximum holding a fund may have in a single asset is 5% of the total fund value. The Falkirk Fund’s largest single holding - in Centrica - is approximately 0.85% of fund value, which is well within the statutory ceiling.

### Cash Holdings

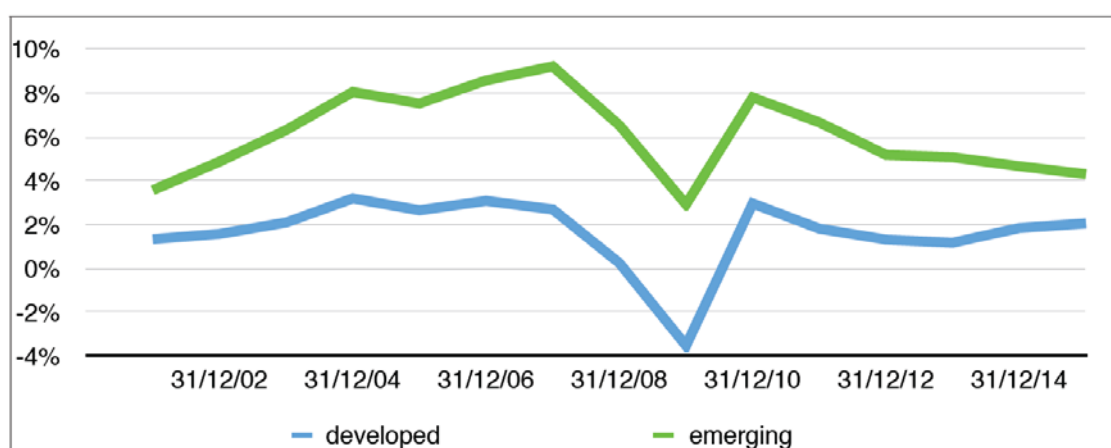
The Fund’s cash holdings with custodian Northern Trust are held in a triple A rated money market account with residual cash being swept into the account on a monthly basis. The Fund retains cash for operational purposes and opportunistic investments in blocks of around £5m with each of Santander, Standard Life, Bank of Scotland and the Clydesdale Bank.

## Investment Market Review

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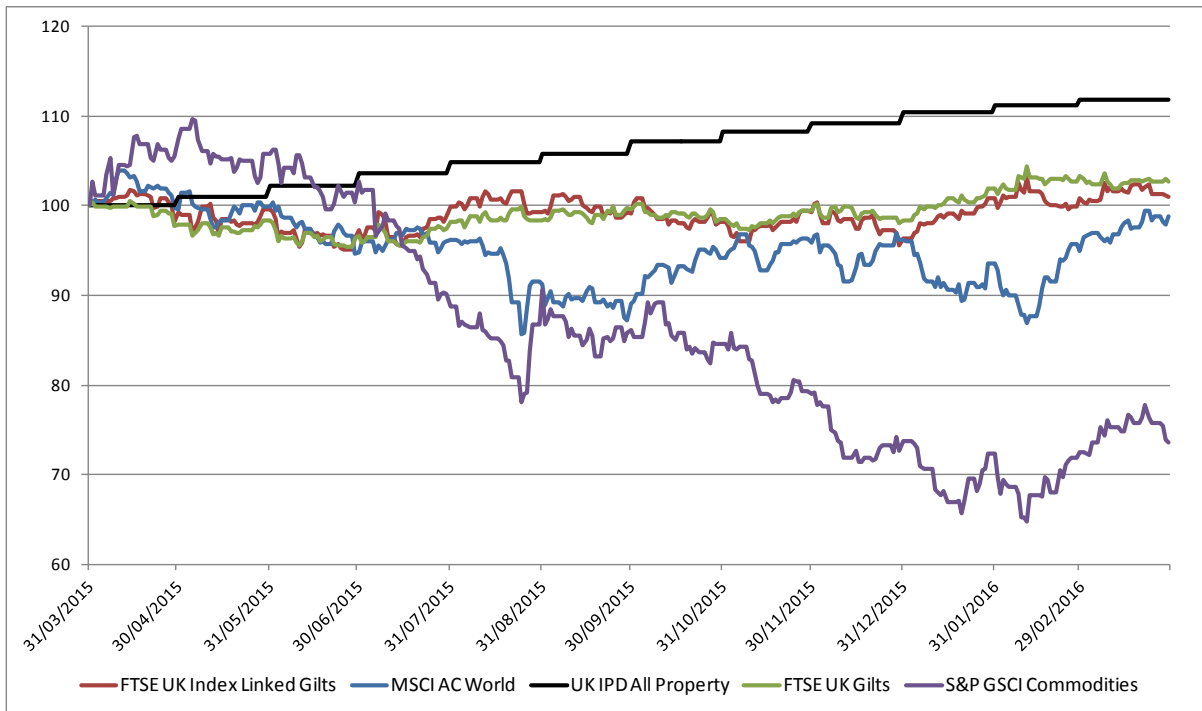
UK economic growth moderated somewhat in 2015, slowing from 2.9% in 2014 to 2.4% in 2015. The recovery in the labour market continued with unemployment falling to a 10 year low of 5%. Despite this, wage growth has remained subdued, with average earnings staying around 2%. The big surprise of 2015 was inflation falling below zero as oil and other commodity prices continued their slump. Other global economies showed quite diverse growth rates. Growth in developed economies has broadly returned to levels prior to the 2007/08 global financial crisis, around 2%. Growth in emerging markets on the other hand, has reduced significantly over recent years. Brazil and Russia are in recession and growth in China has slowed markedly.

### Divergence between Developed Market and Emerging Market Economic Growth



Asset markets gave relatively lacklustre but volatile returns during 2015/16. Equity market returns were mainly negative, with only the US giving a positive return to UK investors, of 3%. The UK, Eurozone and Japan all gave returns of between -4% and -7% to a UK investor. The worst performing equity markets were those of the emerging markets, with Brazil and China returning -9% and -16% respectively in Sterling terms. The UK index-linked government bond market produced a modest positive return of 2%. Property returns were strongly positive, giving a return of +11%.

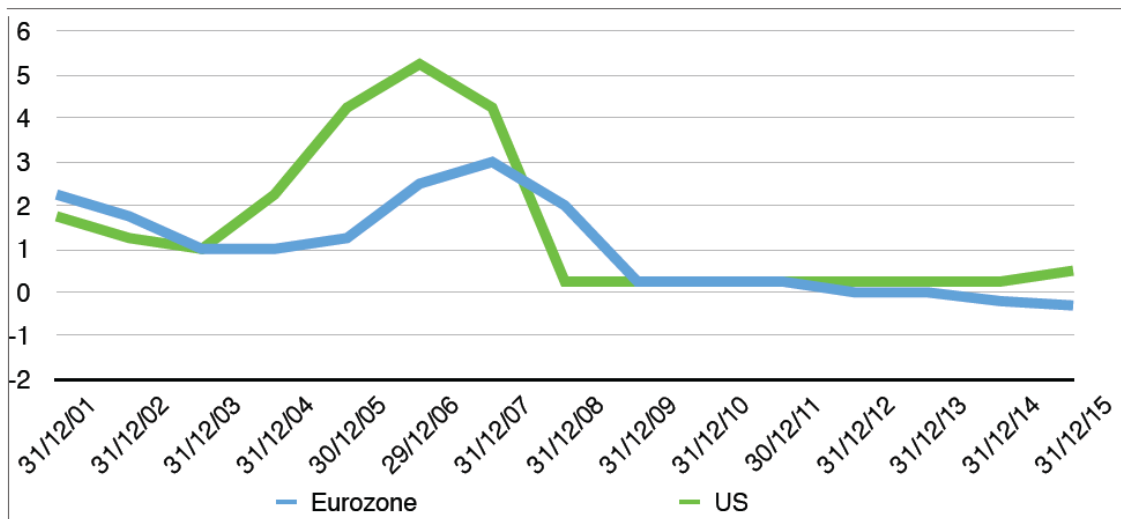
## One Year Asset Class Returns – Major Markets (rebased to 100)



A positive outlook for asset markets relies on developed markets continuing to grow and for emerging markets recovering. In the US, the Federal Reserve has felt confident enough in the growth outlook to raise rates by 0.25%, the first monetary tightening in 9 years. Only a very slow and gradual further increase in interest rates is expected, due to low US inflation and the weakness of the global economy. Both Eurozone and Japan have continued to ease monetary policy in the face of domestic economic weakness and falling inflation. Further easing in both areas is expected in 2016. Growth expectation in the UK is between the US and Eurozone. Brexit fears have weighed on the currency and investment intentions. UK monetary policy has been unchanged for over 7 years.

## Higher US rates, lower European rates

The outcome of the Brexit referendum, the speed of interest rate rises in the US and the performance of emerging economies will have a major impact on global assets. Longer term, asset returns are likely to remain low as global growth, inflation and interest rates all remain subdued.



# Corporate Governance

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## Overview

Consistent with the objectives set out in its **Statement of Investment Principles** and as a responsible investor, the Fund seeks to promote corporate responsibility and good practice amongst all companies in which it invests. To this end, the Fund monitors investee companies to ensure they are meeting standards of acceptable practice. During the year, this monitoring role was achieved by engaging with companies through:

- the Fund's Investment Managers (see note 14c to the financial statements, page 68)
- the Fund's membership of the Local Authority Pension Fund Forum (LAPFF) which comprises around 70 UK local government pension funds and exists to promote and maximise the corporate governance aims of Funds
- the Fund's corporate governance and proxy voting agents, Pensions and Investment Research Consultants (PIRC), who provide advice and research services on environmental, social and governance matters

An update on corporate governance matters is given to members at the quarterly Committee and Board meetings.

## Local Authority Pension Funds Forum

During 2015/16, LAPFF engaged with major companies on a diverse range of issues, including phone hacking, carbon emissions and climate change, executive pay, bankers' bonuses, gender balance, accounting standards, tax avoidance and working conditions in emerging markets. Engagement is invariably at a personal level between LAPFF office bearers and company chairs and senior executives.

LAPFF continues to be a leading participant in the "Aiming for A" campaign – a coalition of asset owners with shared concerns over the risks of climate change. The campaign has led to resolutions at the AGMs of several mining and energy companies including Anglo American, Rio Tinto BP, Royal Dutch Shell and Statoil seeking better disclosure surrounding carbon emissions management, asset portfolio resilience, low carbon R&D as well as performance indicators.

## Voting

The Fund could potentially allow its managers to exercise votes on its behalf at company meetings. However, in order to ensure a consistent approach to voting, it has for the past few years engaged PIRC to undertake this service through its Proxy Voting facility.

During 2015/16, PIRC voted at 121 company meetings with 1,356 votes being cast in favour of resolutions, 318 being opposed and 116 being cases of abstentions. Areas where "oppose" votes were regularly cast included remuneration policies and executive pay, share buybacks, governance, and auditor independence.



“PIRC attend one Committee meeting each year in order to brief members about the latest developments in corporate governance, including environmental and human rights matters.

### **Stewardship Code**

The Fund’s corporate governance responsibilities should also be considered within the context of the UK Stewardship Code. The Code comprises of seven principles which seek to improve the quality of engagement between institutional investors and investee companies. Under the seven principles, companies are required to:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

Consistent with Code requirements, asset managers must produce a statement of their commitment or explain their alternative approach to company engagement. It is pleasing to note that each of the Fund’s investment managers has expressed their commitment to the Code.

**Falkirk Council Pension Fund  
Audited Statement of  
Accounts  
2015/16**

# Statement of Responsibilities

## Administering Authority's Responsibilities

The Authority is required to:

- Make arrangements for the proper administration of the financial affairs of the Falkirk Council Pension Fund and to secure that one of its officers has responsibility for the administration of those affairs. In Falkirk Council, that officer is the Chief Finance Officer;
- Ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003)
- Manage the Fund's affairs to secure economic, efficient and effective use of resources and safeguard its assets; and
- Approve the Annual Accounts for signature.

I confirm that these Annual Accounts were approved for signature by the Falkirk Council Pension Fund Committee at its meeting on 22 September 2016.



**Councillor John Patrick**  
**Convener of Falkirk Council Pensions Committee**

## Chief Finance Officer Responsibilities

The Chief Finance Officer is responsible for the:

- Preparation of the Fund's Annual Accounts in accordance with proper practices as required by legislation and as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code).

In preparing the Annual Accounts, the Chief Finance Officer has:

- Selected suitable accounting policies and then applied them consistently;
- Made judgements and estimates that were reasonable and prudent; and
- Complied with legislation and the Local Authority Accounting Code (in so far as it is compatible with legislation).

The Chief Finance Officer has also:-

- Kept adequate accounting records which were up to date; and
- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

## Certificate by the Chief Finance Officer

I certify that the financial statements give a true and fair view of the financial position of the Pension Fund as at 31 March 2016 and the transactions of the Pension Fund for year ended 31 March 2016.



Bryan Smail, CPFA MBA

Chief Finance Officer

22 September 2016

# Independent Auditor's Report

## **Independent auditor's report to the members of Falkirk Council as administering body for Falkirk Council Pension Fund and the Accounts Commission for Scotland**

I certify that I have audited the financial statements of Falkirk Council Pension Fund for the year ended 31 March 2016 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the pension fund account, the pension fund net assets statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 (the 2015/16 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

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

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. My 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) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices 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 Chief Finance Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2015/16 Code of the financial transactions of the fund during the year ended 31 March 2016, and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2015/16 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

## **Opinion on other prescribed matter**

In my opinion the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

## **Matters on which I required to report by exception**

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Annual Governance Statement has not been prepared in accordance with Delivering Good Governance in Local Government; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.



Fiona Mitchell-Knight FCA  
Assistant Director  
Audit Scotland  
4th Floor (South Suite)  
8 Nelson Mandela Place  
Glasgow  
G2 1BT

22 September 2016

## PENSION FUND ACCOUNT

This statement shows the revenue account of the Pension Fund and separates those transactions which are related to dealings with members from those transactions which are a consequence of investment.

| 2014/15<br>£'000 | Dealings with members, employers and<br>others directly involved in the fund                    | 2015/16<br>£'000 | Note      |
|------------------|---|------------------|-----------|
| (78,905)         | Contributions   | (80,163)         | 7         |
| (2,520)          | Transfers from other pension funds  | (1,730)          | 8         |
| (81,425)         |   | (81,893)         |           |
| 58,546           | Benefits  | 63,169           | 9         |
| 3,531            | Payments to and on account of leavers   | 2,203            | 10        |
| 62,077           |   | 65,372           |           |
| <b>(19,348)</b>  | <b>Net (additions)/withdrawals from<br/>dealing with members</b>                                | <b>(16,521)</b>  |           |
| <b>11,744</b>    | <b>Management expenses</b>  | <b>12,930</b>    | <b>11</b> |
|                  | <b>Returns on investments</b>   |                  |           |
| (27,094)         | Investment income   | (29,031)         | 12        |
| 269              | Taxes on income   | 353              |           |
| (188,736)        | Profit and losses on disposal of<br>investments and changes in market<br>value of investments   | (5,336)          | 14a       |
| <b>(215,561)</b> | <b>Net return on investments</b>  | <b>(34,014)</b>  |           |
| <b>(223,165)</b> | <b>Net (increase)/decrease in the net<br/>assets available for benefits during the<br/>year</b> | <b>(37,605)</b>  |           |
| <b>1,576,681</b> | <b>Opening Net Assets as at 1 April 2015</b>  | <b>1,799,846</b> |           |
| <b>1,799,846</b> | <b>Closing Net Assets as at 31 March 2016</b>   | <b>1,837,451</b> |           |

## PENSION FUND NET ASSETS STATEMENT

This statement discloses the size and type of the net assets of the Fund at the end of the financial year.

| 2014/15<br>£'000 |  | 2015/16<br>£'000 | Note |
|------------------|--|------------------|------|
| 1,794,089        | <b>Investment assets</b>   | 1,832,638        | 14   |
| (3,088)          | <b>Investment liabilities</b>  | (1,324)          | 14   |
| 1,791,001        |  | 1,831,314        |      |
|                  | <b>Non-current assets</b>  |                  |      |
| 171              | Long term debtors  | 75               | 20   |
|                  | <b>Current assets</b>  |                  |      |
| 3,729            | Cash balances  | 3,784            | 21   |
| 7,572            | Debtors  | 6,883            | 21   |
|                  | <b>Current Liabilities</b>   |                  |      |
| (2,627)          | Creditors  | (4,605)          | 22   |
| <b>1,799,846</b> | <b>Net Assets of the fund available to fund benefits<br/>at the period end</b> | <b>1,837,451</b> |      |

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 in Note 19.

The unaudited accounts were issued on 23 June 2016 and the audited accounts were authorised for issue by Bryan Smail, Chief Finance Officer on 22 September 2016. The Statements of Accounts present a true and fair view of the financial position of the Pension Fund as at 31 March 2016 and their income and expenditure for the year ended 31 March 2016.



**Bryan Smail, CPFA MBA**  
**Chief Finance Officer**  
**22 September 2016**



## **1. Fund and Scheme Overview**

### **Introduction**

As part of its statutory obligations, Falkirk Council is required to operate the terms of the Local Government Pension Scheme (LGPS), including the maintenance and administration of a pension fund.

The LGPS is a public sector statutory scheme which provides defined benefits on a career average basis (n.b. benefits accrued prior to April, 2015 are provided on a final salary basis). The Scheme falls under the regulatory framework of the Public Service Pensions Act 2013. The Scheme is contracted-out of the State Second Pension although it should be noted that contracting-out is ending on 5 April 2016. The Scheme is also registered with HM Revenue and Customs as a UK pension scheme.

The scheme rules are made by the Scottish Ministers through the office of the Scottish Public Pensions Agency and are primarily set out in the following statutory instruments:

- the Local Government Pension Scheme (Scotland) Regulations 2014;
- the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014;
- the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015; and
- the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2010.

The rules are augmented by guidance from the Scottish Ministers and the Government Actuary's Department.

Administration of the Falkirk Council Pension Fund is undertaken by an in-house team who oversee the benefits of contributors, deferred members and pensioners on behalf of Clackmannanshire, Falkirk and Stirling Councils, as well as around 35 other employers. Teachers, Police and Firefighters do not come within the scope of the LGPS as they have their own national pension arrangements. A full list of employers who participate in the Falkirk Council Pension Fund is included in this report in Appendix 2.

## Membership

Membership of the LGPS is voluntary with employees being enrolled in the scheme automatically (either as a result of auto enrolment legislation or the Scheme's own contractual enrolment provisions). Employees are free to choose whether to remain in the scheme or, having opted out, join it at a later date.

Organisations participating in the Scheme fall into two categories, namely:

**Scheduled Bodies** - organisations such as local authorities that are statutorily required to offer the Scheme to their employees; and

**Admission Bodies** - mainly charitable, non-profit making bodies that have reached an agreement with an Administering Authority to participate in the Scheme.

Full details of membership numbers are contained on Page 28 of the Annual Report.

## Benefits

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

|  | <b>Service pre<br/>1 April 2009</b>   | <b>Service post<br/>31 March 2009</b>   | <b>Service post<br/>31 March 2015</b>   |
|--|---|---|---|
| Pension  | Each year worked is worth $1/80^{\text{th}}$ x final pensionable salary   | Each year worked is worth $1/60^{\text{th}}$ x final pensionable salary   | Each year worked is worth $1/49$ of pensionable earnings  |
| Lump Sum   | Automatic lump sum of 3 x annual pension<br><br>In addition, part of the pension may be exchanged for a lump sum. The conversion rate is £12 of lump sum for each £1 surrendered. | No automatic lump sum<br><br>Part of the pension may be exchanged for a lump sum. The conversion rate is £12 of lump sum for each £1 surrendered. | No automatic lump sum<br><br>Part of the pension may be exchanged for a lump sum. The conversion rate is £12 of lump sum for each £1 surrendered. |
| The lump sum cannot be greater than 25% of the capital value of the pre 2009 and post 2009 pension rights. |   |   |   |

Benefits from 1 April, 2015 which build up on a career average basis are revalued annually in line with rises in the Consumer Price Index (CPI). Pensions in payment and deferred benefits are also increased in line with CPI.

Additionally, the Scheme provides a range of guaranteed inflation linked benefits including early payment of pension and lump sum on ill health or redundancy grounds and death and survivor benefits.

More information about scheme benefits can be found in the Members' Guide which is accessible in the Forms and Publications Section at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org).

## **Funding**

Benefits are funded by contributions and returns on investments. Contributions are made by active members of the fund in accordance with the Local Government Pensions Scheme (Scotland) Regulations 2014 LGPS. The rate of employee contribution varies depending on a member's full time equivalent pensionable pay with designated pay bands attracting rates of between 5.5% and 12%.

Employer contributions are based on the results of a three yearly actuarial funding valuation. The last valuation was at 31 March, 2014. For the majority of fund employers, contribution rates are in the range 17% – 22% of pensionable pay. A copy of the 2014 Valuation Reports can be found at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications Section.

## **LGPS 2015**

A number of important changes have been made to the Scheme from 1 April, 2015. The changes, which have been agreed between Trade Unions, COSLA and the Scottish Government, ensure that the Scheme complies with the terms of the Public Service Pensions Act 2013.

The main changes are as follows:

- Scheme to operate on a Career Average Re-valued Earnings (CARE) basis;
- Normal Pension Age to be aligned with each member's own State Pension Age;
- Membership rights up to 31 March 2015 to be protected on a Final Salary basis;
- Transitional protection to exist for those closest to retirement; and
- Scheme to have a national Scheme Advisory Board and local Pension Boards.

Rights of members who left the Scheme prior to April, 2015 will continue to be governed by previous Scheme provisions.

## 2. Basis of Preparation

The Statement of Accounts summarises the Fund's transactions for the 2015/16 financial year and its position at year-end as at 31 March 2016.

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

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2016/17 Code:

- Annual Improvements to IFRSs 2010-2012 Cycle
- Annual Improvements to IFRSs 2012-2014 Cycle
- Changes to the format of the Pension Fund Account and the Net Assets Statement

The Code requires implementation from 1 April 2016 and there is therefore no impact on the 2015/16 financial statements.

The amendments are minor and they are not expected to have significant impact on the financial statements.

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.

## 3. Summary of Significant Accounting Policies

### Fund account - revenue recognition

#### a) Contribution income

Normal contributions, both from the members and from employers, are accounted for on an accruals basis. Employer contributions are made at the percentage rate recommended by the Fund Actuary in the payroll period to which they relate. Employee contributions are made in accordance with the rates specified in the Scheme rules.

Employer deficit contributions are separately identified on the schedule of contributions set by the fund actuary.

Employers' pension 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 to be paid 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 and are calculated in accordance with the Local Government Pension Scheme regulations and guidance from the Government Actuary. 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 to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers In.

**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) *Property related income*

Property-related income consists primarily of rental income.

Rental income from operating leases on properties owned by the Fund is recognised on a straight-line basis over the term of the lease. Any lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

Contingent rents based on the future amount of a factor that changes other than with the passage of time, such as turnover rents, are only recognised when contractually due.

v) *Movement in the net market value of investments*

Changes in the net market value of investments (including investment properties) 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) Management Expenses**

In 2014, CIPFA published “Accounting for Local Government Pension Scheme Management Costs” with the aim of promoting transparency, consistency and completeness of financial reporting.

Accordingly, in the preparation of the 2014/15 Accounts, the Falkirk Fund made strenuous efforts (in conjunction with investment managers) to disclose all layers of fees arising from the management of its investments. The same approach has been applied in 2015/16 accounts, again following the principles of transparency, consistency and completeness.

The CIPFA guidance has recently been updated in June 2016 with the new guidance being applicable from April 2016. It now states that “Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the fund account. If pension funds wish to provide information about the total cost of fund of funds investments, this should be included as part of the investments section in the annual report”.

The new guidance will be applied to the 2016/17 annual report and accounts and, assuming the guidance remains unchanged, will result in a reduction of management costs reported under note 11 (i.e. indirect fees will be excluded) and a reduction in changes in market value of the investments.

#### *Administration Expenses*

All administration expenses are accounted for on an accruals basis.

Costs are apportioned between the Fund and the sponsors of the other pension arrangements administered by the pensions administration team. The apportionment is carried out on the basis of share of aggregate membership numbers.

The Fund's share of administration expenses, which include staff costs, associated management costs, accommodation and other overheads are apportioned to this activity and charged to the Fund as expenses.

#### *Oversight and Governance Costs*

All oversight and governance expenses are accounted for on an accruals basis. All costs, associated with governance and oversight, are apportioned to this activity charged to the Fund as expenses.

#### *Investment Management Expenses*

All investment management expenses are accounted for on an accruals basis

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 the investments change.

When an investment manager's fee note has not been received by the balance sheet date, an estimate based upon the market value of their mandate at the end of the year is used for inclusion in the Fund Account.

Expenses charged directly by managers against the capital value of investments have been included within the investment management expenses shown in the Accounts.

### **Net assets statement**

#### **g) 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 the contractual acquisition of the asset.

From this date any gains or losses arising from changes in the fair value of asset are recognised in the Fund account.

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*

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:

- valuations of delisted securities are based on the last sale price prior to delisting, or where subject to liquidation, the amount the Council expects to receive on wind-up, less estimated realisation costs;
- securities subject to takeover offer – the value of the consideration offered under the offer, less estimated realisation costs;
- 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; and
- the values of the investments in private equity funds and unquoted listed partnerships are 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 International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association. The 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.



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*

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.

vi) *Freehold and leasehold properties*

The Fund's direct property holding was valued at 31 March 2014 by DM Hall LLP, Chartered Surveyors, in accordance with the requirements of the RICS Valuation Standards 6th edition. This valuation is completed every 3 years, with the next due 31 March 2017. The valuer's opinion of market value and existing use value was primarily derived using comparable recent market transactions on arms-length terms at the time of the valuation.

**h) Foreign currency transactions and balances**

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:

- a) cash balances held in foreign currency bank accounts,
- b) market values of overseas investments and;
- c) purchases and sales outstanding at the end of the reporting period.

**i) Derivatives**

Some of the Fund's external managers use derivative financial instruments to manage the Fund's exposure to specific risks arising from their investment activities. None of the derivatives are held for speculative purposes.

Derivative contract assets are fair valued at bid prices. Derivative contract liabilities are fair valued at offer prices. Changes in the fair value of derivative contracts are reflected within the change in market value in the net assets statements.

The value of futures contracts is determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin.

The value of exchange traded funds 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 investment manager 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.

**j) Cash and cash equivalents**

Cash comprises cash in hand and demand deposits and includes amounts held by the Fund's external managers.

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.

**k) 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.

**l) Actuarial present value of promised retirement benefits**

The actuarial present value of promised retirement benefits of the Fund is assessed on an annual basis by the Fund Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards. As permitted under the Code, the Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statements (Note 19).

**m) Additional voluntary contributions**

The Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. The Fund has appointed Standard Life and Prudential to act as joint AVC providers. 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.

In accordance with regulation 4(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, AVCs are not included in the pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed in Note 23 on page 85.

## 4. Critical Judgement in Applying Accounting Policies

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

### i) Unquoted Investments

It should be recognised that determining the fair value of private equity and infrastructure investments is highly subjective. Inherently, valuations are based on forward-looking estimates and judgements made on a variety of factors. These valuations are valued by the investment managers in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS.

At 31 March 2016, the Fund had a value of £161m (£127.2m in 2015) invested in unquoted private equity and infrastructure funds.

### (ii) Pension Fund Liability

The pension fund liability is calculated every three years by the appointed actuary, with annual updates in intervening years. The methodology used is 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.

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

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities at the balance sheet date and the amounts reported as revenues and expenses during the year. Estimates and assumptions are made taking into account historical experience, current trends and other relevant factors. However, the nature of estimation means that the actual outcomes could differ from the assumptions and estimates.

The items in the net assets statement at 31 March 2016 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

**(i) Investments**

The Fund's asset allocation to Private Equity and Infrastructure exposes it to investments that are not publicly listed and as such there is a degree of estimation involved in their valuation.

These investments are valued by the respective managers in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association.

**(ii) Actuarial present value of promised retirement benefits**

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in inflation, 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 table below highlights the approximate impact that a small change in the assumptions used would have on the liability of the Fund.

| <b>Change in assumptions<br/>at 31 March 2016</b> | <b>Approximate %<br/>increase in<br/>liabilities</b> | <b>Approximate<br/>monetary<br/>amount (£m)</b> |
|---|--|---|
| <b>0.5% decrease in Real Discount Rate</b>        | <b>11%</b>   | <b>294</b>                                      |
| <b>1 year increase in Member Life Expectancy</b>  | <b>3%</b>  | <b>78</b>                                       |
| <b>0.5% increase in the Salary Increase Rate</b>  | <b>4%</b>  | <b>114</b>                                      |
| <b>0.5% increase in the Pension Increase Rate</b> | <b>7%</b>  | <b>174</b>                                      |

## **6. Events after the Balance Sheet Date**

The unaudited Statement of Accounts were issued by the Chief Finance Officer on 23 June 2016 and the audited Statement of Accounts were authorised for issue on 22 September 2016. Events taking place after this date are not reflected in the financial statements or notes. There have been no material events since the date of the Net Asset Statement which have required the figures in the financial statements and notes to be adjusted.

## 7. Contributions Receivable

### By Category

| 2014/15<br>£'000 |  | 2015/16<br>£'000 |
|------------------|--|------------------|
| 17,910           | Employee's normal contributions                | 17,888           |
| 58,876           | Employers' normal contributions (incl. strain) | 60,304           |
| 2,119            | Employers' deficit recovery contributions      | 1,971            |
| <b>78,905</b>    | <b>Total</b>                                   | <b>80,163</b>    |

### By Authority

| 2014/15<br>£'000 |                           | 2015/16<br>£'000 |
|------------------|---------------------------|------------------|
| 27,100           | Administering authority   | 27,550           |
| 43,671           | Other scheduled bodies    | 43,770           |
| 7,956            | Admission bodies          | 8,634            |
| 178              | Transferee admission body | 209              |
| <b>78,905</b>    | <b>Total</b>              | <b>80,163</b>    |

## 8. Transfers from Other Pension Funds

All transfers during the year related to individual transfer payments and not to bulk transfer payments.

| 2014/15<br>£'000 |                      | 2015/16<br>£'000 |
|------------------|----------------------|------------------|
| 2,520            | Individual transfers | 1,730            |

## 9. Benefits Payable

### By Category

| 2014/15<br>£'000 |  | 2015/16<br>£'000 |
|------------------|--|------------------|
| 44,883           | Pensions                                     | 47,414           |
| 12,470           | Commutation and lump sum retirement benefits | 14,438           |
| 1,193            | Lump sum death benefits                      | 1,317            |
| <b>58,546</b>    | <b>Total</b>                                 | <b>63,169</b>    |

## By Authority

| 2014/15<br>£'000 |                           | 2015/16<br>£'000 |
|------------------|---------------------------|------------------|
| 21,106           | Administering authority   | 25,096           |
| 32,582           | Other scheduled bodies    | 33,451           |
| 4,837            | Admission bodies          | 4,610            |
| 21               | Transferee admission body | 12               |
| <b>58,546</b>    | <b>Total</b>              | <b>63,169</b>    |

## 10. Payments to and on account of leavers

| 2014/15<br>£'000 |                                    | 2015/16<br>£'000 |
|------------------|------------------------------------|------------------|
| 169              | Refunds to members leaving service | 469              |
| 3,362            | Individual transfers               | 1,734            |
| <b>3,531</b>     | <b>Total</b>                       | <b>2,203</b>     |

## 11. Management Expenses

| 2014/15<br>£'000 |   | 2015/16<br>£'000 |
|------------------|---|------------------|
| 750              | Administrative costs                                      | 855              |
| 392              | Oversight and governance costs                            | 524              |
| 4,802            | External management fees invoiced directly                | 4,837            |
| 2,734            | External management fees deducted from capital (direct)   | 2,804            |
| 2,189            | External management fees deducted from capital (indirect) | 2,466            |
| 486              | Transaction costs   | 838              |
| 114              | Custody Fees  | 117              |
| 277              | Other   | 489              |
| <b>11,744</b>    | <b>Total</b>  | <b>12,930</b>    |

The Audit fee of £23k (£23k in 2014/15) is included within the oversight and governance costs.

## 12. Investment Income

| 2014/15<br>£'000 |  | 2015/16<br>£'000 |
|------------------|--|------------------|
| 19,677           | Equity dividends   | 21,263           |
| 1,311            | Private equity income                                    | 1,880            |
| 5,538            | Pooled property investments                              | 5,104            |
| 172              | Pooled investments – unit trusts and other managed funds | 220              |
| 204              | Property   | 190              |
| 4                | Infrastructure   | 49               |
| 188              | Cash & Other Income                                      | 325              |
| <b>27,094</b>    | <b>Total</b>   | <b>29,031</b>    |

Property income relates to West Mains Industrial Estate, Falkirk, fully owned by Pension Fund.

## 13. Taxes on Income

All tax withheld on income for the Fund relates to equity investments.

## 14. Investments

| Market<br>Value<br>31/03/15<br>£'000 | Investment Assets                      | Market<br>Value<br>31/03/16<br>£'000 |
|--------------------------------------|--|--------------------------------------|
|                                      | <b>Investment Assets</b>               |                                      |
| 686,664                              | Equities                               | 690,588                              |
| 768,796                              | Pooled investments                     | 767,046                              |
| 124,536                              | Managed property funds                 | 139,207                              |
| 127,202                              | Private equity/infrastructure          | 137,582                              |
| 2,300                                | Property (West Mains)                  | 2,300                                |
| -                                    | Derivatives – forward foreign exchange | 126                                  |
|                                      | <b>Cash Deposits</b>                   |                                      |
| 18,860                               | Other balances                         | 13,396                               |
| 62,133                               | Deposits                               | 77,157                               |
|                                      | <b>Other Investment Balances</b>       |                                      |
| 2,806                                | Debtors – investment income due        | 3,728                                |
| 792                                  | – due from broker                      | 1,508                                |
| <b>1,794,089</b>                     | <b>Total Investment Assets</b>         | <b>1,832,638</b>                     |
|                                      | <b>Investment Liabilities</b>          |                                      |
| (1)                                  | Derivatives – forward foreign exchange | (1)                                  |
| (3,087)                              | Creditor – due to broker               | (1,323)                              |
| (3,088)                              | <b>Total Investment Liabilities</b>    | (1,324)                              |
| <b>1,791,001</b>                     | <b>Net Investment Assets</b>           | <b>1,831,314</b>                     |



**14a. Reconciliation of movements in investments and derivatives**  
**From 01/04/2015 to 31/03/2016**

|                               | Market<br>Value<br>01/04/15<br>£'000 | Purchases<br>at Cost<br>£'000 | Sale<br>Proceeds<br>£'000 | Change<br>in<br>Market<br>Value<br>£'000 | Market<br>Value<br>31/03/16<br>£'000 |
|-------------------------------|--------------------------------------|-------------------------------|---------------------------|--|--------------------------------------|
| <b>Investment Assets</b>      |                                      |                               |                           |  |                                      |
| Equities                      | 686,664                              | 257,333                       | (234,385)                 | (19,024)                                 | 690,588                              |
| Pooled investments            | 768,796                              | 4,857                         | (5,512)                   | (1,095)                                  | 767,046                              |
| Managed property funds        | 124,536                              | 4,878                         | (326)                     | 10,119                                   | 139,207                              |
| Private equity/infrastructure | 127,202                              | 28,745                        | (32,497)                  | 14,132                                   | 137,582                              |
| Property (West Mains)         | 2,300                                | -                             | -                         | -  | 2,300                                |
| Derivatives                   |                                      |                               |                           |  |                                      |
| - Forward foreign exchange    | (1)                                  | 246                           | (583)                     | 463                                      | 125                                  |
|                               | <u>1,709,497</u>                     | <u>296,059</u>                | <u>(273,304)</u>          | <u>4,595</u>                             | <u>1,736,848</u>                     |
| Other balances                | 18,860                               | -                             | -                         | -  | 13,396                               |
| Deposits                      | 62,133                               | -                             | -                         | 740                                      | 77,157                               |
| Broker balance                | (2,295)                              | -                             | -                         | -  | 185                                  |
| Investment income due         | 2,806                                | -                             | -                         | -  | 3,728                                |
| <b>Net Investment Assets</b>  | <b><u>1,791,001</u></b>              | <b><u>296,059</u></b>         | <b><u>(273,304)</u></b>   | <b><u>5,336</u></b>                      | <b><u>1,831,314</u></b>              |

## Reconciliation of movements in investments and derivatives From 01/04/2014 to 31/03/2015

|                               | Market<br>Value<br>01/04/14<br>£'000 | Purchases<br>at Cost<br>£'000 | Sale<br>Proceeds<br>£'000 | Change<br>in<br>Market<br>Value<br>£'000 | Market<br>Value<br>31/03/15<br>£'000 |
|-------------------------------|--------------------------------------|-------------------------------|---------------------------|--|--------------------------------------|
| <b>Investment Assets</b>      |                                      |                               |                           |  |                                      |
| Equities                      | 613,587                              | 182,060                       | (175,425)                 | 66,442                                   | 686,664                              |
| Pooled investments            | 665,055                              | 8,779                         | (9,255)                   | 104,217                                  | 768,796                              |
| Managed property funds        | 109,735                              | 5,919                         | (3,994)                   | 12,876                                   | 124,536                              |
| Private equity/infrastructure | 117,095                              | 31,586                        | (25,266)                  | 3,787                                    | 127,202                              |
| Property (West Mains)         | 2,300                                | -                             | -                         | -  | 2,300                                |
| Derivatives                   |                                      |                               |                           |  |                                      |
| - Exchange traded futures     | 33                                   | 645                           | (345)                     | (333)                                    | -                                    |
| - Forward foreign exchange    | (44)                                 | 305                           | (338)                     | 76                                       | (1)                                  |
|                               | 1,507,761                            | 229,294                       | (214,623)                 | 187,065                                  | 1,709,497                            |
| Other balances                | 16,164                               | -                             | -                         | (269)                                    | 18,860                               |
| Deposits                      | 41,576                               | -                             | -                         | 1,940                                    | 62,133                               |
| Broker balance                | (568)                                | -                             | -                         | -  | (2,295)                              |
| Investment income due         | 2,962                                | -                             | -                         | -  | 2,806                                |
| <b>Net Investment Assets</b>  | <b>1,567,895</b>                     | <b>229,294</b>                | <b>(214,623)</b>          | <b>188,736</b>                           | <b>1,791,001</b>                     |

## 14b. Analysis of Investments

| 31/03/15<br>£'000 |  | 31/03/16<br>£'000 |
|-------------------|--|-------------------|
|                   | <b><u>Equities</u></b>                           |                   |
| 266,870           | UK   | 271,743           |
| 419,794           | Overseas   | 418,845           |
| <b>686,664</b>    |  | <b>690,588</b>    |
|                   | <b><u>Pooled funds</u></b>                       |                   |
| 146,320           | Equities – UK                                    | 141,768           |
| 244,019           | – Overseas                                       | 241,703           |
| 140,680           | Bonds – UK                                       | 142,934           |
| 14,682            | – Overseas                                       | 13,278            |
| 206,045           | Diversified growth                               | 204,213           |
| 17,050            | Social & affordable housing                      | 23,150            |
| <b>768,796</b>    |  | <b>767,046</b>    |
|                   | <b><u>Property</u></b>                           |                   |
| 119,940           | Managed fund – UK                                | 134,988           |
| 4,596             | - Overseas                                       | 4,219             |
| 2,300             | Direct UK (West Mains)                           | 2,300             |
| <b>126,836</b>    |  | <b>141,507</b>    |
|                   | <b><u>Private Equity</u></b>                     |                   |
| 12,253            | UK   | 10,190            |
| 68,043            | Overseas   | 66,321            |
| <b>80,296</b>     |  | <b>76,511</b>     |
|                   | <b><u>Infrastructure</u></b>                     |                   |
| -                 | UK   | 15,739            |
| 46,906            | Overseas   | 45,333            |
| <b>46,906</b>     |  | <b>61,072</b>     |
| -                 | <b><u>Derivatives</u></b>                        | <b>126</b>        |
| <b>80,993</b>     | <b><u>Cash Deposits &amp; Other Balances</u></b> | <b>90,552</b>     |
| <b>2,806</b>      | <b><u>Investment income due</u></b>              | <b>3,728</b>      |
| <b>792</b>        | <b><u>Amounts due from Broker</u></b>            | <b>1,508</b>      |
| <b>1,794,089</b>  | <b>Total investment assets</b>                   | <b>1,832,638</b>  |
|                   | <b><u>Investment liabilities</u></b>             |                   |
| (1)               | Derivatives                                      | (1)               |
| (3,087)           | Amounts due to Broker                            | (1,323)           |
| <b>(3,088)</b>    | <b>Total investment liabilities</b>              | <b>(1,324)</b>    |
| <b>1,791,001</b>  | <b>Net investment assets</b>                     | <b>1,831,314</b>  |

## 14c. Investments Analysed By Fund Manager

| MARKET VALUE<br>31 March 2015 |              |   | MARKET VALUE<br>31 March 2016 |              |
|-------------------------------|--------------|---|-------------------------------|--------------|
| £ million                     | (%)          |   | £ million                     | (%)          |
| 234                           | 13.1         | Aberdeen Asset Management                     | 223                           | 12.3         |
| 155                           | 8.7          | Baillie Gifford Life Ltd – Bonds              | 156                           | 8.6          |
| 206                           | 11.5         | Baillie Gifford Life Ltd – Diversified Growth | 204                           | 11.2         |
| 377                           | 21.1         | Legal and General Investment Management Ltd   | 371                           | 20.4         |
| 275                           | 15.4         | Newton Investment Management Ltd              | 300                           | 16.5         |
| 241                           | 13.5         | Schroder Investment Management Ltd            | 229                           | 12.6         |
| 128                           | 7.1          | Schroder Investment Management Ltd (Property) | 141                           | 7.8          |
| 39                            | 2.2          | SL Capital Partners LLP                       | 36                            | 2.0          |
| 29                            | 1.6          | Wilshire Private Markets Group                | 30                            | 1.7          |
| 12                            | 0.7          | M&G UK Companies                              | 10                            | 0.6          |
| 47                            | 2.6          | Grosvenor Capital                             | 45                            | 2.5          |
| 17                            | 1.0          | Hearthstone                                   | 23                            | 1.3          |
| -                             | -            | Ancala Partners LP                            | 10                            | 0.6          |
| -                             | -            | FIM Harburnhead LP                            | 3                             | 0.1          |
| -                             | -            | Dalmore Infrastructure Investments LP         | 3                             | 0.1          |
| 28                            | 1.5          | In House Cash                                 | 33                            | 1.7          |
| <b>1,788</b>                  | <b>100.0</b> | <b>Total</b>                                  | <b>1,817</b>                  | <b>100.0</b> |

The Fund holds the following investments in pooled funds, which are in excess of 5% of the value of the Fund.

|  | 31 March 2015 |      | 31 March 2016 |      |
|--|---------------|------|---------------|------|
|  | £'000         | %    | £'000         | %    |
| Baillie Gifford Diversified Growth       | 206,045       | 11.5 | 204,213       | 11.2 |
| L&G – North American Equity Index        | 130,818       | 7.4  | 132,357       | 7.3  |
| L&G – UK Equity Index                    | 132,844       | 7.5  | 129,162       | 7.1  |
| Baillie Gifford Sterling Aggregate Bonds | 93,825        | 5.3  | 94,327        | 5.2  |

Regulation 14 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) 2010 (SSI 2010/233) stipulates the limits on Fund investments. Although the Fund does hold a stock over 10% of the Fund value, this is allowed as the investment is in a pooled vehicle.

## 14d. Securities Lending

The Fund did not participate in any stock lending programmes.

## 14e. Property Holdings

The Fund's investment in its property portfolio comprises investments in pooled property funds and a number of directly owned properties at West Mains Industrial Estate, Falkirk, which are leased commercially to various tenants.

The future minimum lease payments receivable by the Fund are as follows:-

| 2014/15    |                            | 2015/16    |
|------------|----------------------------|------------|
| £'000      |                            | £'000      |
| 173        | Within one year            | 140        |
| 258        | Between one and five years | 479        |
| 142        | Later than five years      | 303        |
| <b>573</b> | <b>Total</b>               | <b>922</b> |

## 15. Analysis of Derivatives

The Fund's approach to derivatives is to allow individual managers to decide to participate in derivative contracts subject to any limits set out in their investment management agreements. At present, only Newton chooses to do so, with derivatives making up 0.04% of their portfolio's value.

| Settlement  | Currency bought | Local Value | Currency Sold | Local Value | Asset Value | Liability Value |
|---|-----------------|-------------|---------------|-------------|-------------|-----------------|
|   |                 | 000         |               | 000         | £'000       | £'000           |
| Up to 4 month   | NOK             | 3,857       | USD           | 3,694       | 126         |                 |
| Up to 1 months  | USD             | 116         | GBP           | 116         |             | (1)             |
| <b>Open forward currency contracts at 31 March 2016</b> |                 |             |               |             | <b>126</b>  | <b>(1)</b>      |
| <b>Net forward currency contracts at 31 March 2016</b>  |                 |             |               |             | <b>125</b>  |                 |

Prior year comparative

|   |  |  |  |  |          |            |
|---|--|--|--|--|----------|------------|
| <b>Open forward currency contracts at 31 March 2015</b> |  |  |  |  | <b>0</b> | <b>(1)</b> |
| <b>Net forward currency contracts at 31 March 2015</b>  |  |  |  |  |          | <b>(1)</b> |

The above contracts are used as hedges reducing the extent to which Newton's portfolio is exposed to currency movement.

## 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 by category and net assets statement heading. No financial assets were reclassified during the accounting period.

All financial instruments are marked to market (at fair value) in the Fund's accounting records, hence there is no difference between the carrying value and fair value.

| 31 March 2015                            |                                |  | 31 March 2016                                   |                                |  |
|--|--------------------------------|--|---|--------------------------------|--|
| Fair value through Fund account<br>£'000 | Loans and receivables<br>£'000 | Financial liabilities at amortised cost<br>£'000 | Fair value through Fund account<br>£'000        | Loans and receivables<br>£'000 | Financial liabilities at amortised cost<br>£'000 |
|  |                                |  | <b>Financial Assets</b>                         |                                |  |
| 686,664                                  |                                | Equities   | 690,588   |                                |  |
| 768,796                                  |                                | Pooled investments                               | 767,046   |                                |  |
| 124,536                                  |                                | Property   | 139,207   |                                |  |
|  |                                | Private  |   |                                |  |
| 127,202                                  |                                | Equity/Infrastructure                            | 137,582   |                                |  |
|  |                                | Derivative contracts                             | 126   |                                |  |
|  | 84,722                         | Cash   |   | 94,337                         |  |
|  |                                | Other investment                                 |   |                                |  |
|  | 3,598                          | balances   |   | 5,236                          |  |
|  | 7,743                          | Debtors  |   | 6,958                          |  |
| <b>1,707,198</b>                         | <b>96,063</b>                  | <b>Total</b>                                     | <b>1,734,549</b>                                | <b>106,531</b>                 |  |
|  |                                |  | <b>Financial Liabilities</b>                    |                                |  |
| (1)                                      |                                | Derivative contracts                             | (1)   |                                |  |
| (3,087)                                  |                                | Other Investment                                 | (1,323)   |                                |  |
|  |                                | balances   |   |                                |  |
|  |                                | Creditors  |   |                                | (4,605)  |
| <b>(3,088)</b>                           |                                | <b>Total</b>                                     | <b>(1,324)</b>                                  |                                | <b>(4,605)</b>                                   |
| <b>1,704,110</b>                         | <b>96,063</b>                  | <b>(2,627)</b>                                   | <b>1,733,225</b>                                | <b>106,531</b>                 | <b>(4,605)</b>                                   |
|  |                                |  | <b>Total net financial instruments</b>          |                                |  |
|  |                                | <b>1,797,546</b>                                 |   |                                | <b>1,835,151</b>                                 |
|  |                                | 2,300  | Amounts not classified as financial instruments |                                | 2,300  |
|  |                                | <b>1,799,846</b>                                 | <b>Total net assets</b>                         |                                | <b>1,837,451</b>                                 |

## 16b. Net Gains and Losses on Financial Instruments

| 31 March<br>2015<br>£'000 |  | 31 March 2016<br>£'000 |
|---------------------------|--|------------------------|
|                           | <b>Financial assets</b>                |                        |
| 186,989                   | Fair value through net asset statement | 4,670                  |
| 1,671                     | Loans and receivables                  | 741                    |
|                           | <b>Financial liabilities</b>           |                        |
| 76                        | Fair value through net asset statement | 463                    |
| -                         | Loans and receivables                  | -                      |
| <b>188,736</b>            | <b>Total</b>                           | <b>5,874</b>           |

## 16c. 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 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 investments in private equity are based on valuations provided by the general partners to the private equity funds in which the Fund has invested. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS. 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 Fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

## Valuation of Financial Instruments Carried at Fair Value

As at 31 March 2016

|  | Quoted<br>market<br>price<br>Level 1<br>£'000 | Using<br>observable<br>inputs<br>Level 2<br>£'000 | With<br>significant<br>unobservable<br>inputs<br>Level 3<br>£'000 | Total at<br>31 March<br>2016<br>£'000 |
|--|---|---|---|---------------------------------------|
| <b>Financial assets</b>                                  |   |   |   |                                       |
| Financial assets at fair value through Fund              | 1,278,395                                     | 295,422   | 160,732   | 1,734,549                             |
| Loans and receivables                                    | 106,531                                       | -   | -   | 106,531                               |
| <b>Total financial assets</b>                            | <b>1,384,926</b>                              | <b>295,422</b>                                    | <b>160,732</b>  | <b>1,841,080</b>                      |
| <b>Financial Liabilities</b>                             |   |   |   |                                       |
| Financial liabilities at fair value through Fund account | (1,324)                                       | -   | -   | (1,324)                               |
| Financial liabilities at amortised cost                  | (4,605)                                       | -   | -   | (4,605)                               |
| <b>Total financial liabilities</b>                       | <b>(5,929)</b>                                | <b>-</b>  | <b>-</b>  | <b>(5,929)</b>                        |
| <b>Net financial assets</b>                              | <b>1,378,997</b>                              | <b>295,422</b>                                    | <b>160,732</b>  | <b>1,835,151</b>                      |



## Valuation of Financial Instruments Carried at Fair Value

As at 31 March 2015

|  | Quoted<br>market<br>price<br>Level 1<br>£'000 | Using<br>observable<br>inputs<br>Level 2<br>£'000 | With<br>significant<br>unobservable<br>inputs<br>Level 3<br>£'000 | Total at<br>31 March<br>2015<br>£'000 |
|--|---|---|---|---------------------------------------|
| <b>Financial assets</b>                                  |   |   |   |                                       |
| Financial assets at fair value through Fund account      | 1,283,049                                     | 279,900   | 144,249   | 1,707,198                             |
| Loans and receivables                                    | 96,063  | -   | -   | 96,063                                |
| <b>Total financial assets</b>                            | <b>1,379,112</b>                              | <b>279,900</b>                                    | <b>144,249</b>  | <b>1,803,261</b>                      |
| <b>Financial Liabilities</b>                             |   |   |   |                                       |
| Financial liabilities at fair value through Fund account | (3,088)                                       | -   | -   | (3,088)                               |
| Financial liabilities at amortised cost                  | (2,627)                                       | -   | -   | (2,627)                               |
| <b>Total financial liabilities</b>                       | <b>(5,715)</b>                                | <b>-</b>  | <b>-</b>  | <b>(5,715)</b>                        |
| <b>Net financial assets</b>                              | <b>1,373,397</b>                              | <b>279,900</b>                                    | <b>144,249</b>  | <b>1,797,546</b>                      |

## 17. Nature and Extent of Risks Arising from Financial Instruments

### Risk and Risk Management

The Fund's primary long-term risk is that its assets will fall short of its liabilities (i.e. the 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 portfolio. The Fund achieves this through asset diversification to reduce market risk and credit risk to an acceptable level. In addition the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet future cashflows. Responsibility for the Fund's risk management strategy rests with the Pensions Committee. Risk management policies are reviewed on a consistent basis to reflect changes in activity and in market condition.

## Types of Investment Risk

Fluctuations in overall price can arise from a variety of sources including market risk, foreign exchange risk, interest rate risk and credit risk. Each of these vary in importance and will not by themselves account for the overall pricing risk faced. To some extent they may offset each other. The Fund's analysis combines these factors when looking at the total market price risk.

### (i) **Market Risk**

Market risk is the risk of loss from fluctuations in equity and other asset 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 as it relates to investments is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on assets. Investment risk is considered further in the Fund's **Statement of Investment Principles**.

In general, excessive volatility in market risk is managed by engaging a range of Fund Managers with differing approaches and philosophies and also through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Administering Authority and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

The Fund's approach to managing risk can be described in two fundamental ways:

- by maintaining asset class exposures such that risk remains within tolerable levels; and
- by applying maximum exposures to individual investments.

### (ii) **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 recognised by the Administering Authority and its investment advisors. The Fund monitors the interest rate risk faced and will adjust its strategy in accordance with its **Statement of Investment Principles**. The Fund's direct exposure to interest rate movement as at the 31 March 2016 is estimated to be around £388.6m.

(iii) **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 Fund (£GBP). The Fund holds both monetary and non-monetary assets denominated in currencies other than £GBP.

The Fund's currency rate risk is recognised by the Administering Authority and its investment advisors. In respect of cash deposits managed internally under the terms of the Cash Management Strategy, it is the Fund's policy to convert all non GBP monies to Sterling at the end of a month to reduce the currency risk faced. In respect of cash held with external Fund Managers, it is left to their discretion as to whether they wish to hedge their currency position or not.

The Fund's currency exposure as at the 31 March 2016 is estimated to be around £551m.

(iv) **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 assets and liabilities (as outlined in Market Risk above).

In essence, the Fund's entire investment portfolio is exposed to some sort of credit risk. However the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner. The Fund has had no experience of default or uncollected deposits over the past five financial years.

The main area where risk is not reflected in a market price is cash deposits which at 31 March 2016 accounted for 4.4% of fund assets.

| <b>Balances<br/>at<br/>31 March<br/>2015<br/>£'000</b> |  | <b>Moody's<br/>Credit<br/>Rating</b> | <b>Balances<br/>at<br/>31 March<br/>2016<br/>£'000</b> |
|--|--|--------------------------------------|--|
|  | <b>Held for investment purposes</b>                        |                                      |  |
| 24,565   | Northern Trust Global Investment Limited – Liquidity Funds | Aaa-mf                               | 36,363   |
| 4,976  | Standard Life Investment Sterling Liquidity Fund           | AAAmf (Fitch)                        | 5,002  |
| 26,590   | Northern Trust Company – Cash Deposits                     | Aaa-mf                               | 29,686   |
| 2,002  | Santander UK PLC   | Aa3                                  | 2,010  |
| 4,000  | Bank of Scotland PLC                                       | A1                                   | 4,045  |
| <b>62,133</b>  | <b>Total investment cash</b>                               |                                      | <b>77,106</b>  |
|  | <b>Held for other purposes</b>                             |                                      |  |
| 3,777  | Clydesdale Bank  | Baa2                                 | 4,091  |
| <b>65,910</b>  | <b>Total cash</b>  |                                      | <b>81,197</b>  |

As part of its approach to managing credit risk, the Fund formalised its Treasury operations during 2015/16 through the implementation of a Cash Management Strategy. These details:

- the counterparties with whom the Fund may have dealings;
- the credit ratings that are deemed acceptable; and
- specific limits and conditions attaching to certain types of deposit.

The credit rating used above is Moody's Long Term Outlook.

Despite its credit rating, the Fund (along with Falkirk Council) continues to use the Clydesdale Bank for its day to day transactional banking operations. Balances, are however, closely monitored and minimised to a level of £4m to £5m.

(v) **Liquidity Risk**

Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Council in its capacity as Administering Authority therefore ensures that the Pension Fund has adequate cash and liquid resources to meet its commitments. The Fund currently does not have access to an overdraft facility for short term cash needs. As part of the ongoing monitoring of the Fund's banking arrangements this position may be reviewed and amended accordingly.

A majority of the Fund's investment assets (estimated to be over 85%) could be converted into cash within three months in normal market conditions.

(vi) **Refinancing Risk**

Refinancing risk is the risk 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 is not bound by any obligation to replenish its investments. In any event, the Fund does not have any financial instruments that have a refinancing risk as part of its Pension Fund management and investment strategies.

### Sensitivity Analysis

The Fund's valuation is sensitive to fluctuations in its asset prices. The level of these fluctuations is known as "volatility" and will differ between asset classes. By analysing historical data, it is possible to gain an indication of the likely volatility of certain asset classes. In consultation with KPMG and Lothian Pension Fund, the following analysis predicts the likely annual volatility of the Fund's assets.

| <b>Asset Type</b>            | <b>Potential price movement (+ or -)</b> |
|------------------------------|--|
| Equities – Developed Markets | 20.5%                                    |
| Equities – Emerging Markets  | 30.0%                                    |
| Private Equity               | 30.0%                                    |
| Commodities                  | 30.0%                                    |
| Property                     | 13.0%                                    |
| Infrastructure               | 18.0%                                    |
| Diversified Credit           | 10.0%                                    |
| Fixed Interest Gilts         | 6.7%                                     |
| Index-Linked Gilts           | 10.8%                                    |
| Cash                         | 1.1%                                     |

Volatility is measured as the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset's change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes don't always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time. Overall, the Fund benefits from "diversification" because it invests in numerous different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests. The following table shows the risks at the asset class level and the overall Fund level.

#### Position as at 31 March 2016

| Asset Type  | Value at 31 March 2016 | Asset Weight  | Volatility   | Potential Change +/- (£m) | Value on increase (£'m) | Value on decrease (£'m) |
|---|------------------------|---------------|--------------|---------------------------|-------------------------|-------------------------|
| Equities - Developed Markets                                  | 1,065.1                | 58.2%         | 20.5%        | 218.3                     | 1,283.4                 | 846.7                   |
| Equities - Emerging Markets                                   | 47.6                   | 2.6%          | 30.0%        | 14.3                      | 61.9                    | 33.3                    |
| Private Equity  | 69.2                   | 3.8%          | 30.0%        | 20.8                      | 89.9                    | 48.4                    |
| Commodities   | 9.6                    | 0.5%          | 30.0%        | 2.9                       | 12.5                    | 6.7                     |
| Property  | 177.3                  | 9.7%          | 13.0%        | 23.1                      | 200.4                   | 154.3                   |
| Infrastructure  | 73.9                   | 4.0%          | 18.0%        | 13.3                      | 87.2                    | 60.6                    |
| Diversified Credit  | 170.3                  | 9.3%          | 10.0%        | 17.0                      | 187.3                   | 153.2                   |
| Fixed Interest Gilts  | 64.3                   | 3.5%          | 6.7%         | 4.3                       | 68.6                    | 60.0                    |
| Index-Linked Gilts  | 32.6                   | 1.8%          | 10.8%        | 3.5                       | 36.2                    | 29.1                    |
| Cash  | 121.4                  | 6.6%          | 1.1%         | 1.3                       | 122.8                   | 120.1                   |
| <b>Total Assets (without correlations)</b>                    | <b>1,831.3</b>         | <b>100.0%</b> | <b>17.4%</b> | <b>318.8</b>              | <b>2,150.2</b>          | <b>1,512.4</b>          |
| <b>Total Assets (including correlations)</b>                  | <b>1,831.3</b>         | <b>100.0%</b> | <b>14.6%</b> | <b>268.1</b>              | <b>2,099.4</b>          | <b>1,563.2</b>          |
| <b>Assets Relative to Liabilities (including correlation)</b> | <b>1,831.3</b>         | <b>100.0%</b> | <b>14.7%</b> | <b>269.8</b>              | <b>2,101.1</b>          | <b>1,561.5</b>          |

The “Potential change” column shows the monetary effect of the expected volatility relative to each asset class. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three. It can also be seen that the risk to the overall Fund assets is lower than the total of the risks to the individual assets.

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities. This risk is shown in the bottom row of the table. The risk is lower than the absolute asset risk, due to the impact of correlation with the discount rate used to value the liabilities.

It should be noted that the asset allocation used for this analysis will differ to that shown in the financial statements earlier. This is due to the Fund reporting its asset allocation in the financial statements according to each Manager's mandate, whilst for this section the most appropriate means is to analyse the mandate according to the underlying elements.

The corresponding details as at 31 March 2015 are set out in the table overleaf.

## Position as at 31 March 2015

| Asset Type  | Value at 31 March 2015 | Asset Weight  | Volatility   | Potential Change +/- (£m) | Value on increase (£'m) | Value on decrease (£'m) |
|---|------------------------|---------------|--------------|---------------------------|-------------------------|-------------------------|
| Equities - Developed Markets                                  | 1,086.8                | 60.7%         | 20.0%        | 217.5                     | 1,304.3                 | 869.3                   |
| Equities - Emerging Markets                                   | 33.8                   | 1.9%          | 30.0%        | 10.1                      | 43.9                    | 23.7                    |
| Private Equity  | 71.3                   | 4.0%          | 30.0%        | 21.4                      | 92.7                    | 49.9                    |
| Commodities   | 10.1                   | 0.6%          | 30.0%        | 3.0                       | 13.1                    | 7.1                     |
| Property  | 150.1                  | 8.4%          | 13.0%        | 19.5                      | 169.6                   | 130.6                   |
| Infrastructure  | 55.8                   | 3.1%          | 8.0%         | 4.5                       | 60.3                    | 51.3                    |
| Diversified Credit  | 179.1                  | 10.0%         | 10.0%        | 17.9                      | 197.0                   | 161.2                   |
| Fixed Interest Gilts  | 52.7                   | 2.8%          | 10.5%        | 5.5                       | 58.2                    | 47.2                    |
| Index-Linked Gilts  | 35.3                   | 2.0%          | 8.5%         | 3.0                       | 38.3                    | 32.3                    |
| Cash  | 116.0                  | 6.5%          | 1.5%         | 1.7                       | 117.7                   | 114.3                   |
| <b>Total Assets (without correlations)</b>                    | <b>1,791.0</b>         | <b>100.0%</b> | <b>17.0%</b> | <b>304.1</b>              | <b>2,095.1</b>          | <b>1,486.9</b>          |
| <b>Total Assets (including correlations)</b>                  | <b>1,791.0</b>         | <b>100.0%</b> | <b>14.6%</b> | <b>262.0</b>              | <b>2,053.0</b>          | <b>1,529.0</b>          |
| <b>Assets Relative to Liabilities (including correlation)</b> | <b>1,791.0</b>         | <b>100.0%</b> | <b>14.0%</b> | <b>250.4</b>              | <b>2,041.4</b>          | <b>1,540.6</b>          |

Last years' accounts included the transposition of two lines - Diversified Credit and Fixed Interest Gilts. This has been updated in the 2015/16 accounts and has had no impact on the core financial statements.

## 18. Funding arrangements

In line with the Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014, the Fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The most recent funding valuation took place as at 31 March 2014. The next valuation will take place on 31 March 2017.



In determining the employer contribution rates, the actuary has taken into account the funding policy as set out in the **Funding Strategy Statement**. The key elements of the funding policy are:

- To ensure the long term solvency of the fund (i.e. that sufficient funds are available to meet all pension liabilities as they fall due for payment);
- To ensure that employer contribution rates are as stable as possible;
- To minimise the long term cost of the scheme by recognising the link between assets and liabilities and adopting an investment strategy that balances risk and return;
- To reflect the different characteristics of employing bodies in determining contributions rates where the Fund considers it reasonable to do so; and
- To use reasonable measure to reduce the risk to other employers and ultimately to the tax payer from an employer defaulting on its pension obligations

The aim is to achieve a funding level of 100% over a period of 20 years; to minimise the downside risk of a poor funding outcome; and to provide stability in employer contributions by spreading any increase in rates over a period of time, normally three years. Employers have been made aware of their respective funding positions and a deficit recovery plan has been built into the contribution rates set by the actuary.

At the 2014 valuation, the Fund was assessed as 85% funded implying a deficit of £283m. At the 2011 valuation, the funding level was 86% and the deficit £194m.

Contribution increases are being phased in over the three year period ending 31 March 2017 for both scheduled and admission bodies. At the 2014 valuation, the common contribution rate (i.e. the rate applicable to the Fund as a whole) was assessed as 23.4% of pay (20.5% at 31 March 2011). The increase was due primarily to the decrease in real gilt yields, the basis on which liabilities are valued.

The common contribution rate is a theoretical figure. In practice, individual employers' rates will vary from the common rate depending on the demographic and actuarial factors peculiar to each employer. Full details of the contribution rates payable and the methods and assumptions used in the 2014 valuation are set out in the actuary's valuation report dated 31 March 2015.

The valuation of the Fund has been undertaken using the projection unit method under which the salary increase for each member is assumed to increase until they leave active service through death, retirement or withdrawal from service. The main assumptions applied at the 2014 and 2011 valuations were as follows:

### Financial Assumptions

| Assumption        | March 2011 | March 2014 |
|-------------------|------------|------------|
| Discount Rate     | 5.9%       | 5.1%       |
| Inflation RPI     | 3.6%       | 3.5%       |
| Inflation CPI     | 2.8%       | 2.7%       |
| Pension Increases | 2.8%       | 2.7%       |
| Pay increases     | 5.1%       | 4.0%       |

### Longevity Assumptions

The life expectancy assumption is based on the Fund's Club Vita analysis with improvements in line with the CMI\_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

|  | Males      | Females    |
|--|------------|------------|
| Current pensioners                             | 22.1 years | 23.8 years |
| Future pensioners (assumed to be currently 45) | 24.3 years | 26.3 years |

### Commutation Assumption

An allowance is made for future retirees to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash for post-April 2009 service.

### 50:50 Option

It is assumed that 10% of members (evenly distributed across the age, service and salary range) will take up the 50:50 option in the Scheme.

### More Information

The Actuary has provided a statement describing the funding arrangements of the Fund during 2015/16. This can be found at Appendix 1 of this report.

Copies of the **Valuation Report** and the **Funding Strategy Statement** can be found at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications section.

## 19. Actuarial Present Value of Promised Retirement Benefits

In addition to the triennial funding valuation, the fund's actuary also undertakes a valuation of the pension fund liabilities, on an IAS19 (International Accounting Standard) basis, every year using the same base data as the funding valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year. This valuation is not carried out on the same basis as that used for setting fund contributions rates and the fund accounts do not take account of obligations to pay pensions and other benefits in the future.

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used to for funding purposes (see Note 18). The actuary has also valued ill health and death benefits in line with IAS19.

|   | <b>31 March 2015</b><br>£'m | <b>31 March 2016</b><br>£'m |
|---|-----------------------------|-----------------------------|
| Present value of promised retirement benefits | 2,748                       | 2,584                       |
| Fair Value of Scheme Assets                   | 1,800                       | 1,837                       |
| Net Liability                                 | 948                         | 747                         |

As noted above, the liabilities are calculated on an IAS 19 basis and will therefore differ from the results of the 2014 triennial funding valuation (see Note 18) because IAS 19 requires liabilities to be valued according to a specific discount rate rather than a rate which reflects the market rates.

The key assumptions relied upon by the actuary in deriving the actuarial present value of promised retirement benefits are as follows:

| <b>Financial Assumptions</b>       | <b>31 March 2015</b><br>% p.a. | <b>31 March 2016</b><br>%p.a. |
|------------------------------------|--------------------------------|-------------------------------|
| Discount rate                      | 3.2                            | 3.5                           |
| Pay increase                       | 3.8                            | 3.7                           |
| Price inflation/Pensions increases | 2.4                            | 2.2                           |

## 20. Non Current Assets

### Long Term Debtors

31 March 2015

£'000

171

Strain on Fund Contributions (Due in over 1 year)

31 March 2016

£'000

75

## 21. Current Assets

31 March 2015

£'000

4,701

1,451

1,288

132

3,729

**11,301**

### Debtors

Contributions due – employers

Contributions due – members

Strain on fund contribution (due within 1 year)

Sundry debtors

**Cash balances**

**Total**

31 March 2016

£'000

4,736

1,446

673

28

3,784

**10,667**

### Analysis of Debtors

31 March 2015

£'000

1,199

4,837

2

22

1,512

**7,572**

Central government bodies

Other local authorities

NHS bodies

Public corporations and trading funds

Other entities and individuals

**Total**

31 March 2016

£'000

1,551

4,349

-

-

983

**6,883**

## 22. Current Liabilities

| 31 March 2015  |  | 31 March 2016  |
|----------------|--|----------------|
| £'000          |  | £'000          |
| (1,246)        | Benefits payable                             | (3,086)        |
| (1,381)        | Miscellaneous creditors and accrued expenses | (1,519)        |
| <b>(2,627)</b> | <b>Total</b>                                 | <b>(4,605)</b> |

### Analysis of Creditors

| 31 March 2015  |                                       | 31 March 2016  |
|----------------|---------------------------------------|----------------|
| £'000          |                                       | £'000          |
| (127)          | Central government bodies             | (8)            |
| (574)          | Other local authorities               | (10)           |
| (1,321)        | Public corporations and trading funds | (1,335)        |
| (605)          | Other entities and individuals        | (3,252)        |
| <b>(2,627)</b> | <b>Total</b>                          | <b>(4,605)</b> |

## 23. Additional Voluntary Contributions

| Market Value<br>31 March 2015 |               | Market Value<br>31 March 2016 |
|-------------------------------|---------------|-------------------------------|
| £'000                         |               | £'000                         |
| 2,847                         | Standard Life | 2,892                         |
| 149                           | Prudential    | 834                           |
| <b>2,996</b>                  | <b>Total</b>  | <b>3,726</b>                  |

AVC contributions of £297k were paid directly to Standard Life (£388k in 2014/15) and £698k to Prudential during the year (£141k in 2014/15).

These amounts are not included in the Pension Fund Accounts in accordance with regulation 4 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (SSI 2010 No. 233).

## 24. Related Party Transactions

### Falkirk Council

Falkirk Council Pension Fund is administered by Falkirk Council. Consequently, there is a strong relationship between the Council and the Pension Fund.

The Council incurred costs of £603k (2014/15: £528k) in relation to the administration of the Fund and was subsequently reimbursed by the Fund for these expenses. The Council is also the single largest employer of members of the Pension Fund and contributed £21.6m to the fund in 2014/15 (2014/15: £21.6m).

Transactions between the Council and the Fund are monitored by the Creditors section within Corporate Finance with the aim of any balances being settled as soon as reasonably practicable. The balance at 31 March 2016 was £307k (£48k 2015).

### Governance

There are two members of the Pensions Committee who are in receipt of pension benefits from the Falkirk Council Pension Fund (Convener J Patrick and Committee Member I McLean). In addition, Committee Members S Carleschi, J Blackwood, CRL Martin and A Douglas are active members of the Pension Fund.

### Key Management Personnel

The following senior officers at Falkirk Council held key positions in the financial management of the Fund during the year:-

| Accrued CETV<br>31 March 2015<br>(£'000) | Role                  | Salary | Service  | Accrued CETV<br>31 March 2016<br>(£'000) |
|--|-----------------------|--------|----------|--|
| 800                                      | Chief Finance Officer | 88     | 31 years | 821                                      |
| 398                                      | Pensions Manager      | 50     | 33 years | 430                                      |

“CETV” means Cash Equivalent Transfer Value.

## 25. Contingent Liabilities and Contractual Commitments

Outstanding capital commitments (investments) at 31 March 2016 totalled £89m (31 March 2015: £58m).

These commitments relate to outstanding call payments due to unquoted limited partnership funds held in the private equity and infrastructure segments of the portfolio. The amounts “called” by these funds are irregular in both size and timing over the life of the investment.

At 31 March 2016 Falkirk Council Pension Fund is exposed to a contingent liability of £13k related to abort costs in respect of the co-investment projects with the Lothian Pension Fund. Contingent liabilities are not recognised in the net assets statement.

## 26. Contingent Assets

Two admission body employers in the Falkirk Council Pension Fund hold insurance bonds to guard against the possibility of being unable to meet their pension obligations. These bonds are drawn in favour of the Pension Fund and payment will only be triggered in the event of employer default.

### Introduction

Falkirk Council Pension Fund is a funded pension scheme operating within the terms of the Local Government Pension Scheme (LGPS)

Whilst the Fund is not a separate legal entity from Falkirk Council, it does have its own individual governance arrangements which sit within the Council's overall governance responsibilities. Collectively, these arrangements are consistent with the principles of the CIPFA/SOLACE Framework "Delivering Good Governance in Local Government".

The Local Authority Accounts (Scotland) Regulations 2014 require that all Councils conduct a review, at least once in each financial year, of the effectiveness of the system of internal controls and that an Annual Governance Statement is included in the Pension Fund Annual Report and Accounts. Whilst Falkirk Council as a whole has complied voluntarily with these requirements for several years, it is recognised from recent fund accounting developments that specific assurance should be provided with regard to Pension Fund activities.

### Pension Fund Governance Framework

The LGPS regulations require Funds to publicise their governance arrangements in a Governance Compliance Statement. These are set out in full at Page 19 of the Fund's Annual Report and Accounts for 2015/16.

### Scope of Responsibility

Under the Council's Scheme of delegation, the Pensions Committee is responsible for Pension Fund business including regulatory compliance and implementation of audit recommendations.

The Chief Finance Officer is responsible for arranging the proper administration of the financial affairs of the Falkirk Council Pension Fund, including the internal audit of the Fund's control environment to provide reasonable assurance that:

- funding arrangements are adequate to meet future pension obligations;
- adequate safeguards are in place to monitor investment manager activity;
- payments are made correctly to scheme beneficiaries; and
- data is securely held.

The following controls are in place to assist in achieving these objectives:

- *adequacy of funding* is assessed through the triennial valuation process with regular funding updates being provided to the Pension Committee;
- records of *investment transactions* are maintained by the Fund's external investment managers and global custodian and reconciled by the pensions team on a regular basis;
- *pension payments* and other financial transactions are initially processed by pensions assistants and authorised independently by senior officers; and
- protocols are in place to *manage data securely* in compliance with the Public Services Network.



## **Control Environment**

Given the role of the external investment managers it is essential that the Fund obtains assurances on the adequacy of the internal financial control systems operated by them. The main source of this assurance is the annual audit report produced by each of the managers' independent service auditors. Fund officers obtain and review these reports for each of the investment managers and the global custodian, who is responsible for the safekeeping and servicing of the Fund's assets. Current practice is for the findings of these reports to be reported to the Pensions Committee only by exception where there are audit concerns. Details of the reports obtained are listed on Page 30 of the Annual Report.

In line with the Council's procedures for investigating fraud and corruption, the Fund participates in the National Fraud Initiative to identify payments being made to deceased pensioners and actively investigates cases of irregularity. These results are reported to the Pensions Committee.

In order to ensure compliance with scheme rules and reduce the risk of incorrect payments being made, the Fund operates a pensions' administration system maintained by a specialist software vendor. The system is used by all other Scottish local authorities and so is subject to peer testing. Operational use of the new administration system began in March 2015 and was overseen by a project team comprising software providers Heywood and senior officers from the Pensions Section. Assurance regarding the data migration was provided to Internal Audit through a membership reconciliation exercise.

To support its overall framework of control, the Council has a Code of Conduct for Members and Officers, and all Members are expected to apply the Standards Commission Scotland's Councillors' Code of Conduct. Contract Standing Orders and Financial Regulations regulate financial and transactional activity, with the latter being updated in October, 2015 to take account of evolving systems and emerging risks.

The Council is committed to the highest standards of openness, probity and accountability. In line with that commitment, the Council, through its Confidential Reporting Policy, encourages employees and others who have serious concerns about any aspect of the Council's work to come forward without fear of victimisation, discrimination or disadvantage.

The Fund's approach to risk management continues to develop and mature, with internal and external risks being considered as part of the cyclical business of the Fund. A revision of the Risk Register took place in 2015/16 and material risks continue to be reported to the Pensions Committee on a quarterly basis.

In overseeing the Fund's control arrangements, and in forming the above opinions, the Chief Finance Officer has worked in conformance with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer in Local Government.

## **Monitoring and Review of Governance Arrangements**

The Fund's governance arrangements are formally monitored via:

- the Pensions Committee and Board framework, and ultimately by Falkirk Council;
- the Corporate Risk Management Group and other Corporate Working Groups;
- Internal/External Audit work as agreed annually with the Pensions Committee

Monitoring is undertaken within the context of the Fund's requirements to operate within a strict statutory framework and also deliver best value.

### **System of Internal Financial Control**

This section deals with the systems of internal financial control of Falkirk Council as administering body of the Pension Fund for the year to 31 March 2016. The Chief Finance Officer is responsible for ensuring the operation and maintenance of an effective system of internal financial control.

The system of internal financial control is based on a framework of risk management; Contract Standing Orders, Financial Regulations, and associated guidance; delegation and accountability; budgeting systems; and robust management information.

The Council's Internal Audit Section provides assurance on arrangements for risk management, governance, and control, and undertakes a regular, risk based, programme of work approved by the Chief Executive, Chief Finance Officer, and Council's Audit Committee. The Pension Fund uses a number of corporate systems, including the Council's Financial Information System and the online HR system. Assurance can therefore be taken from the broad seam of internal audit work undertaken on these and other systems annually.

The Internal Audit Manager has established a Quality Assurance and Improvement Programme for the Section, including annual self-assessment and periodic external assessment of compliance with the Public Sector Internal Audit Standards. The initial self-assessment confirmed broad compliance with the Standards, and an independent External Quality Assessment is planned for 2016/17. In addition, the Council's appointed External Auditors, Audit Scotland, have undertaken an assessment of the adequacy of the Internal Audit function, concluding that they can place reliance on Internal Audit work and that documentation standards and reporting procedures are sound.

All Internal Audit reports are issued to the relevant managers, and include recommendations and agreed action plans. It is then management's responsibility to ensure that appropriate action is taken to address these recommendations. Significant matters arising are brought to the attention of the Pensions Committee. During 2015/16, there were no matters which required to be brought to the attention of the Committee.

In addition, to more general internal audit activity which focused on the Council wide control environment, Internal Audit undertook during 2015/16 a review of Pension Fund Governance and transactional testing. The governance review focused on the revised Governance Policy which came into effect as a result of the Public Service Pensions Act 2013. The transactional testing during 2015/16 was to determine if:

- new member contributions to the Falkirk Council Pension Fund were properly calculated;
- the correct transfer values of pension rights either into or out of the Pension Fund had been received or paid; and
- the correct pension payments (including lump sum payments) were paid to retiring Fund members.

As a result of the work undertaken in 2015/16, Internal Audit were able to provide Substantial Assurance in relation to the adequacy of arrangements and found that the processes were working effectively. This has been reported to the Pensions Committee and Board at their meeting of 23 June 2016.

### **Governance Arrangements – Future Developments and Improvements**

Falkirk Council is committed to ensuring robust and proportionate governance. That said, the ever changing environment within which the Council operates means that there will always be scope for improvement. For example, the creation of a national Scheme Advisory Board and the extension of the Pension Regulator's powers to the Local Government Pension Scheme is resulting in greater scrutiny falling on Fund administration and governance arrangements.

Areas that will be addressed over the coming year include:

- internal audit testing of pensions activity and governance arrangements
- formal reporting to Pensions Committee of internal audit pensions work
- formalising a register of interests for the Pension Board
- assessment of performance against Pension Regulator's Code of Practice
- training for Board Members

### **Certification**

This Annual Governance Statement summarises, openly and transparently, arrangements established by Falkirk Council for 2015/16 and the period to date. It highlights areas for improvement, and is consistent with the Council's established improvement agenda.



**Councillor John Patrick**  
**Convener of the Pensions Committee**  
**22 September 2016**



**Mary Pitcaithly**  
**Chief Executive**  
**22 September 2016**

# **Falkirk Council Pension Fund**

**Local Government Pension Scheme**

## **Governance Compliance Statement**

**June, 2015**

## Part 2 – Governance Compliance Statement

Regulation 53 of the Local Government Pension Scheme (Scotland) Regulations 2014 (SSI 2014/164) requires administering authorities to prepare and publish a written statement setting out the terms of their current governance arrangements. The undernoted Statement tests the Falkirk Fund's compliance with the best practice principles as set out in the SPPA Best Practice Guidelines of April, 2011.

### Principle A – Structure

|     | <b>Requirement</b>   | <b>Level of Compliance</b>                      | <b>Arrangements in Place</b>  |
|-----|--|---|---|
| (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>Full Compliance</b>                          | Falkirk Council, as administering authority of the Falkirk Council Pension Fund, has established a Pensions Committee to which it has delegated the administration of benefits and strategic management of fund assets.                           |
| (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 | <b>Full Compliance</b>                          | The Pensions Committee includes three co-opted members reflecting the Fund's composition of members, pensioners and employers.  |
| (c) | That where a secondary committee or panel has been established, the structure ensures effective communication across both levels   | <b>Full Compliance</b>                          | The main channel of communication between the Pensions Committee and Board lies in the fact that quarterly Committee meetings are actually joint meetings with the Board with a shared agenda and with both parties having full access to papers. |
| (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.   | <b>Not Compliant</b><br>(as no longer relevant) | The statutory role of the Pension Board with oversight of Committee activity means it is not tenable for a Board member to also sit on the Committee.   |



| Requirements |   | Level of Compliance    | Arrangements in Place   |
|--------------|---|------------------------|---|
| (iii)        | Where appropriate, independent professional observers; and  | <b>Not Compliant</b>   | <p>There are no independent professional observers of Committee or Board business.</p> <p>It is considered that:</p> <ul style="list-style-type: none"> <li>▪ the diversity of representation; (employers, pensioner and Unions)</li> <li>▪ the training arrangements;</li> <li>▪ the annual audit process; and</li> <li>▪ attendance of professional advisors</li> </ul> <p>provide robust and adequate scrutiny of pension fund business.</p> |
| (iv)         | Expert advisors (on an ad-hoc basis).   | <b>Full Compliance</b> | <p>Support for the Pensions Committee and Pension Board is provided by the undernoted advisors:</p> <ul style="list-style-type: none"> <li>• actuary and investments, Hymans Robertson</li> <li>• corporate governance, PIRC Ltd</li> <li>• investment managers and custodian, as required.</li> </ul>  |
| (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. | <b>Full Compliance</b> | <p>The three co-opted members who sit on the Pensions Committee and the Pension Board members all have equality of access to papers, meetings and training. The co-opted members also have full opportunity to contribute to the decision making process, including the right to vote.</p>  |

## Principle C – Selection and role of lay members

| Requirement |  | Level of Compliance    | Arrangements in Place   |
|-------------|--|------------------------|---|
| (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 | <b>Full Compliance</b> | <p>Members of the Pensions Committee will be subject to the Falkirk Council Councillors Code of Conduct.</p> <p>Members of the Pension Board will be appointed on the understanding that they will be subject to the Falkirk Council Councillors Code of Conduct.</p> <p>Appropriate training will be delivered to Committee and Board members.</p> |
| (b)         | That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.  | <b>Full Compliance</b> | Declaration of interests is a standard procedure at the start of all Committee/ Board meetings. Declarations are noted in the minutes.  |

## Principle D – Voting

| Requirement |  | Level of Compliance    | Arrangements in Place   |
|-------------|--|------------------------|---|
| (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. | <b>Full Compliance</b> | All members of the Pensions Committee including co-opted members will have voting rights on the basis that they have executive responsibility for pension fund decision making. |



## Principle E – Training / Facility Time / Expenses

|     | <b>Requirement</b>   | <b>Level of Compliance</b> | <b>Arrangements in Place</b>  |
|-----|--|----------------------------|---|
| (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>Full Compliance</b>     | <p>The administering authority's approach to training is set out in its training policy for the Pensions Committee and Pension Board members.</p> <p>Training is delivered in large part by addressing specific items at Committee and Board meetings and complemented by visits to Fund Managers, bespoke training events and attendance at industry seminars and conferences.</p> <p>Expenses incurred by Committee and Board members are met either by the Fund or the Falkirk Council scheme for payment of members expenses.</p> |
| (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.  | <b>Full Compliance</b>     | The Training Policy for the Pensions Committee and Pension Board applies uniformly to all members.  |
| (c) | That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.  | <b>Full Compliance</b>     | The Training Policy for the Pensions Committee and Pensions Board includes the requirement for members to undergo training needs analysis and the development of commensurate training plans. A register of training undertaken will be maintained.   |

## Principle F – Meetings (Frequency/Quorum)

| Requirement |   | Level of Compliance    | Arrangements in Place   |
|-------------|---|------------------------|---|
| (a)         | That an administering authority's main committee or committees meet at least quarterly.   | <b>Full Compliance</b> | The Pensions Committee hold quarterly meetings.<br><br>Additional meetings are called as required.  |
| (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.  | <b>Full Compliance</b> | Pension Board meetings are held concurrently with Pensions Committee meetings which will result in a minimum of 4 meetings per year.<br><br>Additional meetings are called as required.   |
| (c)         | That an administering authority who does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented. | <b>Full Compliance</b> | The Council <i>does</i> include lay members on its Pensions Committee. However, in order to ensure that the interests of wider fund stakeholders can be represented, the Fund holds a Pensions & Investment Conference each year. |

## Principle G – Access

| Requirement |  | Level of Compliance    | Arrangements in Place  |
|-------------|--|------------------------|--|
| (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. | <b>Full Compliance</b> | Members of Pensions Committee and Pension Board have equal access to any committee papers, documents and advice that falls to be considered at meetings of the Pensions Committee. |

## Principle H – Scope

| Requirement   | Level of Compliance    | Arrangements in Place   |
|---|------------------------|---|
| (a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements. | <b>Full Compliance</b> | The agendas for Pensions Committee / Board meetings include reports pertaining to both administration and investment matters such as regulatory changes, actuarial valuation and funding level updates, admission agreements, investment strategy and Fund/ Investment Manager performance. |

## Principle I – Publicity

| Requirement  | Level of Compliance    | Arrangements in Place  |
|--|------------------------|--|
| (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. | <b>Full Compliance</b> | Employers, Unions and Pensioners have been consulted regarding the governance arrangements and invited to participate.<br><br>Full details of the Governance arrangements are published on the Fund's website. |



.....  
**Councillor John Patrick**  
**Convener of the Pensions Committee**  
**22 September 2016**



.....  
**Mary Pitcaithly**  
**Chief Executive**  
**22 September 2016**

## ACTUARIAL STATEMENT FOR 2015/16

### Falkirk Council Pension Fund (“the Fund”) Actuarial Statement for 2015/16

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

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

The funding policy is set out in the Administering Authority’s Funding Strategy Statement (FSS), dated February 2015. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members’/dependants’ benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable, where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (**NB** this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

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 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund’s assets, which at 31 March 2014 were valued at £1,577 million, were sufficient to meet 85% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £283 million.

Individual employers’ contributions for the period 1 April 2015 to 31 March 2018 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 the valuation report dated 31 March 2015.

## 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 2014 valuation were as follows:

| Financial assumptions             | 31 March 2014 |      |       |      |
|-----------------------------------|---------------|------|-------|------|
|                                   | %             | p.a. | %     | p.a. |
|                                   | Nominal       |      | Real  |      |
| Discount rate                     | 5.10%         |      | 2.40% |      |
| Pay increases                     | 4.00%         |      | 1.30% |      |
| Price inflation/Pension increases | 2.70%         |      | -     |      |

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI\_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies at age 65 are as follows:

|                    | Males      | Females    |
|--------------------|------------|------------|
| Current Pensioners | 22.1 years | 23.8 years |
| Future Pensioners* | 24.3 years | 26.3 years |

\*Future pensioners are assumed to be aged 45 at the 2014 valuation.

Copies of the 2014 valuation report and Funding Strategy Statement are available on request from Falkirk Council, the Administering Authority to the Fund.

## **Experience over the period since April 2014**

Experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bond yields have fallen dramatically placing a higher value on liabilities. The effect of this has been only partially offset by the effect of strong asset returns. Funding levels are therefore likely to have worsened and deficits increased over this period.

The next actuarial valuation will be carried out as at 31 March 2017. The Funding Strategy Statement will also be reviewed at that time.

Steven Scott FFA

Fellow of the Institute and Faculty of Actuaries  
For and on behalf of Hymans Robertson LLP  
5 April 2016

## SCHEDULED AND ADMISSION BODIES AS AT 31 MARCH 2016

### Scheduled Bodies

Central Scotland Joint Valuation Board  
 Clackmannanshire Council  
 Falkirk Council  
 Forth Valley College  
 Scottish Children's Reporter Administration (SCRA)  
 Scottish Environment Protection Agency (SEPA)  
 Scottish Fire and Rescue Service (ex Central Scotland Fire & Rescue Service)  
 Scottish Police Authority (ex Central Scotland Police)  
 Stirling Council  
 Visit Scotland (Ex-Argyll, The Isles, Stirling, Loch Lomond and Trossachs Tourist Board)

### Admission Bodies with Active Members

Active Stirling  
 Alsorts  
 Amey (Clackmannanshire Schools Project) \*  
 Association of Scottish Colleges  
 Ballikinrain School  
 Central Carers Association  
 Ceteris  
 Cowane's Hospital  
 Dollar Academy Trust  
 Falkirk Community Trust Ltd  
 Forth and Oban Ltd  
 McLaren Community Leisure Centre \*  
 Open Secret \*  
 Plus \*  
 Scottish Autism  
 Seamab School  
 Smith Art Gallery  
 Snowdon School Ltd  
 Stirling District Tourism Ltd  
 Stirling Enterprise Park Limited (STEP)  
 Strathcarron Hospice  
 Thinkwhere Ltd. (formerly Forth Valley GIS Ltd) \*  
 Valad Management (UK) Ltd \*  
 Water Industry Commission for Scotland  
 Haven Products Ltd  
 \* Closed to new members

### Other Admission Bodies with Continuing Interest in Fund

Central Scotland Council for Regional Equality  
 Stirling University  
 Waterwatch Scotland