

DRAFT

**FALKIRK COUNCIL**

**MINUTE of JOINT MEETING of the PENSIONS COMMITTEE/BOARD held in the MUNICIPAL BUILDINGS, FALKIRK on FRIDAY 26 JUNE 2015 at 9.30 A.M.**

**PRESENT:**

Councillors:  
Tom Coleman  
Steven Carleschi  
Depute Provost John Patrick (Convener)

Councillor Colin Campbell, Stirling Council  
Andrew Douglas, Unison  
Ian McLean, Pensioner Representative

Councillor Archie Drummond, Clackmannanshire Council  
Susan Crook, Unison  
Sandy Harrower, UCATT  
Gordon Laidlaw, Scottish Autism  
Ed Morrison, Scottish Children's Reporter Administration's (SCRA)  
Tommy Murphy, GMB  
Jennifer Welsh, SEPA

**ATTENDING:**

Alastair McGirr, Pensions Manager  
Brian Pirie, Democratic Services Manager  
Bryan Smail, Chief Finance Officer

**ALSO IN  
ATTENDANCE:**

Bruce Miller, Investment Manager, Lothian Pension Fund  
Jim Rundell, Audit Scotland  
Linda Selman, Hymans Robertson  
Vikram Bhaskar and Roger Ammoun, Grosvenor Capital  
Stephen Docherty and Julie Pine, Aberdeen Asset Management

**PE1. APOLOGIES**

Apologies were intimated on behalf of Councillor Blackwood and Herbie Schroder, Unite.

**PE2. DECLARATIONS OF INTEREST**

No declarations were made.

### **PE3. MINUTE**

#### **Decision**

**The minute of the meeting of the Pensions Committee and Panel on 12 March 2015 was approved.**

### **PE4. PENSIONS BOARD CONSTITUTION**

The Committee and Board considered a report by the Chief Governance Officer presenting a draft constitution for the Pension Board.

The report indicated that the Pensions Committee had previously agreed revised governance arrangements for the Falkirk Council Pension Fund in compliance with the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 and the Public Service Pensions Act 2013. The new arrangements included the establishment of a Pension Board from 1 April 2015 with responsibility for assisting the Scheme Manager (the Council) in accordance with the Pension Scheme Regulations and the requirements of the Pensions Regulator.

The draft constitution for the Pensions Board would assist in the administration of the Board and establish the Terms of Reference for its operation based upon the Governance Heads of Agreement and Model Constitution authorised by the Scottish Local Government Pensions Advisory Group (SLOGPAG).

#### **Decision**

**The Committee and Board noted the report and the draft constitution of the Pension Board.**

**The Committee approved the draft constitution of the Pension Board as detailed in the Appendix to the report.**

### **PE5. GOVERNANCE ARRANGEMENTS**

The Committee and Board considered a joint report by the Chief Finance Officer and Chief Governance Officer advising of changes to the Fund's governance arrangements and seeking approval of a revised Governance Policy document.

The report advised that the Pensions Committee, following consultation with the former Pensions Panel and other key stakeholders, agreed to introduce revised governance arrangements for the Falkirk Council Pension Fund from 1 April 2015. The changes were agreed by the Committee on 11 December 2014 and ratified by Falkirk Council on 17 December 2014.

The main changes were as follows:-

- to dissolve the Pensions Panel from 1 April 2015;
- to establish a Pension Board from 1 April 2015;

- to maintain the existing structure of the Pensions Committee (i.e. 6 Falkirk Council members plus 3 co-opted members with one each drawn from Unions, Employers and Pensioners);
- to have a Pension Board of 4 Employer members and 4 Trades Union members;
- to appoint Trades Union members from Unison, GMB, Unite and UCATT; and
- to appoint employer members from each of Clackmannanshire Council, SEPA, SCRA and one other Scheduled or Admission Body with the Clackmannanshire Council place being shared with Stirling Council depending on which Council was already represented on the Pensions Committee.

The report detailed:-

- the appointed employer and Trades Union representatives following a nomination exercise to serve on the Pension Board;
- there being a resignation from the Committee;
- that members of the Board were requested to nominate one of their number to serve as Chair of the Board, to be rotated annually between the Trades Union and Employer sides; and
- the Fund Governance Policy document including the updated statutory Governance Compliance Statement to reflect the recent governance changes.

## **Decision**

**The Committee and Board noted:-**

- (1) the report;
- (2) the associated draft Governance Policy document as detailed in the Appendix to the report;
- (3) the correction to the Unison appointment on the Board to that detailed within the report to Susan Crook and not Margaret Cook; and
- (4) that Andy Douglas had been appointed by Unison to the Committee to replace Mary Keggan.

The Board (a) nominated Councillor Drummond to serve as Chair of the Board from the Employers side; (b) requested that the Trades Union nomination would be submitted to the Clerk to the Board, and (c) that both sides agree and thereafter notify the Clerk to the Board of which side would take the role of Chair first for a period of one year.

**The Committee agreed:-**

- (1) the nomination of Councillor Drummond as Chair to the Board from the Employers side and that the nomination from the Trades Union side would be submitted to the Clerk to the Board together with the rotational arrangements;

- (2) the draft Governance Policy document; and
- (3) that officers bring forward policy documents dealing with conflicts of interest and training arrangements.

**PE6. UNAUDITED ANNUAL REPORT AND ACCOUNTS - 2014/15**

The Committee and Board considered a report by the Chief Finance Officer on the Falkirk Pension Fund's Unaudited Annual Report and Accounts for 2014/2015 and (a) referring to the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, which required administering authorities to publish a Pension Fund annual report, recognising that Fund were separate from other accounts of the administering authority; (b) the various additional requirements of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2014, and (c) attaching as an appendix for inspection, a copy of the Fund's Unaudited Annual Report and Accounts for 2014/15.

**Decision**

The Committee and Board noted the publication of the Unaudited Falkirk Council Pension Fund Annual Report and Accounts 2014/15 detailed in the Appendix to the report.

The Committee approved the Annual Governance Statement contained within the Annual Report and Accounts.

**PE7. FUNDING UPDATE**

The Committee and Board considered a report by the Chief Finance Officer on the latest funding position in relation to the Pension Fund.

**Decision**

The Committee and Board noted the report detailing the funding position at 31 March 2015 as detailed in the Appendix to the report.

**PE8. GENERAL GOVERNANCE MATTERS**

The Committee and Board considered a report by the Chief Finance Officer presenting an update on various matters associated with the governance of the Falkirk Council Pensions Fund.

The report detailed that the new version of the Local Government Pension Scheme came into effect on 1 April 2015 and this included the undernoted key changes:-

- the career average accrual;
- the protection of final salary rights;

- that the scheme's normal retirement age was now equivalent to each member's own State Pension Age;
- the accrual rate of 49ths rather than 60ths;
- the member contribution rate for part time members being based on actual rather than full time pay;
- the overtime hours pensionable for part time members;
- the details of the 50/50 option;
- the no detriment underpin for older members;
- the employer discretions policy due by 30 June 2015; and
- the new governance arrangements.

The new pensions administration system became operational in March 2015. The system was maintained by external software providers and reduced reliance on a key individual for systems development. A degree of further development work was required, in particular in relation to the migration of the pensioner payroll to the Altair platform.

The other areas covered within the report comprised:-

- the risk register;
- the progress of the social and affordable housing investment with Hearthstone plc;
- the UK local infrastructure projects in collaboration with Lothian Pension Fund;
- the National Scheme Advisory Board;
- the Pensions Regular and the Code of Practice – Governance and Administration in Public Service Pension Schemes; and
- the work of the Local Authority Pension Fund Forum (LAPFF) and its Conference in Bournemouth from 2 to 4 December 2015 to be attended by Committee members Councillors Blackwood and Coleman.

## **Decision**

**The Committee and Board noted the report.**

## **PE9. PRESENTATION - ABERDEEN ASSET MANAGEMENT**

The Committee and Board received a presentation by Stephen Docherty and Julie Pine, Aberdeen Asset Management.

The presentation covered the undernoted:-

- Total assets;
- Global Equity;
- Risk in Portfolio;
- Performance and Attribution;
- Current Positioning;
- Portfolio Activity over 12 months; and

- Market Outlook.

The Convener thanked Mr Docherty and Ms Pine for their comprehensive presentation.

#### **Decision**

**The Committee and Board noted the presentation.**

### **PE10. INVESTMENT STRATEGY REVIEW**

The Committee and Board considered a report by the Chief Finance Officer providing an update on the progress of the Pension Fund's Review of the Investment Strategy.

Appendix A to the report provided detail of the current Investment Strategy, the opportunities for risk reduction and further areas for consideration. Appendix B to the report described a draft Terms of Reference for the proposed Investment Sub Group to make recommendations regarding implementation of the Strategy, the range of asset classes, asset allocation and the managers to be deployed by the Fund.

#### **Decision**

**The Committee and Board noted the report.**

**The Committee agreed:-**

- (1) that an Investment Strategy Sub Group be established to work with officers and advisers to make recommendations on the review of Investment Strategy to the Committee;
- (2) to seek nominations from the Committee to the Sub Group;
- (3) to seek nominations from the Board to attend the Sub Group; and
- (4) to invite the Sub Group to report to the Committee and Board in September 2015 on progress of the Investment Strategy Review.

NOTE: Whilst the report recommended limited numbers of nominations from the Committee and Board, the Committee agreed that due to the degree of interest from members higher numbers of members would be accommodated.

### **PE11. FUND MANAGER PERFORMANCE REVIEW**

The Committee and Board considered a report by the Chief Finance Officer reviewing the overall performance of the Fund and of the undernoted Fund Managers:-

- Aberdeen Asset Management;
- Baillie Gifford (Bond Mandate);
- Baillie Gifford (Diversified Growth);

- Legal and General Investment Management;
- Newton Investment Management;
- Schroder Investment Management (UK Equities); and
- Schroder Investment Management (Property).

#### **Decision**

**The Committee and Board noted the Fund Managers' performance and the action taken by them during the quarter to 31 March 2015, in accordance with their investment policies.**

### **PE12. PRIVATE EQUITY AND ALTERNATIVES UPDATE**

The Committee and Board considered a report by the Chief Finance Officer on the progress of the Pension Fund's private equity and alternatives programme arising from the investments programme for SL Capital (Standard Life), Wilshire Associates, Grosvenor Capital, M&G and Hearststone for the quarter ending 31 March 2015.

#### **Decision**

**The Committee and Board noted the progress of the Pension Fund's Private equity, infrastructure and credit markets programme for the quarter ending 31 March 2015.**

### **PE13. PRESENTATION - GROSVENOR CAPITAL**

The Committee and Board received a presentation by Vikram Bhaskar and Roger Ammoun, Grosvenor Capital.

The presentation covered the undernoted:-

- Private Market Approach to Infrastructure;
- Customised Infrastructure Strategies, Overview and Portfolio;
- Comprehensive Alternative Investment;
- Drivers of Infrastructure Opportunities.

The Convener thanked Mr Bhaskar and Mr Ammoun for their comprehensive presentation.

#### **Decision**

**The Committee and Board noted the presentation.**





**FALKIRK COUNCIL**

**Subject: GENERAL GOVERNANCE MATTERS**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 24 SEPTEMBER 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 This report updates the Board and Committee on miscellaneous matters associated with the business of Falkirk Council Pension Fund.

**2. INTERNAL AUDIT REPORT**

- 2.1 An Internal audit report on 'Pension Administration and Pension Fund Governance' was submitted to management on the 15<sup>th</sup> of July 2015. The review focused on fund governance and arrangements for the calculations of new member contribution, paying/receiving transfer values and making leaver payment.
- 2.2 Internal Audit provided substantial assurance in relation to the adequacy of arrangements for Fund governance and for processing of pension related transactions.
- 2.3 Internal audit set out two recommendations:
- Establishing a Register of Interest
  - Addressing risk management points
- 2.4 A copy of the report is appended and Internal Audit will attend the meeting.

**3. PETROBRAS – CLASS ACTIONS**

- 3.1 A report on this was considered by the 12 March 2015 meeting of the Pensions Panel and Committee. It was noted that the New York based firm of Robbins Geller Rudman & Dowd, which advises the Council on USA based actions, had estimated the Council's losses at \$7m.
- 3.2 The Committee agreed to delegate the final decision on participating to the Chief Finance Officer. In the interim, following direct conversation with the legal firm and with advice from Lothian, I have agreed that the legal firm would initiate a Stand Still Action. This protects the Council's position if we elect to opt out of the class action, but does not commit the Council to anything.

- 3.3 It is the nature of such actions, particularly one of this scale and complexity, that the matter will progress over years rather than months. I will keep the Board and Committee informed.

#### **4. LOCAL GOVERNMENT PENSION SCHEME ADVISORY BOARD**

- 4.1 The second meeting of the national Scheme Advisory Board was held in Edinburgh on 27 August. The following paras summarise the key items of business.

- 4.2 Mr Swinney, Depute First Minister, has approved the Board's draft Work Plan, and in so doing, also directed that the Board should:-

- “ (i) pay very early attention on both the impact of fund administrator's policies on setting employer contribution rates for non-local government bodies and its approach to cessation charges. I would be interested in an early report on this particular issue which should include significant input from the affected bodies;
- (ii) that in due course I would be interested in the Board's views on the merits of merging or pooling funds' assets, noting that the UK government is taking a particularly directive approach to that issue;
- (iii) whilst recognising the merits of the Board's bi-partite composition, it is important that there is very close working between the Board and the SPPA on matters of policy. SPPA acts as a custodian of the LGPS regulations on my behalf and therefore I expect there to be clear evidence of that close working relationship.”

- 4.3 A template is being agreed that will allow the collection of data across Scottish Funds in a consistent manner and facilitate benchmarking. This would in turn feed into workstreams considering how transparency of investment decisions might be approved and the structure of the Scottish LGPS.

- 4.4 A QC's opinion on Trustee's fiduciary duty would be pursued so that a contemporary Scottish legal opinion is obtained to match the position in England. This clearly will be an important reference point for the Fund's consideration of Ethical, Social & Governance (ESG) matters and will feed into the current Investment Strategy Review by the Sub Group.

- 4.5 The Government Actuary's Department (GAD) is pursuing work on the Cost Cap Mechanism, based on the 2014 valuation data, consistent with the requirement of the Public Service Pensions Act 2013. The importance of this is that if the measure is +/- 2% from the original Cost Gap then:-

- Change in reformed scheme benefits
- Change in member contributions
- Default is a change in the accrual rate

## **5. THE PENSIONS REGULATOR**

5.1 The jurisdiction of the Pension Regulator now extends to the LGPS and this brings with it responsibilities for reporting breaches of the Law. This as noted below could potentially be quite onerous.

5.2 Examples of breaches are:-

- Failure of an employer to pay over member and employer contributions on time
- Failure to pay member benefits either accurately or in a timely manner
- Failure to maintain accurate records
- Failure to issue annual benefit statements on time.

Consideration would need to be given to materiality.

5.3 The responsibility to report any such breach is wide and extends to all individuals with a role in the LGPS. This therefore would include the scheme manager, pension board members, scheme employers and professional advisers, including the actuary.

5.4 Whilst it is expected that the Regulator may adopt a light touch in the early days, the Fund will need to ensure its monitoring and tracking processes are fit for purpose.

## **6. LOCAL AUTHORITY PENSIONS FUND FORUM (LAPFF)**

6.1 The LAPFF represents the interests of 65 local authority pension funds with combined assets of around £165 billion. Its mission is to promote the highest standards of corporate responsibility amongst the companies in which member funds invest.

6.2 The LAPFF is supported by PIRC Ltd, who are the Forum's company research and engagement partner. PIRC are also the Falkirk Fund's proxy voting agents and advisers on ESG matters.

6.3 As part of its lobbying activities, LAPFF is a leading participant in the "Aiming for A" campaign – a coalition of asset owners with shared concerns over the environmental dangers of climate change and the long term profitability of carbon intensive energy companies.

6.4 The campaign has prompted unprecedented level of support for shareholders resolutions on strategic resilience at the BP and Shell AGMs. The resolutions included a request for an assessment of the companies' asset portfolio resilience against the range of International Energy Agency scenarios. A voting alert was issued for similar resolutions to the Statoil and similar issues highlighted for Chevron, Anadarko and ExxonMobil.

6.5 Other LAPFF activity during the last quarter included:

- Meeting with the chairman of Barclays regarding remuneration committee chairman and accounting standards

- LAPFF representatives attended and proposed motions or addressed the board at eight AGMs during the quarter: Rio Tinto (tax transparency and carbon management), British American Tobacco (health), Carillion & Balfour Beatty (labour supply chain), Next (supply chain))
- Following LAPFF letter to Tesco regarding linkage between executive remuneration and good governance, Tesco announced provisions to claw back bonuses from its CEO and Finance Director
- Raising concerns over employment standards and human rights at National Express AGM

6.6 Following discussions at the last Committee meeting, Councillors Blackwood and Coleman have agreed to attend the LAPFF Annual Conference in Bournemouth on 2<sup>nd</sup> – 4<sup>th</sup> December, 2015.

## **7. RECOMMENDATION**

7.1 The Pensions Committee and Pensions Board are invited to note the content of this report.

pp Director of Corporate & Housing Services

**Date: 14 September 2015**

**Contact Officer: Bryan Smail**

### **LIST OF BACKGROUND PAPERS**

NIL

# FALKIRK COUNCIL

## INTERNAL AUDIT REPORT



# Falkirk Council

## 2015/16 INTERNAL AUDIT REVIEW

### PENSION ADMINISTRATION AND PENSION FUND GOVERNANCE

<b>Overall Assurance</b>	<b>SUBSTANTIAL ASSURANCE</b>
<b>Auditor</b>	Graham Templeton, Senior Internal Auditor
<b>Report Recipients</b>	Bryan Smail, Chief Finance Officer Amanda Templeman, Acting Depute Chief Finance Officer (Corporate Finance) Alastair McGirr, Pensions Manager
<b>Date</b>	15 July 2015

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## 1. INTRODUCTION AND SCOPE

1.1 This review of Pension Fund Governance and the arrangements for processing pension related transactions forms part of our 2015/16 Internal Audit coverage, agreed by the Audit Committee in April 2015.

1.2 Internal Audit, in conjunction with the Pensions Manager, identified the key risks relating to pensions governance and transactions, and agreed Terms of Reference for the review (**Annex 1**).

1.3 Falkirk Council is the Administering Authority for the Falkirk Council Pension Fund (the Fund). The Council is responsible for ensuring that Fund business is legal and in accordance with pension standards. The Fund is used to pay pension, lump sum benefits, and other entitlements to scheme members and their dependants. Contributions to the Fund are made by active members (ie employees) and by participating employers. The Fund also receives income from the assets it holds, which includes equities, property, and bonds.

1.4 Fund membership (see **Table 1**) is made up of active, deferred, and pensioner members. To be eligible for fund membership individuals must be an employee of a participating employer and not eligible to join one of the other public sector pension schemes. In addition to Falkirk Council, participating employers (referred to as either Scheduled or Admission Bodies) include Clackmannanshire and Stirling Councils, Central Scotland Valuation Joint Board, the Scottish Children's Reporter Administration, the Scottish Environment Protection Agency, Forth Valley College, Falkirk Community Trust, and a number of charitable bodies.

**Table 1**  
**Scheme Membership at 31 March 2015**

<b>Active</b>	<b>Deferred</b>	<b>Pensioners</b>	<b>Total</b>
<b>14,589</b>	<b>5,405</b>	<b>8,995</b>	<b>28,989</b>

1.5 There have been a number of recent reforms and changes to pensions. The majority of these were as a result of the Public Service Pensions Act 2013. The reforms and changes include auto enrolment and the change in the Local Government Pension Scheme from a final salary to a career average basis from 01 April 2015.

1.6 Administration is undertaken by the Falkirk Council Pensions Section. The reforms and changes referred to above have meant the Pensions Section has had to procure and implement a new Pensions Administration System. In addition, new corporate governance arrangements for the management of the Fund took effect from 01 April 2015.

1.7 This review has focussed on fund governance, and arrangements within the Pensions Section for the calculation of new member contributions; for paying / receiving transfer values; and for making leaver payments.

## **2. AUDIT ASSURANCE AND EXECUTIVE SUMMARY**

2.1 We can provide **SUBSTANTIAL** assurance in relation to the adequacy of arrangements for Fund governance and for the processing of pensions related transactions (see **Annex 2** for a definition of assurance categories).

2.2 We found that the operational controls associated with the calculation of new member contributions; for paying / receiving transfer values; and for making payments were well managed and working effectively. All staff consulted during the review were clear about their roles and responsibilities.

2.3 The governance arrangements for the Fund have recently changed, and we did note some points where there was scope for enhancing the existing framework of control. In particular, we found there to be a need for more robust risk management arrangements, to ensure that risks are better assessed and managed with ownership clearly stated, and for the maintenance of a Register of Interests for Pension Committee and Board members.

2.4 A summary of our recommendations is set out at Section 4 of this report, with more detail provided at Section 3.



### **3. AUDIT FINDINGS**

#### **Remit Item 1: Governance**

3.1 The Council has delegated responsibility for the administration of the Pension Fund (the Fund) to the Pensions Committee (the Committee), with various operational responsibilities falling to the Chief Financial Officer. During 2014/15 the Committee was supported by an advisory Pensions Panel (the Panel).

3.2 Governance arrangements for the Fund have recently changed. The changes (effective from 01 April 2015) were agreed by the Committee and then ratified by full Council in December 2014. Changes include the establishment of a Pensions Board (the Board) and the discontinuing of the Panel. The Committee configuration has remained unchanged. The Board's constitution was agreed at a joint meeting of the Committee and Board in June 2015. While the Board may convene its own meetings, the expectation is that the Board will meet jointly with the Committee.

3.3 The Fund Governance Policy (the Policy), which includes the statutory Governance Compliance Statement, has been updated to reflect the recent changes. The Policy was also agreed at the inaugural joint meeting of the Committee and Board in June 2015.

3.4 Investment Management of the Fund's assets is undertaken by external fund managers. The Pensions Section oversees this, with the support of the Fund's appointed investment adviser Hymans Robertson. Additional support is provided through a resourcing agreement with the Lothian Pension Fund. The Committee meets on a quarterly basis to review external fund manager actions and performance. In addition, the Fund measures its performance against a number of standards. Performance information is supplied to Scottish Government and CIPFA, and is included within the Annual Report.

3.5 The Fund's Investment Strategy is currently being reviewed, and a report was presented to the March 2015 Committee on the level of risk associated with various strategies, the options for reducing risk, and how the chosen strategy can be put into practice. The review will focus on ways to reduce exposure to riskier assets without compromising the Fund's prospects of returning to fully funded status in the medium to long term. The agreed changes

will result in a revised Statement of Investment Principles once the Investment Strategy review is concluded.

3.6 The unaudited Annual Report and Accounts for 2014/15 confirm that a Conflicts of Interest Policy will be prepared during 2015/16. Conflicts of Interest are a standing agenda item at Committee / Board meetings. To supplement this, we **recommend** that a Register of Interests is established to record details of any actual / potential conflicts relating to members of the Committee and the Board. The Register should be published on the Fund's website.

3.7 At an operational level, roles and responsibilities were well understood by Pensions Section staff. Operational procedures are in place, and these are being updated to reflect the revised processes established following implementation of the new Pensions Administration System. A range of key performance indicators, in relation to membership and benefits administration, are monitored by the Pensions Manager, and these are summarised in the Annual Report and Accounts. The performance indicators will be reviewed by the Pensions Manager as the new Pensions Administration System is developed.

## **Remit Item 2: Risk Management Arrangements**

3.8 The Policy summarises risk management arrangements in relation to Fund activities. The Pension Fund Risk Register focuses mainly on the risks to the administrative functions, and the Board is advised of any significant changes in risk level as well as the reason for the change. Investment risks are detailed in the Statement of Investment Principles, and risks also feature in the Funding Strategy Statement.

3.9 A commitment is made in the unaudited 2014/15 Annual Report and Accounts that the Pensions Section will review risk management over the coming year. In undertaking this review, we **recommend** that the following points are considered:

3.9.1 the risks detailed in the Statement of Investment Principles and Funding Strategy Statement have no specific owner, ranking, or score. It is also not stated how movement in these risks are reported to the Committee / Board; and

3.9.2 the Risk Register does not reflect the current live risk position. In future, the Board should be advised of the change to the risk score to enable the Board to quantify

the scope of any movement, and the Risk Register should be updated on an ongoing basis.

### **Remit Item 3: Arrangements for the actuarial valuation of the Pension Fund**

3.10 The actuarial valuation of the Pension Fund is undertaken every three years. The valuation determines the financial position of the Fund and sets an appropriate rate of employers' contributions for the next three years. The last actuarial valuation, carried out by Hymans Robertson, covered the period to 31 March 2014. The key results from the 2011 and 2014 valuations are summarised in Table 2.

**Table 2**  
**Actuarial Valuation**

	<b>Valuation at 31 March 2011</b>	<b>Valuation at 31 March 2014</b>
Past Service Liabilities	£1,392m	£1,860m
Assets	£1,199m	£1,577m
Funding Deficit	£193m	£283m
<b>Funding Level</b>	<b>86.1%</b>	<b>84.8%</b>

3.11 The results from the actuarial valuation were reported to the Committee / Panel in March 2015. The 2014 valuation showed that the Fund is 85% funded (meaning that it has 85% of monies needed to pay all the future benefits of scheme members based on the rights that they had accumulated to that date).

3.12 The valuation also highlighted that, whilst asset performance between 2011–2014 was significantly better than the return targeted, this had been outstripped by an increase in fund liabilities. The Council's approach to funding scheme liabilities is set out in the Funding Strategy Statement which was agreed by the Committee / Panel in March 2015. During 2014/15, the Fund has increased its exposure to alternative assets by making a £30m commitment to Social and Affordable Housing, and a further £30m commitment to be invested in UK infrastructure.

3.13 A further estimated funding position, as at 31 March 2015, was provided to the Committee / Board at the June 2015 meeting.

#### **Remit Item 4: Guidance and Training**

3.14 Various seminars, conferences, and in-house training events are made available to Committee / Board members. This includes the Falkirk Council Pension Fund annual conference. The current Pension Fund Training Policy was approved by the (then) Investment Committee in March 2012, and the unaudited Annual Report and Accounts for 2014/15 confirm that training arrangements will be addressed during 2015/16.

3.15 The new Board met for the first time in June 2015. Arrangements are being made for Board members to be provided with training. It is also recognised that the Training Policy will require to be updated and that training arrangements will continue to be broad-based to support member decision making.

#### **Remit Item 5: Transactional Arrangements**

##### **New Members**

3.16 We reviewed a sample of recent applications and were content that these had been processed accurately. A new member notification form is completed by the employee and employer and submitted to the Pensions Section. The form is checked by the Pensions Section, in particular to ensure that pensionable pay and the contribution rates are correct. Member details are added to the Pensions Administration System and a welcome pack (that includes the statutory notification form) is sent to the employee.

##### **Paying / receiving transfer values**

3.17 Arrangements for the payment and receipt of transfer values were sound. Transfers can fall into three categories: inter-fund adjustments (from other Local Authority funds); public sector scheme transfer (from other public sector funds); and private sector pension transfers.

3.18 When paying out transfer values the Pensions Section will receive a request for a transfer value (usually from the other pension scheme or a financial adviser on behalf of the employee). The transfer value is then calculated and statement of entitlement, transfer information sheet, and transfer request / discharge forms are issued. For inter-fund transfers,

an inter-fund adjustment calculation is issued. The transfer will proceed on receipt of the authorised transfer form.

3.19 For transfers into the Fund the Pensions Section become aware of these once the member has joined and indicated that they have previous pension rights. If the member confirms they are interested in transferring, a request is made to the other pension scheme(s) for confirmation of the pension value and duration of membership (for inter-fund adjustments a transfer value is received). This information is then used by the Pensions Section to calculate the adjusted transfer value / number of days service. Details of the calculation are recorded (on the service credit working paper) and the member is advised of these details in writing. The member also has to confirm in writing if they want to proceed.

3.20 We tested a sample of recent transfers (both payments and receipts) and were content that the necessary supporting documentation was available, had been appropriately completed and authorised, and that the correct value of funds had been received or paid out.

### **Pension Payments**

3.21 Once the Pensions Section are notified of a leaver or retirement, a statement of pensionable remuneration is issued by the relevant payroll department with their final salary details.

3.22 Where the individual is retiring the Pensions Section write to them to confirm how they wish to receive their retirement benefits. This information is included in a retirement pack which consists of a pension enrolment form, lifetime allowance declaration, and lump sum request form. Prior to this, the value of the annual pension, monthly pension, and lump sum is checked by the Pensions Officer.

3.23 We tested a number of pension payments (including lump sums), and were content that they had been correctly calculated and had been appropriately completed and authorised.

#### 4. RECOMMENDATIONS AND ACTION PLAN

Rec No.	Recommendation	Reason for Recommendation	Agreed Management Action	Responsible Owner	Action Due
1.	<p>A Register of Interests should be established to record details of any actual / potential conflicts relating to members of the Committee and the Board.</p> <p>The Register should be published on the Fund's website.</p> <p><b>Report Paragraph: 3.6</b></p>	To ensure that any dual interests or responsibilities are being recorded and monitored on an ongoing basis.	<p><b>Recommendation Accepted</b></p> <p>Once the Conflicts of Interest Policy has been agreed the Democratic Services Manager and the Pensions Manager will discuss further.</p>	Democratic Services Manager / Pensions Manager	31 March 2016
2.	<p>The points in relation to the risk ownership, ranking, and score; and updating the risk register for the Fund; should be addressed.</p> <p><b>Report Paragraph: 3.9</b></p>	To demonstrate that all risks are being identified, assessed and managed.	<p><b>Recommendation Accepted</b></p> <p>The risk management points will be addressed.</p>	Pensions Manager	31 March 2016

## Terms of Reference



<b>Service:</b>	Chief Executive Office – Finance Services	<b>Audit Year:</b>	2015/16
<b>Depute CFO:</b>	Amanda Templeman	<b>Audit Manager:</b>	Gordon O'Connor
<b>Manager:</b>	Alastair McGirr	<b>Lead Auditor:</b>	Graham Templeton
<b>Audit Area:</b>	Pension Administration and Pension Fund – Governance Arrangements		

### **SCOPE**

The scope of this review was to evaluate and report on controls established to manage the risks relating to the governance and management of the Falkirk Council Pension Fund and the processing of pension related transactions. This review formed part of our 2015/16 coverage of Falkirk Council, agreed by the Audit Committee on 20 April 2015.

### **KEY RISKS**

These are the key risks that could exist if the main elements of the internal control framework are not in place. The purpose of the review was to assess the adequacy of the controls established to manage these risks. The following were identified as key risks:

- lack of clarity in Pension Fund Governance arrangements results in poor investment decisions and / or non compliance with legislation and codes of practice;
- lines of accountability poorly defined or unclear, results in pension fund risks not being identified, prioritised, and managed in a coordinated manner;
- pressure of fund assets, resulting in adverse impact on Council budgets;
- lack of guidance and training, leading to poor administration of the Pension Fund and resulting in non-compliance with legislation, best practice, or Financial Regulations; and
- lack of clarity in pension transaction processing roles and responsibilities, resulting in financial loss and / or not meeting customer requirements.

### **REMIT ITEMS**

We developed our audit work-plan to obtain the necessary evidence to provide assurance that appropriate systems are in place to mitigate the above risks. This was done by reviewing the following:

1. Pension Fund governance. To include roles and responsibilities of the Pensions Committee, Pensions Panel / Board, and professional advisers;
2. Pension Fund risk management arrangements;
3. Arrangements for the actuarial valuation of the Pension Fund;
4. Guidance and training. To include Pensions Committee and Pensions Board members, as well as Council staff.
5. Roles and responsibilities of those involved in:
  - ensuring that new member contributions are properly calculated;
  - paying / receiving transfer values; and
  - pension payments (including lump sum payments).

This included testing of a sample of transactions, and reviewing the adequacy of supporting policies and procedures.

### DEFINITION OF ASSURANCE CATEGORIES

Level of Assurance	Definition
<b>Substantial assurance</b>	Largely satisfactory risk, control, and governance systems are in place. There may be some scope for improvement as current arrangements may undermine the achievement of objectives or leave them vulnerable to error or abuse.
<b>Limited assurance</b>	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or abuse.
<b>No assurance</b>	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or abuse is unacceptable. Significant improvements are required.



**FALKIRK COUNCIL**

**Subject: FALKIRK COUNCIL PENSION FUND - ANNUAL ACCOUNTS 2014/15**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 24 SEPTEMBER 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 The purpose of this report is to ask the Pensions Committee and Board to review the Audited Accounts and Annual Audit Report of the Fund for 2014/15 and to ask the Pensions Committee to give its approval.

**2. AUDIT PROCESS**

- 2.1 The Pension Fund Annual Report and Accounts 2014/15 have now been audited and copies are attached. The auditor's certificate is free from qualification.
- 2.2 Matters arising have been highlighted by Audit Scotland in their Annual Audit Report 14/15. Members should note that Annual Audit Report now incorporates the ISA 260 report i.e. report to those charge with governance. Last year this was issued in a separate report.
- 2.3 A copy of the audited accounts and annual report will be posted on the Pension Fund website and will be brought to the attention of all Fund employers.

**3. RECOMMENDATIONS**

- 3.1 Members of the Pension Committee and Board are asked to review the Audited Falkirk Council Pension Fund Annual Report and Accounts 2014/15.
- 3.2 Members of the Pensions Committee are asked to approve the Audited Falkirk Council Pension Fund Annual Report and Accounts 2014/15

pp **Director of Corporate & Housing Services**  
**Date: 16 September 2015**

**Contact Officer: Bryan Smail/Justyna Korszen-Bennett**

**LIST OF BACKGROUND PAPERS**

NIL



# **Falkirk Council Pension Fund**

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## **Annual Report and Accounts**

### **2014/15**

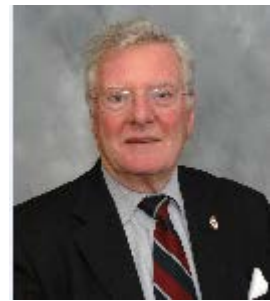


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# Foreword from the Chair of the Pensions Committee Councillor John Patrick



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 2014/15 Annual Report and Statement of Accounts.

The world of Pensions continues to evolve and face major challenges in the shape of key initiatives such as Auto Enrolment, Freedom and Choice and the introduction of a Single State Pension. These far reaching reforms, bringing pensions to a wider audience than ever before and providing greater flexibility over the way that pension savings can be realised, are likely to impact on generations to come.

In common with most other public sector pension schemes, the Local Government Pension Scheme (LGPS) is moving from a 'Final Salary' basis to a 'Career Average' basis from 1 April 2015. Much work has taken place during 2014/15 preparing the way for what will be a momentous change to the nature of the Local Government Pension Scheme. Those involved including Unions, Employers, the SPPA and Fund staff are all to be commended for their hard work in bringing this new version of the Scheme to fruition.

It is pleasing to note that, despite the changes, the Scheme remains one of significant quality with guaranteed, inflation linked benefits offering security and stability of income for present and future generations of members.

Of course, it is important that the overall balance of cost between member, employer and tax payer remains appropriate, and a national valuation of the Local Government Pension Scheme in Scotland is currently being co-ordinated by the Government Actuary on behalf of Scottish Ministers and should be a barometer of fairness to all parties.

I realise that pensions are a highly complicated subject. It is, however, crucially important that members take time to try and understand the scale of benefits that they will receive when they retire - whether this is from the Local Government Pension Scheme itself or through other pension arrangements, such as the State Pension. The Pension Section sends out around 12,000 statements every year showing the scheme benefits that members have built up, whilst an indication of State Pension can be found at [www.gov.uk/calculate-state-pension](http://www.gov.uk/calculate-state-pension). If you think that your benefits will be insufficient to meet your needs, then there are options to allow benefits to be topped up.

Lastly, may I take this opportunity to thank my colleagues on both the Pensions Committee and Pensions Panel, the staff and our advisors for their commitment and support over the past year.

John Patrick  
Convener of Falkirk Council Pensions Committee

# Introduction from the Chief Finance Officer

## Bryan Smail

Councillor John Patrick in his Foreword has already, and properly so, highlighted the major changes in the world of pensions, and both the benefits and complexity of pensions.

This year has been a particularly busy year for the Pensions Committee and Panel and for the staff and advisors who support them. From the genesis of the Hutton review, the long-standing final salary scheme has now been changed to one based on career-average. The Council has needed to procure a new system, fit for purpose, to cope with this much more complex operating environment. This has also been a triennial Valuation year with all the attendant work which that entails, not least extensive engagement with the many employers in our Pension Fund. The latter, I believe has been a mutually beneficial exercise.

Looking forward, there is much to be done. New corporate governance arrangements apply to the management of the Pension Fund from 1 April 2015. The Valuation provides an opportunity and a sound platform to undertake a review of the Pension Fund's investment strategy and take stock of how we are balancing risk and return.

In the longer term, it remains to be seen whether the changes made so far appropriately address and balance the interests of the different stakeholders and provide sustainable pensions.

Bryan Smail, CPFA MBA  
Chief Finance Officer  
24 September 2015

## Contact Us

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General enquiries about this document: Alastair McGirr, Pensions Manager

Tel: 01324 506304

Fax: 01324 506303

Email: [alastair.mcgirr@falkirk.gov.uk](mailto:alastair.mcgirr@falkirk.gov.uk)

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Enquiries about pension benefits: Falkirk Council Pension Fund

Tel: 01324 506329

Fax: 01324 506304

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

Post: Pensions Section

PO Box 14882

Falkirk Council

Municipal Buildings

Falkirk

FK1 5RS

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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 506304

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 Municipal Buildings West Bridge Street Falkirk FK1 5RS
<b>Fund Officers:</b>	Bryan Smail, Chief Finance Officer Alastair McGirr, Pensions Manager
<b>Legal Advisors:</b>	Falkirk Council – Legal Services McLay, Murray and Spens
<b>Fund Custodian:</b>	The Northern Trust Company
<b>Performance Measurement:</b>	The Northern Trust Company
<b>Actuary:</b>	Hymans Robertson LLP
<b>Investment Advisor:</b>	Hymans Robertson LLP
<b>Fund Managers:</b>	Schroder Investment Managers Newton Investment Managers Aberdeen Asset Management Baillie Gifford Legal and General SL Capital Partners Wilshire Associates Grosvenor Capital Hearthstone Investments M & G Investments
<b>Bankers:</b>	Clydesdale Bank
<b>AVC Providers:</b>	Prudential and Standard Life

## Independent Auditor:

The Auditor appointed by the Accounts Commission for Scotland for the purpose of auditing the annual report and accounts is Fiona Mitchell-Knight FCA, Assistant Director (Audit Services), 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 be able to join the scheme, a person must be employed by a relevant employer and not be eligible to join another public sector pension 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, to Fund employers and to 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

**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 23.

**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 Adviser. 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. More information on the Governance process can be found in the Governance Section on Page 18.

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

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

Over the last year, the Falkirk Fund has continued to deliver positive performance, with a return across all assets of over 13%. This was substantially greater than the returns available on cash and ahead of the Fund's long term strategic funding requirement.

Fund assets are now close to £1.8 billion, an increase of over £220 million over the year, reflecting the favourable market conditions for investors during the year.

Fund liabilities have also increased and are estimated to have risen from £1.8bn at 31 March 2014 to £2.2bn at 31 March 2015 as a result of the continued fall in gilt yields. Regular funding reviews are undertaken to ensure that the Fund's deficit remains manageable. The liability figure of £2.2bn has been estimated by the Fund Actuary rolling forward cash flows and investment returns from the 2014 triennial valuation. The £2.2bn 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 2015.

On the benefits side, contributions increased by £2.4m due to the fact that most employers were scheduled to pay a higher contribution rate in 2014/15. Transfers in and contribution refunds were down from 2013/14 reflecting a slowdown in member turnover, attributable to the restraints on recruitment within the public sector.

A significant change from last year's accounts has been the inclusion of direct expenses from Private Equity and Infrastructure investments. Whilst this has increased the management expenses, this has been compensated through the profit and loss on disposal of investment so the overall effect on the accounts has been neutral. More information on management expenses is contained in Notes 2, 12 and 15 of the Accounts.

## 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.

A valuation of the Fund as at 31 March 2014 was completed during 2014/15 in accordance with regulatory requirements. 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 valuation disclosed that whilst asset performance between 2011 and 2014 had been significantly better than the return targeted by the Actuary (28% return against a target of 19%), this had been outstripped by an increase in fund liabilities. This increase was due a sharp decline in the yield on government bonds – the yardstick used to measure fund liabilities. The key results from the 2011 and 2014 valuations are summarised below:

	Valuation at 31/03/2011	Valuation at 31/03/2014
<b>Past Service Liabilities</b>	£1,392m	£1,860m
<b>Assets</b>	£1,199m	£1,577m
<b>Funding Deficit</b>	£193m	£283m
<b>Funding Level</b>	86.1%	84.8%
<b>Future Service Cost</b>	16.2% of pay	17.9% of pay
<b>Past Service Cost</b>	4.3% of pay	5.5% of pay
<b>Total Employer Contribution</b>	20.5% of pay	23.4% of pay

The positive asset performance has kept the funding level relatively stable which is pleasing considering the upward pressure on liabilities due to the falling yields – a factor itself beyond the Fund's control. On the negative side, the cost of providing future benefits has risen, due again in large measure due to the fall in yields. Together with the increased deficit, this means that employers are continuing to face challenging contribution levels. In view of this, the Pensions Manager and Fund Actuary have met individually with most of the Fund employers to ensure they are aware of their individual funding circumstances.

The 2014 valuation is the first occasion in which the actuary has based longevity assumptions on "Club Vita" evidence. Club Vita is compiled by Hymans Robertson, the Fund Actuary, and is an extensive database of mortality information, based on factors such as postcode and pay on retirement. More information on the Club Vita process is contained in the 2014 valuation report which can be viewed at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications section.

A statement by the Actuary on the Fund's actuarial position is also 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 revised 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 in early 2015 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.

Although the Fund is seeking to gradually reduce its exposure to riskier asset classes, the bulk of its assets are still held in growth-seeking rather than defensive assets. This is consistent with the Fund seeking to repair the funding deficit which was assessed at £283m at the 2014 valuation. As a result of its exposure to equities, the relative performance of the Fund against its benchmark can be volatile over the short term. However, as the majority of Fund employers have very strong covenants, the Fund can afford to take a long term view across successive investment cycles.

More information on the Fund's investment strategy can be found in this report on Pages 31 to 36.

## 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 2014/15 was as follows:

Membership and Benefits Administration Cost to be less than £25 pa per member	
Achieved in Full	Per member cost was £23.51

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

Respond to 70% of Ad hoc enquiries within 14 days	
Not Achieved	The response rate achieved was 65%

Fund to achieve its benchmark return	
Achieved in Full	Fund returned 13.4% against a benchmark of 12.1%

Fund Managers to achieve their individual benchmark returns	
Achieved in Part	Benchmark was exceeded in 5 out of 8 mandates – but all managers delivered positive absolute returns

- Member costs, which for a number of years have been amongst the lowest of Scottish local authority funds, rose in 2014/15 as a result of the procurement of the new pension administration system.
- The installation of the new system, preparations for LGPS 2015, freedom of information requests and the strong flow of severance estimates has meant that non statutory transactions have taken longer to process than normal.
- 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 2015/16 and costs for 2014/15 are provided on Page 25 of the Annual Report and on Page 62 in Note 12 in the Accounts Section of this report.

More information on administration performance can be found on Page 23.

More information on investment performance can be found on Page 31.

## Trends and Influences - Administration

- The introduction of the Career Average version of the Local Government Pension Scheme from April, 2015 is the single most significant factor affecting the activities of the administration team.
- To ensure compliance with the new arrangements, the 20 year old in-house pensions administration system has been replaced with *Altair*. 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.
- Member communication and employer support are expected to be common themes of 2015/16 as members and employers seek to understand the rules of the new scheme.
- 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 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 leave the scheme. The Fund will seek to ensure that any exits are carefully managed and that the position of remaining employers is protected.

## 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 high water mark, investment managers may struggle to post positive returns in 2015/16.
- The improving economic data from the US and UK has brought forward the prospect of interest rate rises in the second half of 2015. Whilst falling yields will reduce the value of the Fund's fixed income portfolio, the overall impact will be beneficial as Fund liabilities will fall as a result of being benchmarked to gilt yields.
- Analysis by Hymans Robertson in its dual role of Actuary and Investment Adviser indicates that the Fund could look to reduce its equity exposure without this impacting on prospects of returning to fully funded status. The Pensions Committee has agreed to adopt a strategy of gradual de-risking (i.e. reducing growth assets and increasing defensive assets). A review of investment strategy will be conducted in 2015/16 to

determine how the strategy can best be implemented. Agreed changes will be formalised in a revised **Statement of Investment Principles**.

- 2015/16 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.
- In May, 2014, the Department of Communities and Local Government issued a consultation paper "Opportunities for Collaboration, Cost Savings and Efficiencies". The consultation focused on ways in which Funds could invest more efficiently and sought to gauge opinion on funds using collective investment vehicles and/or making greater use of passive managers. A Government response following the consultation is awaited.
- At a macro level, geo-political concerns are being fuelled by tensions in the Middle East and Ukraine. In the Eurozone, weakness persists in the economies of Southern Europe accompanied by concerns on the possibility of a Greek debt default or exit from the Euro. In the UK, with the 2015 General Election decided, the stage is set for a referendum on the UK's future membership of the EU. These are issues that all have the potential to create nervousness in the markets and a negative impact on asset valuations
- A more detailed review of global market conditions in 2014/15 can be found on Page 37.

## **Trends and Influences - Governance**

- Under revised Governance arrangements, a new local Pension Board will meet for the first time in June, 2015. Arrangements are being made for Board members to be provided with training and for Board terms of reference to be finalised.
- The new governance regime entails the Pensions Regulator (TPR) having oversight of administration standards in the LGPS and a new national Scheme Advisory Board being established to make recommendations to Ministers regarding scheme rule changes. Inevitably, Funds will be impacted by the workplans of these bodies.

## 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 2014/15 include those involving executive remuneration and governance arrangements.

### 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 over 60 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.lapffforum.org](http://www.lapffforum.org). More information about Corporate Governance matters can be found on Page 39 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 Adviser, 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 result in the construction of around 190 social housing units in the Clackmannanshire, Falkirk and Stirling areas and additional units of affordable housing in Scotland.

The Fund is also investing in the UK economy through a £30m commitment to UK infrastructure. An initial investment in a renewables hydro project has already been made.



## Staffing Resources

The Pension Section's staffing compliment at 31/03/15 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 Project Officer	1	0
Pension Support Officer	0	1
Trainee Pension Officer	0	1
Pension Assistants	0	4
Clerical Assistant	0	0.5

### Investment and Accounting Officers

	No. of Males	No. of Females
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.

The Pension Fund Accountant post became vacant in September 2014 and a temporary appointment was made in March, 2015 from the Council's existing accounting resource.

## Director's Report

In respect of the Fund's senior officers, no personal data incidents or sickness absences were recorded during 2014/15.

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 26 of the Accounts.

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

.....  
**Date**

.....  
**Chief Executive**

.....  
**Date**

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

.....  
**Date**

# 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 31A of The Local Government Pension Scheme (Scotland)(Administration) Regulations 2008, all LGPS Funds are required to publish an Annual Report.

This document is the Annual Report of the Falkirk Council Pension Fund for 2014/15.

## 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 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 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<sup>st</sup> April, 2015, benefits in LGPS (Scotland) were calculated on a "Final Salary" basis. From 1<sup>st</sup> 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.

Falkirk Council has delegated its pensions function to the Pensions Committee, with various operational activities being delegated to the Chief Finance Officer. During 2014/15, the work of the Pensions Committee has been supported by an advisory Pensions Panel. These arrangements were approved by Falkirk Council on 14 March 2012.

In discharging this overall responsibility the Pension Fund is responsible for putting in place proper arrangements for the governance of its affairs and facilitating the effective exercise of its functions including arrangements for the management of risk.

The Fund has its own Governance Policy Statement which is consistent with the relevant regulations concerning the governance of funds within the LGPS.

Governance arrangements are 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 reviewed on a regular basis and are subject to consultation with stakeholders to ensure they remain relevant and effective.

## 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<sup>1</sup> 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 2014/15 is set out in full on page 90.

## Governance Compliance Statement

Regulation 27 of the Local Government Pension Scheme (Scotland)(Administration) Regulations 2008 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 94.

## Pensions Committee

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

The Committee consists of nine members – six elected members from Falkirk Council and three members drawn from the Pensions Panel. 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 Alastair Redpath	-	Pensioner Representative
Miss Mary Keggan	-	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 approve the Annual Report and Accounts

(Councillors Blackwood, Carleschi, Dr CR Martin and Miss Keggan were active members of the Scheme during 2014/15. Councillor Patrick and Mr Redpath 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 2014/15 meetings.

## Pensions Panel

The Panel's main responsibility is to provide advice and guidance to the Pensions Committee on all matters relating to the business of the Falkirk Council Pension Fund. The Panel is also supported by officers and professional advisers.

The Panel comprises 15 members and includes Trade Union, Employer and Pensioner representatives. One member from each of these representative groups has been co-opted to sit on the Pensions Committee where they have full access to papers and voting rights. The Panel meets on a quarterly basis approximately two weeks prior to the corresponding Committee meeting. Members of the Panel are as follows:

Councillor Callum Campbell (Convener)	-	Employer Rep. (Stirling Council)
Mr Willie Watson	-	Employer Rep. (Stirling Council)
Mr Gordon Laidlaw	-	Employer Rep. (Scottish Autism)
Mr Ed Morrison	-	Employer Rep. (SCRA)
Mrs Jennifer Welsh	-	Employer Rep. (SEPA)
Mrs Alison Stewart	-	Employer Rep. (Forth Valley College)
Mrs Susan Mackay	-	Employer Rep. (Clackmannanshire Council)
Councillor Archie Drummond	-	Employer Rep. (Clackmannanshire Council)
Mrs Jackie McAuley	-	Employer Rep. (Falkirk Council)
Vacant	-	Employer Rep. (Falkirk Council)
Mr Alastair Redpath	-	Pensioner Representative
Mr Ian McLean	-	Pensioner Representative
Miss Mary Keggan	-	Union Representative
Mr Sandy Harrower	-	Union Representative
Mr Andy Douglas	-	Union Representative

Mr Watson and Mrs Mackay have stood down during 2014/15

## Future Governance Arrangements

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. In view of the new governance requirements, and after consultation with stakeholders, the decision has been taken to wind up the Pensions Panel. Full details of the revised governance arrangements can be found on the Fund website at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Governance Policy Document in the Forms and Publications section.

## 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 Panel members to attend, During 2014/15, these have included:

16/04/2014 – Falkirk Council Pension Fund - Annual Conference, Falkirk  
12/10/2014 – Local Government Pension and Investment Forum, London  
02/02/2015 – In house event - Investment Strategy Workshop, Falkirk

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

Training arrangements for 2015/16 will continue to be broad based in order to support member decision making. Particular attention will be given to the training needs of the new Pension Board.

### **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 Panel 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 Panel 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 occasional 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 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	32 years	Yes
Pensions Project Officer	1	44 years	Yes
Fund Accountant	1	0 years	Yes
Pensions Officers	2	29 years	Yes (1)
Pensions Support Officer	1	24 years	No
Accountancy Assistant	0.5	11 years	No
Trainee Pensions Officer	1	1 year	No
Pensions Assistants	4	14 years	No
Clerical Assistant	0.5	1 year	No
Total	12		

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 Panel
- 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
In-House Pensions Administration System	Ingres	Pensions Administration
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 2014/15, records have been migrated from the in-house administration system to an externally hosted system. This process has been 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.

## Performance Indicators

The main indicators used by the Pensions Section in relation to membership and benefits administration are as follows:

	Target	2010/11	2011/12	2012/13	2013/14	2014/15
Annual Admin. Cost per member	Under £25 per member	£16.12	£16.45	£14.50	£15.77	£23.51
Staff/Member ratio	Between 1:2500 and 1:3200	1:2893	1:2932	1:2972	1:3237	1:3307
Key Statutory deadlines met	All achieved	Yes	Yes	Yes	Yes	Yes
No. of Complaints	0	4	1	1	3	4
* Answer ad hoc queries in 14 days	70%	71%	72%	73%	73%	65%
Lump Sums payments	Pay within 7 days	92%	99%	99%	99%	99%

\*The enquiries completion rate has been impacted by the absence of a pensions assistant, the installation of the new pensions system, the preparations for the new scheme and the heightened level of engagement required to support severance arrangements.

## Pension Section Budget

A summary of the Pension Section's administrative expenditure for 2014/15, together with the approved budget for 2015/16 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.

	2014/15 Budget	Outturn for 2014/15	2014/15 Variance	2015/16 Budget
Employee Costs	£409,800	£353,573	(£56,227)	£417,480
Supplies & Services - Indirect	£93,860	£86,924	(£6,936)	£94,050
Central Support Charges	£88,120	£91,322	£3,202	£95,820
Income	(£2,000)	(£3,619)	(£1,619)	(£2,000)
Benefits Administration Costs – Direct	£340,000	£340,681	£681	£450,000
Oversight and Governance Cost – Direct	£270,000	£272,952	£2,952	£270,000
Investment Management Costs – Direct	£4,916,000	£4,916,186	£186	£5,088,070
Pension Fund Total	£6,115,780	£6,058,019	(£57,761)	£6,413,420

The main variance between budgeted and actual amounts related to:

- an underspend in employee costs relating to the Pension Accountant vacancy and maternity leave of Pensions Support Assistant

The budget for Investment Management Expenses in 2015/16 has been set at £5,088,070. Allowances have been made in the 2015/16 budget for:-

- New Pensions System
- Review of Investment Strategy
- Temporary staffing appointments

## **Review of 2014/15 Administration**

### **LGPS 2015**

2014/15 has been dominated by scheme reform, with centre stage being taken by preparations for the Career Average version of the Scheme starting on 1 April 2015.

Various statutory instruments have been laid during the year to define the precise terms of the new arrangements.

To ensure compliance with LGPS2015, a new pension administration system was procured in autumn 2014. The remainder of the year focused on migrating data from the old in-house system to the new system with staff receiving training to ensure a “business as usual” transition.

A major communications exercise publicising the new scheme has taken place with members and employers during 2014/15. This has included the development of a national LGPS2015 website in collaboration with other Funds, training workshops for employers, news items on [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org), the mailing of a newsletter with annual statements and e-literature issued to members via employer portals.

Governance has also been impacted by the new scheme and work has been successfully undertaken to establish the Fund’s new Pension Board by the deadline of April, 2015.

### **Valuation and Funding Strategy**

The 2014 Valuation was completed successfully in March, 2015, following a review of Funding Strategy, in accordance with the statutory deadline.

### **Miscellaneous**

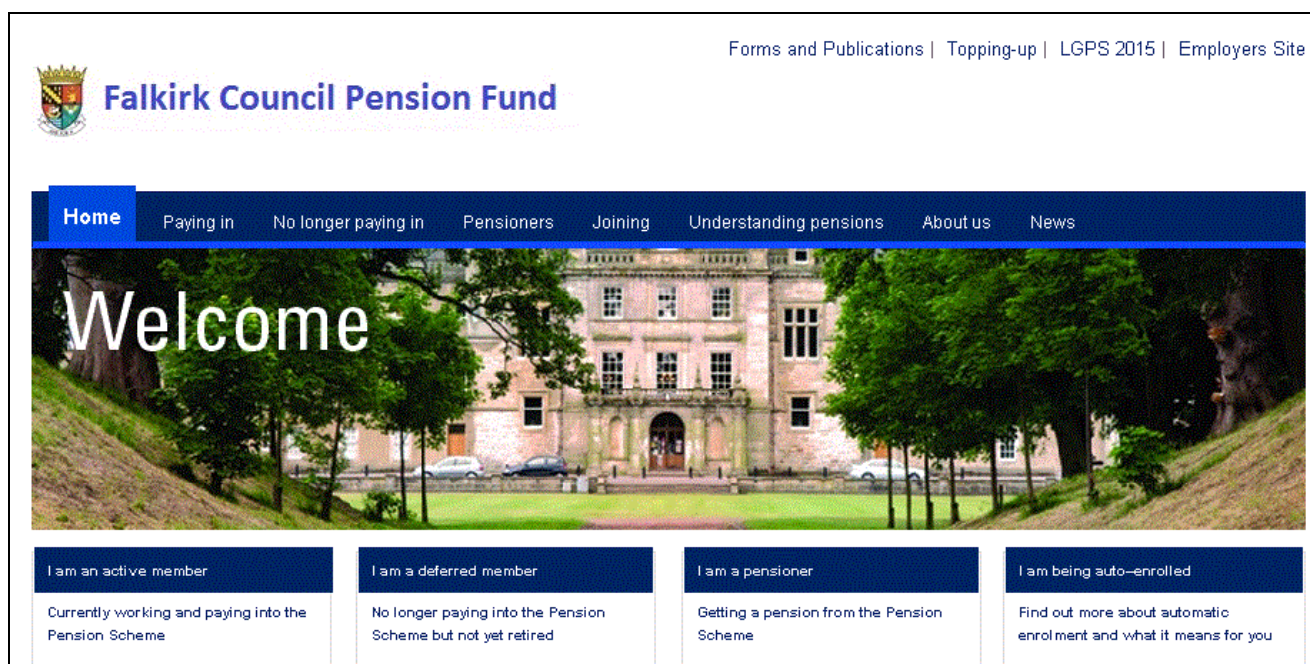
- Prudential were appointed as a new Additional Voluntary Contribution (AVC) provider during the summer of 2014. This has improved the AVC take up rate with around 90 new members electing to make contributions.

- In February, 2015, the Scottish Public Pensions Agency (SPPA) assumed responsibility from Falkirk Council for administration of the local Police and Firefighter Pension Schemes. The Pensions Section was heavily involved in the data cleansing and data migration process and assisted with the smooth transition of this responsibility.
- 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 2014/15 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.



## 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 ongoing benefits.

Recent membership movements show that:

- Active membership has remained broadly stable during 2014/15, 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 has halted the maturing of the Fund which appeared to be occurring prior to 2013/14.

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

	2010/11	2011/12	2012/13	2013/14	2014/15
<b>Active</b>	<b>12,939</b>	<b>12,668</b>	<b>12,880</b>	<b>14,690</b>	<b>14,589</b>
<b>Deferred</b>	<b>4,869</b>	<b>5,085</b>	<b>5,204</b>	<b>5,320</b>	<b>5,405</b>
<b>Pensioner</b>	<b>7,600</b>	<b>8,119</b>	<b>8,372</b>	<b>8,693</b>	<b>8,995</b>
<b>Total</b>	<b>25,408</b>	<b>25,872</b>	<b>26,456</b>	<b>28,703</b>	<b>28,989</b>

<b>Maturity Level</b> (% of Deferred & Pensioner Members to Total Members)	<b>51.04%</b>	<b>51.32%</b>	<b>48.82%</b>	<b>49.7%</b>
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### Split of Membership between Scheduled and Admission Bodies

	2010/11	2011/12	2012/13	2013/14	2014/15
<b>Scheduled</b>	<b>23,607</b>	<b>23,583</b>	<b>24,045</b>	<b>26,055</b>	<b>26,160</b>
<b>Admission</b>	<b>1,801</b>	<b>2,289</b>	<b>2,411</b>	<b>2,648</b>	<b>2,829</b>
<b>Total</b>	<b>25,408</b>	<b>25,872</b>	<b>24,456</b>	<b>28,703</b>	<b>28,989</b>

# Risk Management

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## Overview

Pension fund management is not immune from risk. These may be the risks 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 focuses mainly on the risks related to the Fund's administrative functions, whereas investment risk is addressed in the **Statement of Investment Principles**. Other Risk Plans describe the more detailed actions that would be taken in the event of an emergency situation taking place.

The Pension Fund Risk Register is a standing item at the quarterly meetings of both the Pensions Committee and Pensions Panel. Individual risks and proposed mitigations are identified by the Chief Finance Officer and Pensions Manager with the support of fund advisers. Key risks, including some of those identified during 2014/15 are set out below:

- Investment Managers may not have appropriate control framework in place
- Custody arrangements may not be sufficient to safeguard Fund's assets
- Data Security may be compromised
- Funding position may be affected by falling asset values or falling bonds yields
- 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 together with any mitigation are 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. This tends to take place following the completion of the triennial valuation process.

Investment risk is considered in further detail in the Notes to the Financial Statements and as a consequence, Committee and Panel are alerted to these matters at least twice annually when considering the unaudited and audited accounts. More information on investment risk is contained in Note 18 on Page 74.

The Fund's **Statement of Investment Principles** 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 2014-15, ten external investment managers managed the Fund's assets:

Manager	Mandate
Aberdeen Asset Management	Global Equities – Active
Baillie Gifford	Fixed Interest and Diversified Growth
Grosvenor Capital	Global Infrastructure
Hearthstone Investments	UK Social and Affordable Housing
Legal & General (L&G)	Global Equities - Passive
M&G	UK Credit Market
Newton Investment Management	Global Equities – Active
Schroder Investment Management	UK Equities and UK focused Property
SL Capital Partners	European focused 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	FTSE All World Index
Schroder UK Equities	FTSE All Share Index
Schroder Property	AREF/IPD UK Quarterly Property

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**.

## Changes since 31/3/2015

Since the year end, the Fund has made the first of what is expected to be a series of investments in UK Infrastructure sourced by the in-house team in collaboration with Lothian Pension Fund. The commitment to UK Infrastructure through this mandate is £30m.



## 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 2014/15 the Fund has continued to build upon this strategy of alternatives diversification, making a £30m commitment to a Social and Affordable Housing mandate with Hearthstone Investments and a further £30m commitment to be invested in UK Infrastructure.

In spite of the significant allocation to alternatives, the Fund's actual equity allocation has continued to exceed its strategic allocation due to the very strong performance of global equity markets over the past three years. The Fund's strategic allocation to all asset classes is being re-appraised in the ongoing review of investment strategy.

A comparison of the strategic allocation of Fund Assets with the actual allocation at 31 March 2015 is set out below:

Asset Class	Strategic Allocation	Actual Allocation at 31/3/2015
<b>Equities</b>	60%	63%
<b>Bonds</b>	10%	9%
<b>Property</b>	10%	7%
<b>Diversified Growth</b>	10%	12%
<b>Social/Affordable Housing</b>	2%	1%
<b>Other Alternatives</b>	8%	8%
<b>Totals</b>	<b>100%</b>	<b>100%</b>

Within "Other Alternatives", the Fund is holding a 2% allocation to cash in anticipation of making imminent investments in Social and Affordable Housing and UK Infrastructure.

The current investment review will focus on ways to reduce exposure to riskier assets without compromising the Fund's prospects of returning to fully funded status in the medium to long term.

## 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.

	2014/15 %	3 years % per annum	5 years % per Annum	Inception % per annum
<b>Fund Return</b>	13.4%	12.0%	9.7%	7.6%
<b>Benchmark Return</b>	12.1%	9.8%	7.9%	7.2%
<b>Excess</b>	1.3%	2.2%	1.8%	0.4%

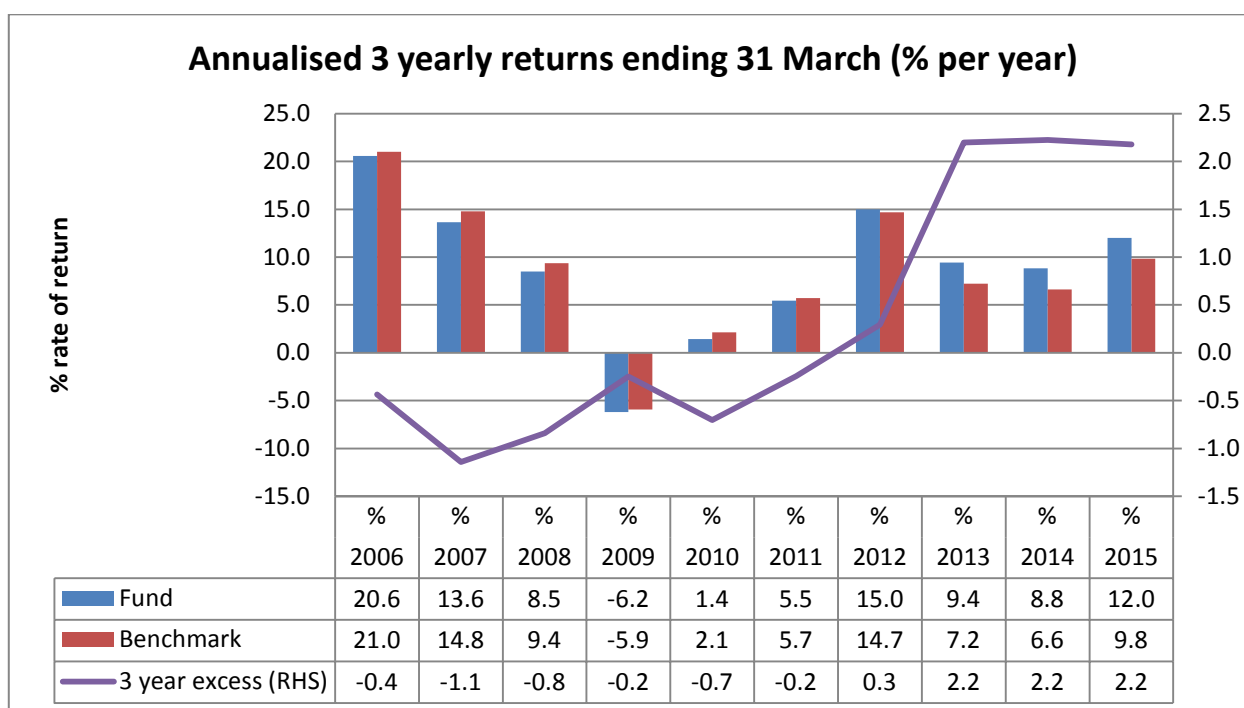
\* "Inception" records performance from 2001 when the current custodian appointment was made.

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

	2014/15 %	3 years % per annum	5 years % per annum	Inception % per annum
<b>Fund Return</b>	13.4%	12.0%	9.7%	7.6%
<b>Retail Price Index</b>	0.9%	2.3%	3.2%	2.9%
<b>Consumer Price Index</b>	0.0%	1.5%	2.4%	2.2%
<b>National Average Earnings</b>	3.3%	1.5%	1.7%	2.8%

\* 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-06 %	Mar-07 %	Mar-08 %	Mar-09 %	Mar-10 %	Mar-11 %	Mar-12 %	Mar-13 %	Mar-14 %	Mar-15 %
<b>Fund</b>	20.6	13.7	8.5	-6.2	1.4	5.5	15.0	9.4	8.8	12.0
<b>Benchmark</b>	21.0	14.8	9.4	-5.9	2.1	5.7	14.7	7.2	6.6	9.8
<b>Relative</b>	-0.4	-1.1	-0.8	-0.3	-0.7	-0.3	0.3	2.2	2.2	2.2

### Manager Returns

The Fund's investment managers had the following performance against benchmark over 2014/15:

Fund Manager	Mandate	1 Year %	Benchmark %	Excess %
Aberdeen Asset Management	Global Equities – Active	10.5	19.0	-8.5
Baillie Gifford	Fixed Interest	14.9	15.0	-0.1
Baillie Gifford	Diversified Growth	8.7	0.5	+8.2
Legal & General	Global Equities – Passive	15.0	14.9	+0.1
Newton Inv. Management Ltd	Global Equities – Active	21.0	19.2	+1.8
Schroder Inv. Management Ltd	UK Equities – Active	7.7	6.6	+1.1
Schroder Inv. Management Ltd	Property	15.6	16.6	-1.0
Alternatives	Private Equity/Infrastructure	14.7	0.4	+13.3

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

## Comments on 2014/15 Manager Performance

- In a strong year for equities and bonds, all managers posted positive absolute returns.
- Returns from Legal and General were in line with their benchmark as one would expect from a passive manager.
- Aberdeen's performance disappointed and they are now behind their benchmark across all relevant time periods. Despite these setbacks, Aberdeen remains committed to its philosophy of using local teams to source investments in strong cash generative companies undervalued by markets.
- Newton's performance in global equities was a strong one returning over 20% against a benchmark of 19.2%. 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.
- The Schroder UK Equities mandate remains ahead of benchmark across all time periods. The returns in 2014/15 fell short of the stellar returns (18%) in 2013/14, 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. The failure to achieve the benchmark was attributable to the mandate's exposure to a continental European property fund where values have been declining for several years due to depressed Eurozone economies. The strength of Sterling against the Euro and the absence of the continental European fund from the benchmark also played against achieving the benchmark.
- Baillie Gifford had a strong year in both absolute and relative terms with its fixed interest mandate benefitting from the low interest rate environment and an insatiable demand for bonds by financial institutions generally. The Fund also invests in Baillie Gifford's Diversified Growth Fund in order to achieve equity like returns but with lower levels of volatility. Both return and volatility targets were adequately satisfied during 2014/15.
- 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. Returns from the Grosvenor Capital mandate have been noteworthy with total value to paid-in capital showing a multiple of 1.3 after only 3 years of capital deployment.

## Key Investment Holdings

The Fund's 10 largest equity holdings at 31/03/2015 are as listed below:

Name of Stock	Market Value as at 31/03/2015
Vodafone	£18,347,513
Roche	£14,887,143
GlaxoSmithKline	£14,434,306
Royal Dutch Shell	£14,017,562
Novartis	£13,445,911
Friends Life	£12,745,873
British American Tobacco	£12,709,896
HSBC	£11,687,443
BP	£11,663,663
AstraZeneca	£11,450,263

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 Vodafone - is approximately 1% of fund value, which is well within the statutory ceiling.

## Cash Holdings

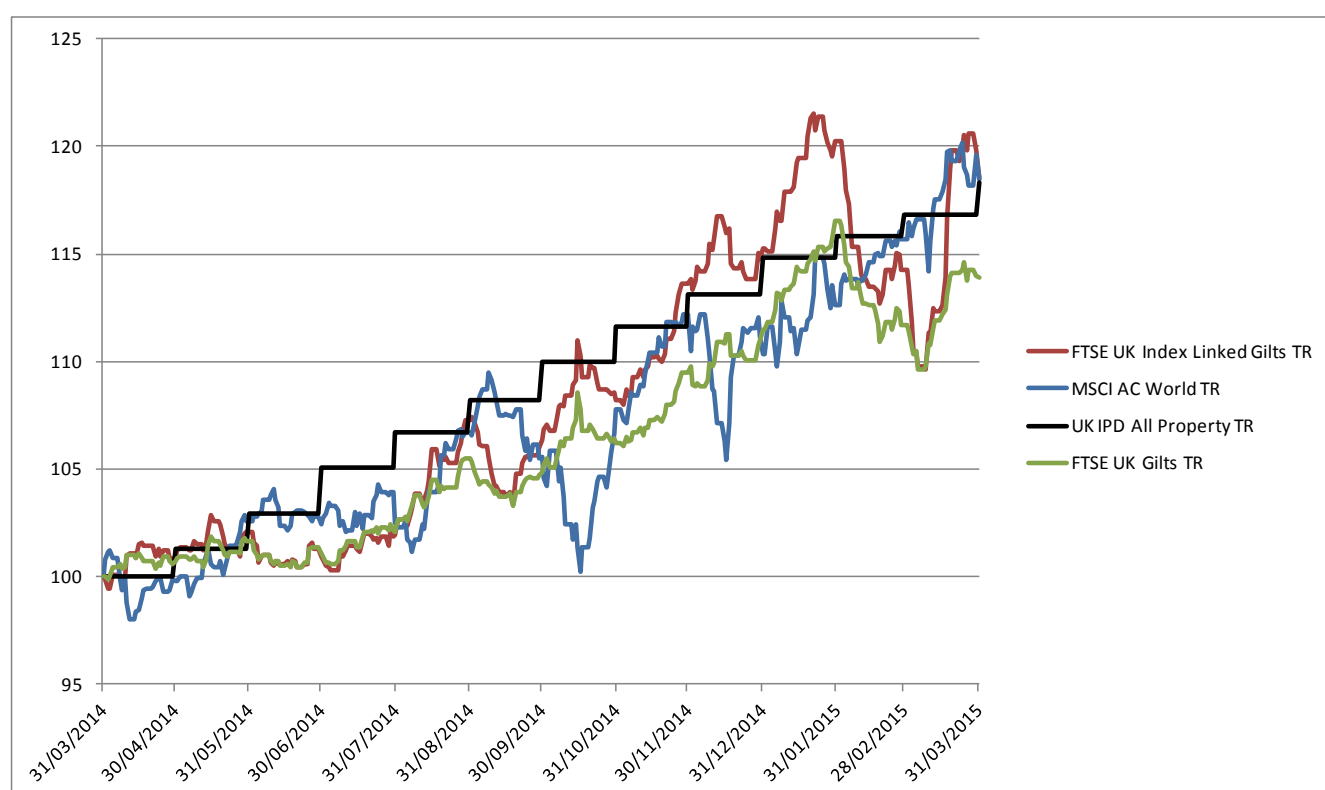
The Fund's cash holdings with custodian Northern Trust are held in a triple A rated money market account with residual cash being swept into the account on a monthly basis. The Fund retains cash for operational purposes and opportunistic investments in blocks of approximately £5m with each of Santander,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

## Investment Market Review

The UK economy has made a solid recovery since the dark days of the global financial crisis in 2008/09. Unemployment has shrunk to 6% from a peak of 8% in 2009, and the employment rate of 73.3% is the highest since records began. The public sector deficit has halved since 2010. In 2014, the UK economy expanded by 2.8%, although it slowed in the first quarter of 2015. US economic growth has been robust for the last few years, and even regions such as Japan and Europe are now displaying some springtime shoots of recovery.

Asset markets continue to respond positively to low interest rates and unconventional monetary policies (bond buying by central banks) aimed at stimulating economic growth. Perhaps unsurprisingly, government and corporate bond markets made handsome gains as investors anticipated strong central bank buying support for these assets. Equity markets benefited too. The US equity market is now comfortably in excess of its two previous peaks, Japanese equities continued to perform well and the UK stock market is once again hovering around its historical high point. Even the continental European stock markets have shown signs of reviving, but after a long period in the doldrums, the outstanding equity market performer over 2014/15 was the Shanghai Stock Exchange in China, which soared 56%. Other asset classes, such as property also made attractive returns. The key feature in currency markets was US dollar strength. The only real disappointment was commodities, where oil and iron ore prices in particular fell sharply.

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



Looking ahead, investors are wondering how long the current positive environment for asset markets can last. Given that the low interest rates and unconventional monetary policy (so-called quantitative easing) are inextricably linked with prices in asset markets, the fear is that this element of support will be withdrawn and interest rates will rise. This is front and centre of mind in one of the two largest economies in the world, the USA, where wage inflationary pressure could cause the economy to overheat. This is not the case across the globe. The European Central Bank has only recently resorted to stimulating the economy with quantitative easing and the other giant economy in the world, China, seems quite out of sync with the USA, having recently embarked on a policy of cutting interest rates in the face of a slowing economy and low inflationary pressure.

So, the timing of less supportive central bank policies is far from clear (further market gains are quite possible), but that tightening monetary policy will cause increased volatility and declines in bond and equity markets with high valuations is crystal clear. It appears unlikely that the high returns of 2014/15 will be sustained over the long term.

Other than monetary policy, there are a number of issues that will affect asset market returns in an unpredictable way going forward. These include Greek debt, Chinese expansion, the Ukraine conflict, war in Syria and fallout from the lower oil price in producing countries such as Norway, Russia, Venezuela and Saudi Arabia. These geopolitical risks are manageable to the extent that it is in nobody's interests to let them get out of control. Uncertainty is a constant in the investment backdrop and it is the uncertainty which creates the opportunities for investors to earn returns higher than those available from risk-free assets. With the benefit of economic growth and advancement over the coming years and decades, a diversified portfolio of assets should provide that risk premium over the long term.

# 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 16b to the financial statements, page 68);
- the Fund's membership of the Local Authority Pension Fund Forum (LAPFF) which comprises over 60 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 Panel and Committee meetings.

## Local Authority Pension Funds Forum

During 2014/15, 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, 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 is also 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 prompted resolutions dealing with heightened disclosure around operational emissions management, asset portfolio resilience, low carbon energy R&D and investment, executive performance indicators and public policy positions relating to climate change to be approved by shareholders of BP, Royal Dutch Shell and Statoil.

## 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 2014/15, PIRC voted at 135 company meetings with 1,458 votes being cast in favour of resolutions, 390 being opposed and 139 being cases of abstentions. Areas where "oppose" votes were cast included remuneration policies, gender balance on boards, governance, and auditor independence.



PIRC attend one Panel and one Committee meeting each year in order to brief members about the latest developments in corporate governance, including any 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**

### **2014/15**

# 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;
- 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 24 September 2015.

**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 2015 and the transactions of the Pension Fund for year ended 31 March 2015.

Bryan Smail, CPFA MBA  
Chief Finance Officer  
24 September 2015

# 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 2015 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 2014/15 (the 2014/15 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 2014/15 Code of the financial transactions of the fund during the year ended 31 March 2015, 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 2014/15 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 am 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 Services)  
Audit Scotland  
4th Floor, South Suite  
Athenaeum building  
8 Nelson Mandela Place  
Glasgow  
G2 1BT

24 September 2015

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.

<b>Restated 2013/14 £'000</b>	<b>Dealings with members, employers and others directly involved in the fund</b>	<b>2014/15 £'000</b>	<b>Note</b>
(76,433)	Contributions	(78,905)	8
(3,316)	Transfers from other pension funds	(2,520)	9
(79,749)		(81,425)	
56,485	Benefits	58,546	10
4,655	Payments to and on account of leavers	3,531	11
61,140		62,077	
<b>(18,609)</b>	<b>Net (additions)/withdrawals from dealing with members</b>	<b>(19,348)</b>	
<b>10,575</b>	<b>Management expenses</b>	<b>11,744</b>	<b>12</b>
	<b>Returns on investments</b>		
(26,484)	Investment income	(27,094)	13
268	Taxes on income	269	
(79,356)	Profit and losses on disposal of investments and changes in market value of investments	(188,736)	16a
<b>(105,572)</b>	<b>Net return on investments</b>	<b>(215,561)</b>	
<b>(113,606)</b>	<b>Net (increase)/decrease in the net assets available for benefits during the year</b>	<b>(223,165)</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.

2013/14 £'000		2014/15 £'000	Note
1,575,496	<b>Investment assets</b>	1,794,089	16
(7,601)	<b>Investment liabilities</b>	(3,088)	16
1,567,895		1,791,001	
	<b>Non-current assets</b>		
816	Long term debtors	171	21
	<b>Current assets</b>		
4,228	Cash balances	3,729	22
6,735	Debtors	7,572	23
	<b>Current Liabilities</b>		
(2,993)	Creditors	(2,627)	24
	<b>Net Assets of the fund available to fund benefits at the period end</b>	<b>1,799,846</b>	
1,576,681			

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 20.

The unaudited accounts were issued on 26 June 2015 and the audited accounts were authorised for issue by Bryan Smail, Chief Finance Officer on 24 September 2015. The Statement of Accounts presents a true and fair view of the financial position of the Pension Fund as at 31 March 2015 and their income and expenditure for the year ended 31 March 2015.

Bryan Smail, CPFA MBA  
Chief Finance Officer  
24 September 2015



## **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 final salary basis (n.b. from April, 2015, it is changing to a career average basis). The Scheme is established under the Superannuation Act 1972 and from April, 2015 will fall under the regulatory framework of the Public Service Pensions Act 2013. The Scheme is contracted-out of the State Second Pension and is 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 in relation to 2014/15 were set out in the following statutory instruments:

- the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008;
- the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008; and
- the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2010.

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 and, although employees may have been 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.

## Funding

Benefits are funded by contributions and returns on investments. Contributions are made by active members of the fund in accordance with the LGPS (Benefits, Membership and Contributions) (Scotland) Regulations 2008. 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%.

Employee Contributions are matched by employer contributions which are based on the results of the three yearly actuarial funding valuation. The last valuation was at 31 March, 2014. However, for 2014/15, employer contribution rates were determined by the valuation at 31 March, 2011. For the majority of fund employers, contribution rates are in the range 17% – 22% of pensionable pay. Copies of the 2011 and 2014 Valuation Reports can be found at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications Section.

## Benefits

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

	<b>Service pre 1 April 2009</b>	<b>Service post 31 March 2009</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
Lump Sum	Automatic lump sum of 3 x annual pension  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  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.	

Going forward, benefits from 1 April, 2015 will build up on a career average basis at the rate of  $1/49^{\text{th}}$  of annual pensionable earnings.

The measure of inflation currently used by the Scheme in determining annual increases is the Consumer Price Index. Prior to April, 2010, the measure used was the Retail Price Index.

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

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

### **LGPS 2015**

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

New regulations setting out the detail of the new Scheme have been laid during 2014/15. These are as follows:

- The Local Government Pension Scheme (Scotland) Regulations 2014 (SSI 2014-164)
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 (SSI 2014-233)
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 (SSI 2015-60)

## 2. Prior Year Adjustment

During the year, the Fund has changed its accounting policy in relation to the treatment of expenses deducted from investment capital. As such a restatement of the 2013/14 results is required.

Last year attempts were made to increase the transparency of management fees arising from the Fund's private equity and infrastructure investments. These expenses were disclosed as a note under Investment Management Expenses in the 2013/14 accounts. This year, the range of expenses captured has been expanded to include broker fees and indirect expenses arising from fund of fund structures. In addition, the accounting treatment of investment expenses has been revised to include them on the face of the Accounts within Investment Management Expenses. This has increased the Fund's Profit and Loss on disposal as well as its Management Expenses and led to the following restatement.

	<b>2013/14 Restated Balance</b>	<b>Adjustment</b>
	<b>£'000</b>	<b>£'000</b>
Profit and losses on disposal of investments and changes in market value of investments	(79,356)	(4,055)
Management expenses	10,575	4,055

## 3. Basis of Preparation

The Statement of Accounts summarises the Fund's transactions for the 2014/15 financial year and its position at year-end as at 31 March 2015.

The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 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 2014/15 Code:

- IFRS13 Fair Value Measurement (May 2011)
- Annual Improvements to IFRS 2011-2013 Cycle

The Code requires implementation from 1 April 2015 and there is therefore no impact on the 2014/15 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.

## 4. 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 not separately identified on the schedule of contributions set by the fund actuary and are therefore accounted for as part of the normal employer contributions.

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**

The Code does not require any breakdown of pension fund administration expenses. However, in the interests of greater transparency, the Council discloses its pension fund management expenses in accordance with the CIPFA Guidance *Accounting for Local Government Pension Scheme Management Costs*.

*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

All investment manager fee notes for 2014/15 have been received by the balance sheet date and therefore there has been no need to estimate outstanding fees.

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 20).

**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. (n.b. Prudential were appointed as additional providers 1 June 2014).

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 25 on page 87.

## 5. 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 2015, the Fund had a value of £127.2m (2014 £117.1m) 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 19. This estimate is subject to significant variances based on changes to the underlying assumptions.

## 6. 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 2015 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.

Change in assumptions at 31 March 2015	Approximate % increase in liabilities	Approximate monetary amount (£m)
0.5% decrease in Real Discount Rate	11%	302
1 year increase in member life expectancy	3%	82
0.5% increase in the Salary Increase Rate	4%	110
0.5% increase in the Pension Increase Rate	6%	165

## 7. Events after the Balance Sheet Date

The unaudited Statement of Accounts were issued by the Chief Finance Officer on 26 June 2015 and the audited Statement of Accounts were authorised for issue on 24 September 2015. 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.

## 8. Contributions Receivable

### By Category

2013/14 £'000		2014/15 £'000
17,449	Members contributions	17,910
54,432	Employers – normal contributions (incl. deficit)	57,113
4,552	Employers – strain contributions	3,882
76,433	Total	78,905

### By Authority

2013/14		2014/15	
Members £'000	Employers £'000	Members £'000	Employers £'000
5,978	19,690	6,094	21,006
9,721	33,194	9,928	33,743
1,713	5,968	1,849	6,107
37	132	39	139
17,449	58,984	17,910	60,995

### By Type

2013/14 £'000		2014/15 £'000
17,449	Members contributions	17,910
57,236	Employers' normal contributions (incl. strain)	58,876
1,748	Employers' deficit recovery contributions	2,119
76,433	Total	78,905

## 9. Transfers from Other Pension Funds

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

2013/14 £'000		2014/15 £'000
3,316	Individual transfers	2,520

## 10. Benefits Payable

### By Category

2013/14 £'000		2014/15 £'000
42,038	Pensions	44,883
12,919	Commutation and lump sum retirement benefits	12,470
1,528	Lump sum death benefits	1,193
56,485	Total	58,546

### By Authority

2013/14			2014/15	
Pensions £'000	Lump Sum* £'000		Pensions £'000	Lump Sum* £'000
15,452	4,343	Administering authority	16,269	4,837
23,272	9,359	Other scheduled bodies	25,121	7,461
3,304	745	Admission bodies	3,481	1,356
10	-	Transferee admission body	12	9
42,038	14,447	Total	44,883	13,663

\* Lump Sum includes death benefits

## 11. Payments to and on account of leavers

2013/14 £'000		2014/15 £'000
151	Refunds to members leaving service	169
4,504	Individual transfers	3,362
4,655	Total	3,531

## 12. Management Expenses

2013/14 £'000		2014/15 £'000
379	Administrative costs	750
9,855	Investment management expenses	10,602
341	Oversight and governance costs	392
10,575	Total	11,744

Further analysis of Investment Management expenses is given in Note 15.

The Audit fee of £23k is included within the oversight and governance costs.

## 13. Investment Income

2013/14 £'000		2014/15 £'000
11,293	UK Equities	11,034
180	UK Pooled Equities	172
3,357	UK Managed Funds – Property	3,609
8,206	Overseas Equities	8,643
372	Overseas Managed Funds – Property	1,929
1,551	UK Private Equity	-
1,215	Overseas Private Equity	1,311
21	Overseas Infrastructure	4
183	UK Property	204
106	Cash & Other Income	188
26,484	Total	27,094

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

## 14. Taxes on Income

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

## 15. Investment Expenses

2013/14 £'000		2014/15 £'000
4,249	Management fees	4,802
4,879	Fees deducted from capital	5,200
630	Transaction costs	486
97	Custody fees	114
9,855	Total	10,602

## 16. Investments

Market Value 31/03/14 £'000	Investment Assets	Market Value 31/03/15 £'000
	<b>Investment Assets</b>	
613,587	Equities	686,664
665,055	Pooled Investments	768,796
109,735	Managed Property Funds	124,536
117,095	Private Equity/Infrastructure	127,202
2,300	Property (West Mains)	2,300
33	Derivatives - Futures Contract	-
	<b>Cash Deposits</b>	
16,164	Other Balances	18,860
41,576	Deposits	62,133
	<b>Other Investment Balances</b>	
2,962	Debtors – Investment Income Due	2,806
6,989	– Due from Broker	792
<b>1,575,496</b>	<b>Total Investment Assets</b>	<b>1,794,089</b>
	<b>Investment Liabilities</b>	
(44)	Derivatives – Forward Foreign Exchange	(1)
(7,557)	Creditor – Due to Broker	(3,087)
(7,601)	<b>Total Investment Liabilities</b>	(3,088)
<b>1,567,895</b>	<b>Net Investment Assets</b>	<b>1,791,001</b>



**16a. Reconciliation of movements in investments and derivatives**  
**From 01/04/2014 to 31/03/2015**

<b>Investment Assets</b>	<b>Market Value 01/04/14 £'000</b>	<b>Purchases at Cost £'000</b>	<b>Sale Proceeds £'000</b>	<b>Change in Market Value £'000</b>	<b>Market Value 31/03/15 £'000</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>

## Reconciliation of movements in investments and derivatives

### From 01/04/2013 to 31/03/2014

	Market Value 01/04/13 £'000	Purchases at Cost £'000	Sale Proceeds £'000	Change in Market Value £'000	Market Value 31/03/14 £'000
<b>Investment Assets</b>					
Equities	599,593	172,697	(200,876)	42,173	613,587
Pooled Investments	578,486	67,500	(15,737)	34,806	665,055
Managed Property Funds	92,734	12,267	(1,984)	6,718	109,735
Private Equity/Infrastructure	113,762	18,132	(18,266)	3,467	117,095
Property (West Mains)	2,300	-	-	-	2,300
Derivatives					
- Exchange Traded Futures	-	639	-	(606)	33
- Forward Foreign Exchange	185	429	(299)	(359)	(44)
	1,387,060	271,664	(237,162)	86,199	1,507,761
Other Balances	8,376	65,825	(56,783)	(1,505)	16,164
Deposits	46,536	-	-	(5,338)	41,576
Broker Balance	(224)	-	-	-	(568)
Investment Income Due	3,296	-	-	-	2,962
<b>Net Investment Assets</b>	<b>1,445,044</b>	<b>337,489</b>	<b>(293,945)</b>	<b>79,356</b>	<b>1,567,895</b>

Transaction costs incurred during 2014/15 total £486,000 (2013/14 : £630,000). In addition to these costs, indirect costs are incurred through the bid-offer spread on investment purchases and sales.

## 16b. Analysis of Investments (excluding derivative contracts)

31/03/14 £'000		31/03/15 £'000
	<b><u>Equities</u></b>	
270,001	UK	266,870
343,586	Overseas	419,794
<b>613,587</b>		<b>686,664</b>
	<b><u>Pooled funds</u></b>	
131,425	Equities – UK	146,320
209,037	- Overseas	244,019
124,154	Bonds – UK	140,680
10,943	- Overseas	14,682
189,496	Diversified growth	206,045
-	Social & affordable housing	17,050
<b>665,055</b>		<b>768,796</b>
	<b><u>Property</u></b>	
102,554	Managed fund – UK	119,940
7,181	- Overseas	4,596
2,300	Direct UK (West Mains)	2,300
<b>112,035</b>		<b>126,836</b>
	<b><u>Private Equity</u></b>	
56,558	UK	51,148
26,729	Overseas	29,148
<b>83,287</b>		<b>80,296</b>
	<b><u>Infrastructure</u></b>	
33,808	Overseas	46,906
<b>1,507,772</b>		<b>1,709,498</b>

### 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 0.0005% of their portfolio's value.

## Summary of Contracts held at 31 March 2015

### Derivatives – Forward Foreign Exchange

Contract	Settlement Date	Value of Currency Bought £'000	Asset £'000	Liability £'000	Net £'000
Various Currency Forwards	Within 1 month	138		(1)	(1)

## Summary of Contracts held at 31 March 2014

### Derivatives – Exchange Traded Futures Contracts

Contract	Settlement Date	Value of Currency Bought £'000	Market Value £'000
Overseas Equity	Within 1 month	110	33

### Derivatives – Forward Foreign Exchange

Contract	Settlement Date	Value of Currency Bought £'000	Asset £'000	Liability £'000	Net £'000
Various Currency Forwards	Within 1 month	4,826		(44)	(44)

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

## Investments analysed by fund manager

MARKET VALUE 31 March 2014			MARKET VALUE 31 March 2015		
£ million	(%)		£ million	(%)	
212.0	13.5	Aberdeen Asset Management	234.3	13.1	
135.1	8.6	Baillie Gifford Life Ltd – Bonds	155.4	8.7	
189.5	12.1	Baillie Gifford Life Ltd – Diversified Growth	206.0	11.5	
327.5	20.9	Legal and General Investment Management Ltd.	376.9	21.1	
227.5	14.5	Newton Investment Management Ltd.	275.3	15.4	
223.8	14.3	Schroder Investment Management Ltd.	241.0	13.5	
110.5	7.1	Schroder Investment Management Ltd. (Property)	127.5	7.1	
43.1	2.8	SL Capital Partners LLP	38.9	2.2	
26.7	1.7	Wilshire Private Markets Group	29.1	1.6	
13.4	0.9	M&G UK Companies	12.3	0.7	
33.8	2.2	Grosvenor Capital	46.9	2.6	
-	-	Hearthstone	17.1	1.0	
22.7	1.4	In House Cash	28.0	1.5	
1,565.6	100.0	Total	1,788.7	100.0	

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

	31 March 2014		31 March 2015	
	£'000	%	£'000	%
Baillie Gifford Diversified Growth	189,496	12.2	206,045	11.6
L&G – UK Equity Index	118,426	7.6	132,844	7.5
L&G – North American Equity Index	112,624	7.3	130,818	7.4
Baillie Gifford Sterling Aggregate Bonds	82,263	5.3	93,825	5.3

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.

## 16c. Securities Lending

The Fund did not participate in any stock lending programmes.

## 16d. 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:-

<b>2013/14</b>		<b>2014/15</b>
<b>£'000</b>		<b>£'000</b>
165	Within one year	173
238	Between one and five years	258
198	Later than five years	142
601		573

## 17. Financial Instruments

### 17a. 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.

## Classification of Financial Instruments

31 March 2014				31 March 2015			
Fair value through fund account £'000	Loans and receivables £'000	Financial liabilities at amortised cost £'000	Financial Assets	Fair value through fund account £'000	Loans and receivables £'000	Financial liabilities at amortised cost £'000	
			<b>Investment assets</b>				
613,587	-	-	Equities	686,664	-	-	
665,055	-	-	Pooled investments	768,796	-	-	
109,735	-	-	Property	124,536	-	-	
	-	-	Private				
117,095			Equity/Infrastructure	127,202	-	-	
33	-	-	Derivative contracts	-	-	-	
-	57,740	-	Cash	-	80,993	-	
			Other investment				
-	9,951	-	balances		3,598		
1,505,505	67,691	-		1,707,198	84,591	-	
			<b>Other assets</b>				
-	4,228	-	Cash Balances	-	3,729	-	
-	7,551	-	Debtors	-	7,743	-	
-	11,779	-		-	11,472	-	
1,505,505	79,470	-	<b>Assets Total</b>	1,707,198	96,063	-	
			<b>Financial Liabilities</b>				
			<b>Investment liabilities</b>				
(44)	-	-	Derivative contracts	(1)	-	-	
(7,557)	-	-	Other Investment	(3,087)	-	-	
			balances				
			<b>Other liabilities</b>				
-	-	(2,993)	Creditors	-	-	(2,627)	
(7,601)	-	(2,993)	<b>Liabilities Total</b>	(3,088)	-	(2,627)	
1,497,904	79,470	(2,993)		1,704,110	96,063	(2,627)	
		1,574,381	<b>Total net financial instruments</b>			1,797,546	
		2,300	Amounts not classified as financial instruments			2,300	
		<u>1,576,681</u>	<b>Total net assets</b>			<u>1,799,846</u>	

## 17b. Net Gains and Losses on Financial Instruments

31 March 2014 £'000		31 March 2015 £'000
86,199	Fair value through net asset statement	187,065
(6,843)	Loans and receivables	1,671
-	Financial liabilities at amortised cost	-
79,356	Net gains and losses on financial instruments	188,736
-	Gains and losses on directly held freehold property	-
79,356	Change in market value of investments per fund account	188,736



## 17c. 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 pension 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 2015

	Quoted market price Level 1 £'000	Using observable inputs Level 2 £'000	With significant unobservable inputs Level 3 £'000	Total at 31 March 2015 £'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>

## Valuation of Financial Instruments Carried at Fair Value

As at 31 March 2014

	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Total at 31 March 2014 £'000
<b>Financial assets</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Financial assets at fair value through net asset statement	1,143,578	244,835	117,092	1,505,505
Loans and receivables	79,470	-	-	79,470
<b>Total financial assets</b>	<b>1,223,048</b>	<b>244,835</b>	<b>117,092</b>	<b>1,584,975</b>
<b>Financial liabilities</b>				
Financial liabilities at fair value through net asset statement	(7,601)	-	-	(7,601)
Financial liabilities at amortised cost	(2,993)	-	-	(2,993)
<b>Total financial liabilities</b>	<b>(10,594)</b>	<b>-</b>	<b>-</b>	<b>(10,594)</b>
<b>Net financial assets</b>	<b>1,212,454</b>	<b>244,835</b>	<b>117,092</b>	<b>1,574,381</b>

## 18. 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 2015 is estimated to be around £383.1m.

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

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 2015 is estimated to be around £940m.

(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 2015 accounted for 3.6% of fund assets.

<b>Balances at 31 March 2014 £'000</b>		<b>Moody's Credit Rating</b>	<b>Balances at 31 March 2015 £'000</b>
	<b>Held for investment purposes</b>		
12,400	Northern Trust Global Investment Limited – Liquidity Funds	Aaa-mf	24,565
4,953	Ignis Asset Management Sterling Liquidity Fund	AAAmf (Fitch)	4,976
14,223	Northern Trust Company – Cash Deposits	A1	26,590
5,000	Santander UK PLC	A2	2,002
5,000	Bank of Scotland PLC	A1	4,000
41,576	Total investment cash		62,133
	<b>Held for other purposes</b>		
3,927	Clydesdale Bank	Baa2	3,777
45,503	Total cash		65,910

As part of its approach to managing credit risk, the Fund formalised its Treasury operations during 2014/15 through the implementation of a Cash Management Strategy. This 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 £3m to £4m.

(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	20.0%
Equities – Emerging Markets	30.0%
Private Equity	30.0%
Commodities	30.0%
Property – Balanced	13.0%
Property – Infrastructure	8.0%
Diversified Credit	10.0%
Fixed Interest Gilts	10.5%
Index-Linked Gilts	8.5%
Cash	1.5%

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 2015

Asset Type	Value at 31 March 2015 £'m	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	52.7	2.8%	10.5%	5.5	58.2	47.2
Fixed Interest Gilts	179.1	10.0%	10.0%	17.9	197.0	161.2
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>n/a</b>	<b>14.0%</b>	<b>250.4</b>	<b>n/a</b>	<b>n/a</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 2014 are set out in the table overleaf.

## Falkirk Pension Fund sensitivity analysis

### Position as at 31 March 2014

Asset Type	Value at 31 March 2014 £'m	Asset Weight	Volatility	Potential Change =/- £'m	Value on increase £'m	Value on decrease £'m
Equities - Developed Markets	951.3	60.7%	20.0%	190.3	1,141.6	761.0
Equities - Emerging Markets	31.1	2.0%	30.0%	9.3	40.4	21.8
Private Equity	75.2	4.8%	30.0%	22.6	97.8	52.6
Commodities	13.1	0.8%	30.0%	3.9	17.0	9.2
Property	116.0	7.4%	13.0%	15.1	131.1	100.9
Infrastructure	41.4	2.6%	8.0%	3.3	44.7	38.1
Diversified Credit	162.7	10.4%	10.0%	16.3	179.0	146.4
Fixed Interest Gilts	63.5	4%	10.5%	6.7	70.2	56.8
Index-Linked Gilts	32.6	2.1%	8.5%	2.8	35.4	29.8
Cash	81.0	5.2%	1.5%	1.2	82.2	79.8
<b>Total Assets (without correlations)</b>	<b>1,567.9</b>	<b>100.0%</b>	<b>17.3%</b>	<b>271.5</b>	<b>1,839.4</b>	<b>1,296.4</b>
<b>Total Assets (including correlations)</b>	<b>1,567.9</b>		<b>14.9%</b>	<b>233.0</b>	<b>1,800.9</b>	<b>1,334.9</b>
<b>Assets Relative to Liabilities (including correlation)</b>	<b>1,567.9</b>		<b>14.1%</b>	<b>221.1</b>	<b>n/a</b>	<b>n/a</b>

## 19. Funding arrangements

In line with the Regulation 32 of the Local Government Pension Scheme (Administration)(Scotland) Regulations 2008, 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 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 took 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 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 is primarily due to the decrease in the 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 were as follows:

### Financial Assumptions

Assumption	Return	Comment
Investment Return (discount rate)	5.1%	Return on Government Bonds plus 1.6%
Inflation (RPI)	3.5%	
Salary Increases	4.0%	RPI + 0.5%
Pension Increases (CPI)	2.7%	RPI – 0.8%

### Mortality Assumptions

Future life expectancy based on the actuary's fund specific mortality review was as follows:

Assumed Life Expectancy at Age 65	Male	Female
Current pensioners	22.1 years	23.8 years
Active and Deferred members	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.

### Historic Mortality

Life expectancies for the year ended 31 March 2014 are based on the SAPS tables. The allowance for future improvements are shown below:-

Period Ended	Prospective Pensioners	Pensioners
31 March 2014	Year of birth, medium cohort and 1% p.a. minimum improvements from 2008	Year of birth, medium cohort and 1% p.a. minimum improvements from 2008

### More Information

The Actuary has provided a statement describing the funding arrangements of the Fund during 2014/15. 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.

## 20. 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 19). The actuary has also valued ill health and death benefits in line with IAS19.

Calculated on an IAS19 basis, the actuarial value of promised retirement benefits at 31 March 2015, based on a roll forward of the 31 March 2014 valuation and assumptions consistent with IAS19, has been estimated by the Fund Actuary as £2,748m (£2,281m at 31 March 2014). The net assets available to pay benefits as at 31 March 2015 were £1,800m (£1,577 at 31 March 2014). The implied fund deficit as at 31 March 2015 was therefore £948m (£704m at 31 March 2014).

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 19) because IAS 19 requires liabilities to be valued according to a discount rate derived from a specific type of corporate bond rather than a rate which reflects the Fund's long term expectation of investment returns.

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 2014 % p.a.</b>	<b>31 March 2015 %p.a.</b>
Discount rate	4.3	3.2
Pay increase *	5.1	3.8
Price inflation/Pensions increases	2.8	2.4

\* Pay increases are 1% p.a. nominal until 31 March 2015 reverting to long term rate thereafter.

### 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

Please note that the longevity assumptions have changed since the IAS 26 disclosure in the 2014 accounts.

### Commutation Assumptions

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.

## 21. Non Current Assets

### Long Term Debtors

31 March 2014

£'000

816

Strain on Fund Contributions (Due in over 1 year)

31 March 2015

£'000

171

### Analysis of Long Term Debtors

31 March 2014

£'000

-

Central government bodies

702

Other local authorities

-

NHS bodies

-

Public corporations and trading funds

114

Other entities and individuals

816

Total

31 March 2015

£'000

-

114

-

-

57

171

## 22. Cash Balances

31 March 2014		31 March 2015
£'000		£'000
3,927	Bank Account	3,777
301	Balance held by Falkirk Council	(48)
4,228	Total	3,729

As stipulated by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (SSI 2010 No. 233), all Local Authority Pension Funds have been required to operate their own bank account from 1 April 2011. From 1 April 2011 all payments made to the Fund are paid directly into the Fund's separate bank account.

Due to the Fund using Falkirk Council's financial management systems, there was a working balance at year end.

## 23. Current Assets

### Debtors

31 March 2014		31 March 2015
£'000		£'000
3,917	Contributions due – employers	4,701
1,228	Contributions due – members	1,451
1,508	Strain on fund contribution (due within 1 year)	1,288
12	Benefits paid in advance	3
70	Sundry debtors	129
6,735	Total	7,572

### Analysis of Debtors

31 March 2014		31 March 2015
£'000		£'000
430	Central government bodies	1,199
5,486	Other local authorities	4,837
2	NHS bodies	2
4	Public corporations and trading funds	22
813	Other entities and individuals	1,512
6,735	Total	7,572

## 24. Current Liabilities

31 March 2014		31 March 2015
£'000		£'000
(1,740)	Benefits payable	(1,246)
(1,253)	Miscellaneous creditors and accrued expenses	(1,381)
(2,993)	Total	(2,627)

### Analysis of Creditors

31 March 2014		31 March 2015
£'000		£'000
(15)	Central government bodies	(127)
(14)	Other local authorities	(574)
(1,126)	Public corporations and trading funds	(1,321)
(1,838)	Other entities and individuals	(605)
(2,993)	Total	(2,627)

## 25. Additional Voluntary Contributions

Market Value 31 March 2014		Market Value 31 March 2015
£'000		£'000
2,481	Standard Life	2,847
-	Prudential	149
2,481	Total	2,996

AVC contributions of £388k were paid directly to Standard Life (£268k in 2013/14) and £141k to Prudential during the year.

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).



## 26. 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 £528k (2013/14: £505k) 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 (2013/14: £19.7m).

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 2015 was £48k (£301k 2014).

### 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 A Redpath). In addition, Committee Members S Carleschi, J Blackwood, CRL Martin and M Keggan 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:-

<b>Accrued CETV 31 March 2014  (£'000)</b>	<b>Role</b>	<b>Salary  (£'000)</b>	<b>Service</b>	<b>Accrued CETV 31 March 2015  (£'000)</b>
767	Chief Finance Officer	88	30 years	800
368	Pensions Manager	50	32 years	398

“CETV” means Cash Equivalent Transfer Value.

## **27. Contingent Liabilities and Contractual Commitments**

Outstanding capital commitments (investments) at 31 March 2015 totalled £58m (31 March 2014: £63m).

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.

## **28. 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 18 of the Fund's Annual Report and Accounts for 2014/15.

### 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.

In line with the Council's procedures for investigating fraud and corruption, the Fund participates in the National Fraud Initiative and actively investigates all data matches found identified through the process. These results are reported to the Pensions Committee.

2014/15 has seen the Fund put in place arrangements to ensure regulatory compliance with the career average version of the LGPS being launched on 1<sup>st</sup> April 2015.

The installation of a new administration system has been overseen by a project team comprising software providers Heywood and senior officers from the Pensions Section. The project team has undertaken significant testing, resulting in a number of minor issues requiring to be addressed, but with no material weaknesses being identified. Further assurance has been 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, and the latter will be subject to a full review and refresh during 2015/16 to take account of evolving systems and emerging risks.

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 Risk Register is maintained and new risks reported to the Pensions Committee on a quarterly basis. Where the risk is sufficiently material, the risk register is updated.

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

The Fund's governance arrangements are formally monitored via:

- the Pensions Committee and Panel 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 2015. 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 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 scheduled for 2015/16. 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 are able to 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, and recommendations which remain outstanding beyond their agreed implementation date, are brought to the attention of the Pensions Committee. During 2014/15, there were however no matters which required to be brought to the attention of the Committee.

Whilst internal audit work for 2014/15 has focused on the Council wide control environment rather than specifically the pension fund, the Chief Finance Officer has concluded on the basis of audit work undertaken in previous years and the range of other controls in place that substantial assurance can be placed on the adequacy and effectiveness of the Fund's internal control systems for the year to 31 March 2015.

In undertaking his duties, and in forming the above opinions, the Chief Finance Officer worked in conformance with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer in Local Government.

### **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 LGPS is likely to result 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
- extension of training arrangements for Board members
- development of conflicts of interest policy
- review of risk management

### **Certification**

This Annual Governance Statement summarises, openly and transparently, arrangements established by Falkirk Council for 2014/15 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**  
**24 September 2015**

.....  
**Mary Pitcaithly**  
**Chief Executive**  
**24 September 2015**

# **Falkirk Council Pension Fund**

**Local Government Pension Scheme**

## **Governance Compliance Statement**

## Part 2 – Governance Compliance Statement

Regulation 27 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (SSI 2008/228) 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

Requirement		Level of Compliance	Arrangements in Place
(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 members co-opted from the Pensions Panel representing the interests 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 the Pensions Panel lies with the three Committee members who are also Panel members. Communication is also assisted by the synchronising Panel meetings with the corresponding Committee meeting.
(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>Full Compliance</b>	Three places on the Pensions Committee are reserved for members of the Pensions Panel.

## Principle B – Representation

Requirement		Level of Compliance	Arrangements in Place
(a)	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:		
	<p>(i) Employing authorities (including e.g. admission bodies);</p> <p>(ii) Scheme members (including deferred and pensioner scheme members);</p>	<p><b>Full Compliance</b></p> <p><b>Full Compliance</b></p>	<p>Representatives of major fund employers, including one admission body, sit on the Pensions Panel. A nominee from the Panel's employer representatives sits on the Pensions Committee.</p> <p>Non-pensioners are represented by the Trade Union Panel members and by the Union representative who sits on the Pensions Committee. Pensioners are represented by the pensioner members who sit on the Panel and the member who sits on the Committee.</p>

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 Panel 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>▪ access to existing 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 Pensions Panel 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>	Panel members who are co-opted onto the Pensions Committee have equality of access to papers, meetings and training and have full opportunity to contribute to the decision making process, including the right to vote.
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## 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 Pensions Panel will be appointed on the understanding that they will be subject to the Falkirk Council Councillors Code of Conduct.</p> <p>Induction training will be delivered to Committee and Panel 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 and Panel 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 / FacilityTime / Expenses

Requirement		Level of Compliance	Arrangements in Place
(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 Pensions Panel members.</p> <p>Training is delivered in large part by addressing specific items at Committee and Panel 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 Panel 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 Pensions Panel 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 Panel 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.
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## 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.  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>	The Pensions Panel hold quarterly meetings and meets roughly two weeks in advance of the Pension Committee.  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 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 Pensions Panel 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 Pensions Committee and Panel agendas 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.  Full details of the Governance arrangements are published on the Fund's website.

Chief Finance Officer  
Falkirk Council

24<sup>th</sup> September, 2015

## ACTUARIAL STATEMENT FOR 2014/15

### **Falkirk Council Pension Fund (“the Fund”) Actuarial Statement for 2014/15**

This statement has been prepared in accordance with Regulation 31A(1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2014/15. 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 March 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. Nominal	% p.a. 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 over the year to 31 March 2015 (excluding the effect of any membership movements). Real bond yields have fallen dramatically and the

effect of this has been only partially offset by the effect of strong asset returns, meaning that funding levels are 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  
17 September 2015

<b>SCHEDULED AND ADMISSION BODIES AS AT 31 MARCH 2015</b>
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**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 Scotland Council for Regional Equality \*  
 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**

Stirling University  
Waterwatch Scotland



**FALKIRK COUNCIL**

**Subject: FALKIRK COUNCIL PENSION FUND - REPORT TO THOSE CHARGED WITH GOVERNANCE ON THE 2014/15 AUDIT**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 24 SEPTEMBER 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 This report invites the Pensions Board and Committee to consider the Annual Audit Report 2014/15 incorporating ISA 260 Report to those charged with Governance.

**2. BACKGROUND**

- 2.1 Regulation 31A of the Local Government Pension Scheme (Administration)(Scotland) Regulations 2008 requires administering authorities to publish a pension fund annual report and accounts that are separate from the other accounts of the administering authority. The fund annual report and accounts also require to be subject to a separate audit.
- 2.2 The audit for 2014/15 was undertaken by the Fund's external auditors, Audit Scotland.

**3. AUDIT PROCESS**

- 3.1 The Annual Audit Plan was presented to the Pensions Committee on 12 March, 2015.
- 3.2 The Fund's Unaudited Annual Report and Accounts for 2014/15 were submitted for audit on 19 June 2015 in line with the required statutory deadline.
- 3.3 Annual Audit Report to those charged with governance summarises main findings from the 2014/15 Audit of Falkirk Pension Fund and draws attention to any significant matters arising from the audit of the financial statements prior to the formal signing of the independent auditor's report.

**4. AUDIT OUTCOME**

- 4.1 The ISA 260 reports that the audit will be unqualified.

## **5. MATTERS ARISING**

5.1 In terms of IAS 260, there are two points to note:

- Annual Governance Statement has been revised since presenting unaudited accounts to members to reflect feedback from external audit
- Year end reconciliation between annual returns from employing bodies and the ledger was incomplete, because not all admitted bodies submitted their return. All the main admitted bodies have submitted now their annual return and any variances highlighted by the reconciliation are not material. All admitted bodies will be reminded to submit their annual returns timeously.

5.2 External Audit highlighted that the Pensions Committee should receive a copy of internal audit plans, specifying any pensions related items, to ensure that the scope of work is significant, to allow Committee to obtain independent assurance on internal controls and risk management.

5.3 The Local Authority Accounts (Scotland) Regulations 2014 introduced a new requirement from 2014-15 for all local authorities (including pension funds) to undertake an annual review of their control system and report this in an annual governance statement. Pension Committee should obtain an annual assurance report from Internal Audit giving their opinion on the control environment including the new pensions system.

5.4 Internal audit plan for the financial year 2014-2015 did not include any pension specific work. However, this was rectified by including specific pension work in the 2015/16 internal audit plan, submitted to the council's Audit Committee in April 2015. Subsequently the work was undertaken in early 2015-16 and reported to the management on the 15 July 2015. The Internal Audit report is covered in the General Governance Matters report.

5.5 The report also highlighted concerns about the staffing level in the pension administration team and the permanent accountant post.

5.6 Matters arising from the 2013-14 report to those charged with governance were subsequently addressed during 2014-15.

## **6. CONCLUSION**

6.1 The Fund's external auditors, Audit Scotland, have completed their report to those charged with governance and anticipate being able to issue an unqualified audit certificate.

6.2 Matters arising from the audit will be taken forward in preparing the 2015/16 accounts.

**7. RECOMMENDATION**

- 7.1 Members are asked to approve the Proposed Annual Audit Report, incorporating ISA 260 report to those charged with governance from Audit Scotland.**

pp **Director of Corporate & Housing Services**

**Date: 16 September 2015**

**Contact Officer: Bryan Smail/Justyna Korszen-Bennett**

**LIST OF BACKGROUND PAPERS**

NIL

# Falkirk Council Pension Fund

Proposed Annual Audit  
Report to Members and  
the Controller of Audit

September 2015

The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies. ([www.audit-scotland.gov.uk/about/ac](http://www.audit-scotland.gov.uk/about/ac))

Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General. ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk))

The Accounts Commission has appointed Fiona Mitchell Knight as the external auditor of Falkirk Council Pension Fund Council for the period 2011/12 to 2015/16.

This report has been prepared for the use of Falkirk Council Pension Fund and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

## Key contacts

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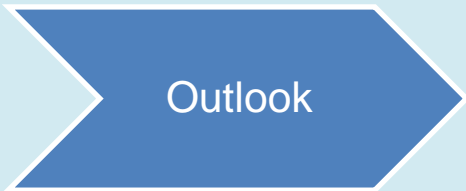
Website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)

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## Key messages

 <p>Audit of financial statements</p>	<ul style="list-style-type: none"><li>• The independent auditor's report on the 2014/15 financial statements of Falkirk Council Pension Fund is unqualified.</li><li>• No adjustments required to the Fund's financial statements.</li></ul>
 <p>Financial management and sustainability</p>	<ul style="list-style-type: none"><li>• The 2014 triennial valuation reported that the Fund's assets were sufficient to meet 84.4% of its liabilities. A more recent interim valuation by the Fund's actuary estimated that funding deficit had declined to 79.3%.</li><li>• Fund net assets at 31 March 2015 were £1,799.8 million, an increase of £223.2 million (or 14.3%) over the year, reflecting the favourable market conditions for investors during the year.</li><li>• The Fund has prepared an administration budget for the first time.</li></ul>
 <p>Governance and transparency</p>	<ul style="list-style-type: none"><li>• Overall, the Fund had effective governance arrangements in place during the year.</li><li>• New governance arrangements were implemented from 1 April 2015 to comply with the Public Service Pension Act 2013. This included the establishment of a local Pension Board.</li><li>• The Fund actively participates in the National Fraud Initiative.</li><li>• A timescale has yet to be agreed for the recruitment and appointment of a permanent accountant.</li><li>• Aspects of governance could be improved including the Internal Audit Manager providing the Pensions Committee with an annual assurance report on the systems of internal control.</li></ul>

 Performance	<ul style="list-style-type: none"><li>• The Fund has good performance management arrangements.</li><li>• The Fund achieved a 13.4% return on investments in 2014/15 compared to a benchmark target of 12.1%. Also, it outperformed benchmark targets over the medium and longer term.</li><li>• All fund managers posted positive absolute returns on investment performance in 2014/15 reflecting a strong year for equities and bonds although performance of Aberdeen Asset Management continues to remain under close scrutiny.</li><li>• Administration performance has deteriorated due to pressures on staff resources.</li></ul>
 Outlook	<ul style="list-style-type: none"><li>• From the start of 2015/16, the Fund will provide benefits on a “career average” basis. This change will increase the complexity and workload of Fund administration.</li><li>• The pensioners’ payroll system is due to transfer from the council’s Resourcelink system to a module on Altair. This will require good project management.</li><li>• The global investment outlook continues to be marred by political and economic challenges.</li></ul>



# Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of Falkirk Council Pension Fund (the 'Fund'). The report is divided into sections which reflect our public sector audit model.
2. The management of the Fund is responsible for:
  - preparing financial statements which give a true and fair view
  - implementing appropriate internal control systems
  - putting in place proper arrangements for the conduct of its affairs
  - ensuring that the financial position is soundly based.
3. Our responsibility, as the external auditor of Falkirk Council Pension Fund, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.
5. **Appendix III** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Falkirk Council Pension Fund understands its risks and has arrangements in place to manage these risks. The council and executive officers group should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
6. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
7. We are grateful for the cooperation and assistance we received from officers during the course of the audit.

# Audit of the 2014/15 financial statements

<b>Audit opinion</b>	<ul style="list-style-type: none"> <li>We have completed our audit and issued an unqualified independent auditor's report.</li> </ul>
<b>Going concern</b>	<ul style="list-style-type: none"> <li>The financial statements of Falkirk Council Pension Fund have been prepared on the going concern basis. We are not aware of any events or conditions that cast doubt on the Fund's ability to continue as a going concern.</li> </ul>
<b>Other information</b>	<ul style="list-style-type: none"> <li>We review and report on other information published with the financial statements, including the management commentary, governance compliance statement and annual governance statement. We have nothing to report in respect of these statements.</li> </ul>

## Submission of financial statements for audit

8. We received the unaudited financial statements on 19 June 2015, in accordance with the agreed timetable. The working papers were of a good standard and council staff provided good support to the audit team which assisted the delivery of the audit to deadline.

## Overview of the scope of the audit of the financial statements

9. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Pension Committee on 12 March 2015.
10. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.
11. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix I** sets out the significant audit risks

identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

12. Our audit involved 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.

## Materiality

13. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).
14. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
15. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of Falkirk Council Pension Fund we set our planning materiality for 2014/15 at £7.643 million or 10% of contributions (based on the audited 2013/14 accounts). We also report all misstatements greater than £100,000. Performance materiality was calculated at £3.822million, to reduce to an acceptable level the probability of

uncorrected and undetected audit differences exceeding our planning materiality level.

16. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our original calculation remained appropriate.

## Evaluation of misstatements

17. A number of presentational adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements. A small number of monetary errors were also identified that have been corrected; they had no impact on the bottom line figures.

## Significant findings from the audit

18. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:
  - the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures
  - significant difficulties encountered during the audit
  - significant matters arising from the audit that were discussed, or subject to correspondence with management
  - written representation requested by the auditor

- other matters which in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

19. There has been a significant improvement in the disclosure of investment management expenses which now include direct expenses from private equity and infrastructure investments.
20. The table overleaf contains a summary of the significant findings that, in our view, require to be communicated to you in accordance with ISA 260.

Issue	Resolution
<p><b>Annual Governance Statement (AGS):</b></p> <p>The Annual Governance Statement contained a number of factual inaccuracies and potentially misleading information on the scope of internal audit work. External audit requested that a number of changes be made to the content of the AGS particularly in relation to internal audit.</p>	<p>The Annual Governance Statement revised to take accounts of points raised by external audit.</p>
<p><b>Year end reconciliation of employer / employee contributions:</b></p> <p>The monthly returns of employee and employer contributions received from admitted bodies are recorded on a controls spreadsheet by pensions staff. These are then posted to the ledger after checking to receipt through bank statements. Reasonableness checks are carried out on the contributions at the time of receipt. In previous years, a detailed check of contributions has been carried out at the year end when detailed data returns from employers have been received.</p> <p>The year end reconciliation was not complete at the time of our audit with returns still outstanding from 11 out of 37 admitted bodies. For those bodies where returns have been received the differences on reconciliations are immaterial relative to total contributions. Where returns are still outstanding the total value of contributions from those bodies is approximately £831,000 out of total contributions received of approximately £75,000,000 (1.1%) which is not material to the accounts.</p>	<p>The monthly checks performed on the remittance advices provide assurance that the figures in the ledger are reliable and materially correct. The ledger figures were used in compiling the Annual Report and Accounts.</p>

## Recent developments

### Public Services Pensions Act 2013

21. In terms of the 2013 Act, a number of significant changes to the Local Government Pension Scheme (LGPS) (Scotland) that apply from 1 April 2015 including those illustrated below:

Benefits from 1 April 2015 will build up on a career average basis at the rate of 1/49th of annual pensionable earnings

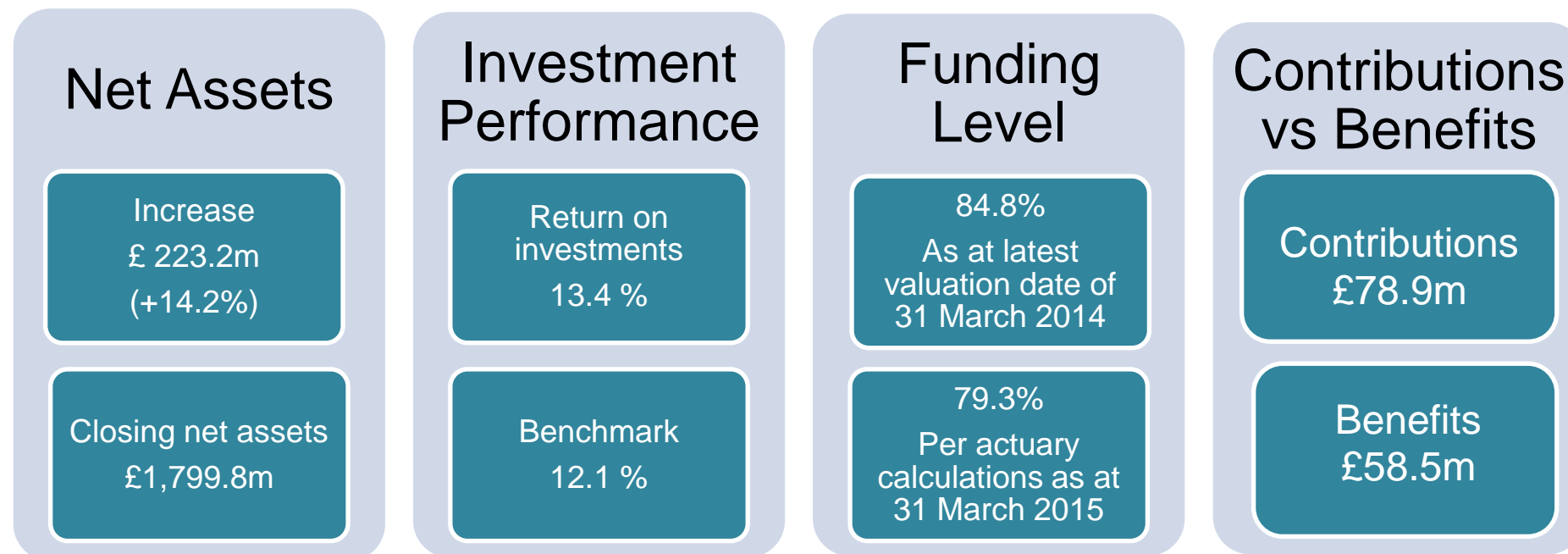
Normal Pension Age will be aligned with each member's own State Pension Age

The LGPS will have a national Advisory Board and local pension Boards

### Revised governance arrangements

22. The 2013 Act is supported by a number of new sets of regulations including the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015. These set out the new governance arrangements from 1 April 2015.
23. At a national level the new arrangements include the establishment of a Scheme Advisory Board. Its role is to:
- provide advice to Scottish Ministers on proposed changes to the LGPS (Scotland)
  - provide advice to Scheme Managers or the Scheme's Pension Boards on the effective and efficient administration of the Scheme and any funds within the Scheme.
24. The act also extends the powers of the Pensions Regulator to cover standards of governance and administration in the LGPS (Scotland).
25. Another key feature of the new governance arrangements is the requirement for a local Pension Board to be established from 1 April 2015 to assist the Scheme Manager (i.e. Falkirk Council) in securing compliance with the scheme rules and with the Pension Regulator's Codes of Practice. In the Governance and Transparency section of this report we comment on progress made in implementing these new arrangements.

# Financial management and sustainability



## Financial management

26. In this section we comment on the Fund's financial outcomes and assess its financial management arrangements.
27. Pension fund finances are independently assessed every three years by the Fund's actuary. Employer contribution rates are determined by the actuary and used by the council as administering body to set an annual budget for the Fund's expenditure and income. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

### Financial outcomes

28. The Fund reported an increase in net assets of £223.2 million (14.2%) to approximately £1.8 billion. The increase is due mainly to £27.1million from investment income and £188.7 million from increases in the value of investments as a result of favourable conditions in the equities market. The Fund has also benefited from investment in growth generating assets.
29. The Fund's Actuary, Hymans Robertson, have estimated that the Fund's liabilities have risen from £1.8 billion at 31 March 2014 to £2.2 billion at 31 March 2015. This is a result of falling gilt yields which in turn leads to a lower discount rate and higher values being placed on the Fund's liabilities.
30. It is important to note that the £2.2 billion does not appear in the financial statements as they do not take account of the Fund's obligations to pay pensions after the 31 March 2015.

## Financial management arrangements

31. As auditors, we consider whether pension funds have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
- the proper officer has sufficient status within the council to be able to deliver good financial management
  - financial regulations are comprehensive, current and promoted within the council
  - reports monitoring performance against budgets are accurate and provided regularly to budget holders
  - monitoring reports do not just contain financial data but are linked to information about performance
  - members provide a good level of challenge and question budget holders on significant variances.
32. We assessed the role and status of the proper officer against the Chartered Institute of Public Finance and Accountancy's *Statement on the role of the Chief Finance Officer in Local Government*. We concluded that, in relation to the Fund, the council as administering body generally complied with the statement's five principles. However, we have raised some concerns about whether the Pensions Section is sufficiently resourced to be fit for purpose (refer to paragraphs 87 to 89).
33. The Fund relies on the council's standing orders and financial regulations. The former were updated in May and take account of the new governance arrangements resulting from the Public



Services Pensions Act 2013. Financial regulations while comprehensive are due to be updated sometime later this year.

34. An administration budget was prepared for the first time in the current financial year while the budget for 2015/16 was reported to the Pensions Committee in March 2015. Also, the Fund's Annual Report and Accounts includes details of actual income and expenditure against approved budget with explanations for significant variances.
35. The Fund has good performance arrangements with regular review monitoring and review of investment managers' performance.

## Conclusion on financial management

36. Overall, subject to comments on staff resourcing, we concluded that financial management arrangements are effective.

## Financial sustainability

37. The Fund gives its members a guarantee that in exchange for contributions during their employment, the Fund will pay a pension until the end of each member's life. Financial sustainability means that the Fund maintains the capacity to meet the current and future needs of its members despite changes in investment performance and life expectancy.
38. In assessing financial sustainability we look at various aspects of activity, including the funding position, membership levels and long-term recovery measures where there is a deficit.

## Funding position

39. One of the key objectives of the Administering Authority as set in the Fund's Funding Strategy Statement is to hold sufficient assets to meet the assessed cost of members' past service benefits. A funding level of 100% would be needed for this objective to be met at the valuation date.
40. The most recent triennial valuation of the Fund was completed during 2014/15. This valuation showed that the Fund's assets amounted to £1,577 million at 31 March 2014 and these were sufficient to meet 84.8% of its liabilities at that date. The funding shortfall was £283 million as illustrated below.

**Table 1: Funding valuations 2008 to 2014**

Fund Details	March 2008 £ million	March 2011 £million	March 2014 £million
<b>Assets</b>	947	1,199	1,577
<b>Liabilities</b>	(1,203)	(1,392)	(1,860)
<b>Net Liability</b>	(255)	(193)	(283)
<b>Funding Level</b>	78.7%	86.1%	84.8%

Source: Falkirk Council Pension Fund Annual Reports and Accounts

41. The current funding position represents a slightly weaker position than that reported in March 2011 when the funding position was 86.1% although still a stronger position than the 78.7% funding level reported in March 2008.

42. Hymans Robertson, also review the funding position annually and by their calculations the estimated funding position at 31 March 2015 was 79.3%. This is based on assets of £1,820 million and liabilities of £2,297 million which produces a net liability of £0.477 million. This weaker position is due primarily to the fall in gilt yields from 5.1% (March 2014) to 3.8% (March 2015) and reflects market uncertainty in the short term.
43. In reducing the funding deficit the factor most likely to have a beneficial effect is a rise in interest rates. This will drive up bond yields and reduce overall liabilities. Interest rates are not expected to increase until late next year.
44. Following the 2014 valuation, the Actuary has specified that the majority of Fund employers pay deficit contributions as a fixed sum rather than as a percentage of pay. This will provide greater certainty for the Fund over the level of deficit contributions that it receives.
45. Fund membership has remained fairly stable over the year. Also, there has been an increase in active members with numbers rising from 12,939 in 2010/11 to 14,589 in 2014/15; an 11% increase. Furthermore, there was surplus of contribution income over the over the cost of pensions with contributions of £79.8 million exceeding benefits of £58.9 million by £21.3 million. This surplus contributes towards the Fund's requirement to provide current and future needs of members.
46. It is important that the Fund closely monitors membership and contribution levels so that it can continue to pay benefits from its regular contribution inflow.
47. The Investment Strategy is under review. The aim of the strategy will be to return the Fund to a positive funding position in the longer term.
48. An investment sub-group has been formed to oversee the construction of a gradual de-risking plan to enable the Fund to allocate more assets to fixed income as the funding level improves and thereby reduce the exposure to investment risk.
49. Subsequently review will cover the mix of assets to be targeted in order to meet its objectives. Determination of managers for the asset mix will then be considered.

## Conclusion on financial management

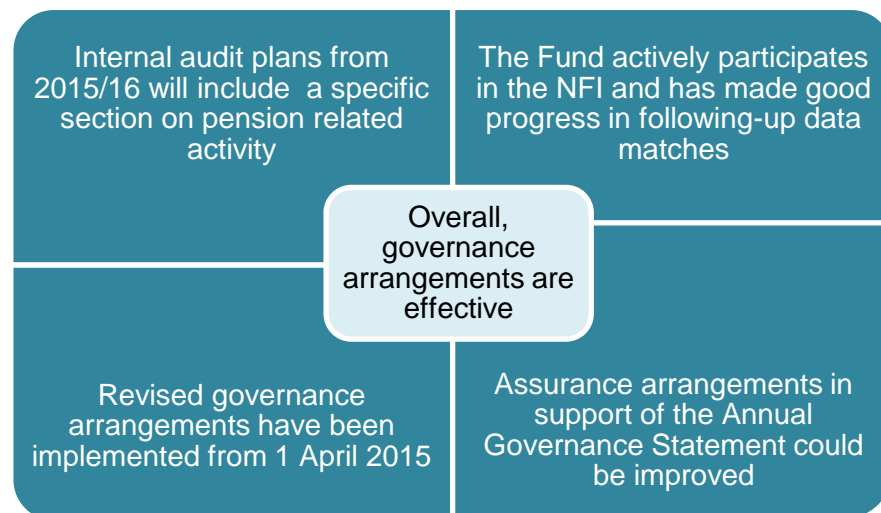
50. Overall, we concluded that, despite the current deficit, the Fund is financially sustainable because of increasing contribution levels and the long-term view of investments.

## Outlook

51. It is clear that the outlook for public spending remains very challenging and the need for spending constraints and budget reductions will continue. Any further staff reduction schemes introduced by employers will place pressures on the Fund from increased administration workloads and reductions in member contribution levels.

- 52. The Public Service Pensions Act 2013 is designed to ensure the continued sustainability of the LGPS. In particular, the introduction of the 'employer cost cap' which will shift some of the risk of future rises in scheme costs onto members.
- 53. The Scottish LGPS Advisory Board is being formed with effect from 1 April 2015 under section 7 of the Public Service Pensions Act 2013. It is expected to operate at national level and will have members drawn from employers, trade unions, professional advisors and bodies such as the Pensions Regulator and the National Association of Pension Funds.
- 54. The UK Government's pension initiatives including auto enrolment, freedom and choice and abolition of contracting out means that the pace of pension reform remains challenging.

# Governance and transparency



55. Falkirk Council is the administering body for the Fund. Members and management of the council are responsible for establishing governance arrangements for the Fund. This to ensure that its business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements.
56. As part of our planning work on the council audit we reviewed various aspects of governance that also apply to the Fund including standing orders, financial regulations, Codes of Conduct

for officers and members and anti-fraud and corruption arrangements.

57. Overall we concluded that these arrangements are adequate and support governance arrangements. We also concluded that the Fund conducts its business in an open and transparent manner.

## Governance structures

58. The main governance structures in place during 2014/15 are summarised below:
- **Pensions Committee.** This committee comprised six councillors from Falkirk Council and three co-opted members drawn from the Union, Employer and Pensioner groupings. This committee has delegated authority to maintain and administer all aspects of Fund business including governance, formulating investment policy, managing assets, accounting and funding matters.
  - **Pension Panel.** This consisted of 15 members representing the interests of scheme members, employers and pensioners. Its role was to support the Pensions Committee in scrutinising the activities of the Fund.
59. As previously mentioned at paragraphs 22 to 25 new governance arrangements came into force on 1 April 2015. These were discussed and agreed by the Pensions Committee in December 2014 and were ratified by Falkirk Council in the same month.

- 60. The main change has been the dissolution of the Pensions Panel and its replacement by a local Pension Board in compliance with the Public Service Pension Act 2013. The Board's role is to assist the Scheme Manager (i.e. Falkirk Council) in ensuring compliance with the rules relating to scheme governance and administration.
- 61. These changes were included in the Governance Policy and Compliance Statement reported to the first joint meeting of the Pensions Committee and Pension Board on 26 June 2015. The Committee and Board plan to meet concurrently to avoid duplication and ensure that business is focused and streamlined.
- 62. Based on our observations and through attendance at the Pensions Panel and Pension Committee during the year we concluded that the governance arrangements were operating effectively. Also, good progress has been made in implementing revised governance arrangements to comply with the requirements of the Public Service Pension Act 2013.

## Transparency

- 63. Transparency means that scheme members have access to understandable, relevant and timely information about how the Fund is taking decisions and how it is using its resources. Members should also be able to hold the Fund to account for the decisions it makes.
- 64. The meetings of the Pensions Committee are open to the public. Committee agenda, papers and reports are published on Falkirk Council's website (save the occasional exempt paper) which is

easy to access and navigate around. The Committee papers and reports provide comprehensive information on all aspects of the Fund's activities including investment performance and the performance of individual companies used by the Fund to manage its portfolio investments.

- 65. The Fund also has its own dedicated website where members can access a range of information including new pensions regulations, the Annual Report and Accounts and the role of the Pensions Committee.
- 66. Scheme members also receive an annual statement that provides details of benefits accrued, information on topical pension issues and a review of the Fund's progress. Due to current staffing issues there is a delay in the deferred members' statements being processed but active members' statements have been administered.
- 67. Overall we concluded that the Fund is open and transparent in the way it conducts its business with scheme members and the public is able to attend regular meetings of the Pension Committee.

## Internal control

- 68. As auditors we concentrate on the significant systems and the key controls within them to provide us with assurance on the accuracy and reliability of figures generated by those systems. For those systems provided by the council (e.g. trade payables, trade receivables and ledger) we carried out a mixture of testing and reliance on the work of internal audit.

69. For pension specific systems (e.g. pension's administration and investments) we carried out a high level review of controls because testing in previous years' had not identified any significant control weaknesses. A recent internal audit report issued on 15 July also concluded that substantial assurance can be placed on governance arrangements and on key controls within pension related systems (e.g. pensioner payroll).

70. Based on the work carried out we concluded that systems were operating effectively and no significant issues were identified that require to be brought to the attention of members.

## Internal audit

71. Internal audit provides members and management of the council with independent assurance on risk management, internal control and corporate governance processes. The Fund's internal audit service is provided by Falkirk Council's internal audit function.

72. We are required by international auditing standards to make an assessment of the internal audit function and the extent to which we can formally rely on their work. We concluded that the internal audit function operated in accordance with the Public Service Internal Audit Standards and had sound documentation standards and procedures in place. Consequently, we were able to take assurance on aspects of internal audit work where systems (e.g. trade receivables) are shared with the authority and the Fund.

73. In our 2013/14 Annual Audit Report and 2014/15 Annual Audit Plan we highlighted that the internal audit plan for the council, in the 2014/15 financial year, did not include any pension specific work. Management subsequently addressed this by including a pension section within the council's 2015/16 internal audit plan. While this plan was submitted to the council's Audit Committee in April 2015 it was not presented to the Pensions Committee for consideration.

### Recommendation 1

74. In future, the Internal Audit Manager (or his representative) plans to attend the Pension Board, as required, to present audit findings and answer questions raised by members.

75. The Pension Fund section of the council's internal audit plan for 2015/16 outlines the work to be undertaken, namely:

- a review of the arrangements for the governance and management of the Fund; and
- transactional testing

although, an outline of the scope of internal audit work was not detailed in the audit plan.

76. This work was undertaken early in 2015/16 and reported to management on 15 July. The transactional testing covered transfer values, contributions and pension payments with samples drawn from the 2014/15 financial year.

## Annual Governance Statement

77. The Local Authority Accounts (Scotland) Regulations 2014 introduced a new requirement from 2014/15 for local authorities, or appropriate committee, to undertake a review at least once in each financial year of the effectiveness of its system of internal control and consider findings before approving an Annual Governance Statement.
78. In the case of the Falkirk Council Pension Fund, the Pensions Committee has delegated responsibility for governance issues. At its meeting on the 26 June 2015 the committee approved the Annual Governance Statement but without full consideration of the system of internal control. In particular, the committee did not receive an Annual Assurance Report from internal audit in which the Audit Manager is required to provide an opinion on the adequacy and effectiveness of the system of internal control. Also, in terms of the 2014 Accounts Regulations the Pensions Committee must from time to time assess the efficiency and effectiveness of the internal audit function in accordance with recognised standards and practices in relation to internal auditing.

### Recommendation 2

## Arrangements for the prevention & detection of fraud & corruption and maintaining standards of conduct

79. The Fund has adopted the policies used by Falkirk Council for preventing and detecting fraud. Also, the Fund is governed by the Council's Code of Conduct for Members and Officers. Additionally, all members are expected to apply the Standards Commission Scotland's Councillors' Code of Conduct. We reviewed these arrangements as part of our planning of the council and concluded that they were adequate.

## National Fraud Initiative

80. The Fund also participates in the National Fraud Initiative. This is a biennial counter fraud exercise led by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different systems, to identify data matches that might suggest the existence of fraud or error.
81. The Fund has made good progress to date in investigating data matches with 242 out of 415 (58%) matches investigated by July 2015. This level of review exceeds the minimum requirements. All high risk matches have been reviewed and the remaining cases are categorised as low risk or areas where investigation is not required. No frauds or potential frauds have been identified by this date. The Internal Audit Manager also maintains oversight of the NFI process to monitor progress in investigating matches.
82. Overall we concluded that pension fund staff is proactive in reviewing and investigating NFI matches.



## Data migration to Altair system

- 83. During the course of 2014/15, Pension Fund records migrated from the in-house Pensions Administration System (PAS) to an externally hosted system (i.e. Altair). As part of our audit we carried out sample testing of records both before and after the migration process for completeness and accuracy.
- 84. Our audit work did not identify any significant risks affecting the overall completeness and accuracy of membership data. Furthermore, during the migration process there was discussion between management and the system provider (Heywood). This was evident prior to, during and post implementation stages of the migration process.
- 85. Fund administration staff also carried out their own testing of the system. However, a clear audit trail was not maintained detailing the extent of the testing or findings resulting from this work. There are plans to transfer the pensioners' payroll to a new system in the near future. It is important when the transfer takes place that a clear audit trail of checks is put in place to assess the effectiveness of the process.
- 86. Overall, the migration from the old to the new pension administration system was successful and our testing of the migration process did not identify any significant issues that require to be brought to the attention of members.

## Staff resources

- 87. The Fund's administration section has been carrying a vacancy for a pension fund accountant post since September 2014. An accountant was seconded from corporate finance in April 2015 to provide accounting support and help in the preparation of the financial statements.
- 88. Since then the secondee has secured a promoted post within corporate finance and it is not clear how long they will be able to continue to provide support to the Fund. Also, there is no clear timeframe for appointing a permanent fund accountant. At the same time the pensions manager is off on long term planned leave and the pension fund accountant could normally be expected to cover some of his responsibilities.
- 89. There are other staffing issues which could also have an adverse impact on the work of the Fund's administration section. The section is under considerable pressure to maintain current levels of service due to one staff member being on long term absence while another very experienced member of staff has recently retired. This has resulted in a backlog of processing and is reflected in a deterioration of performance against administration targets as summarised in paragraphs 104 to 109. Also this has meant that individual records on the Altair system have not been fully updated. The pressures on staff will only increase with the introduction career average pensions.

### Recommendation 3

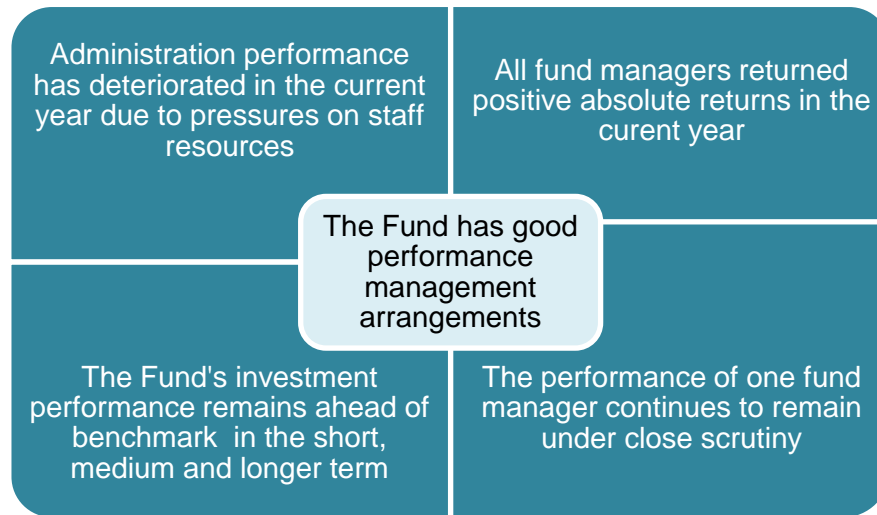


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## Outlook

- 90. The introduction of career average pensions from 1 April 2015 will increase administrative workloads but could also generate more enquiries from Fund members seeking clarification of their benefits on an ongoing basis.
- 91. The pensioners' payroll system is due to transfer from the council's Resourcelink system to a module on Altair. This was originally scheduled for autumn 2015 but has now been deferred until a later date. This will require a lot of careful planning and testing.

# Best Value



92. The Fund has a duty to ensure Best Value in the provision of services and to report performance publicly so that fund members, employers and other stakeholders know the quality of service being delivered and what they can expect in the future.
93. The Fund is covered by the overall Best Value arrangements of the council as the administering authority. A recent Best Value audit reported in August did not identify any specific actions for the pension fund to address. The council is preparing an action plan in response to the findings from the audit. The council's auditors will report on progress.

## Performance management

94. The Pension Committee meets on a quarterly basis to review performance. The Committee is helped in its work by professional advisers. It is normal practice for two investment managers to present at the quarterly meetings of the Committee. This gives members and their advisers the opportunity to hold managers to account for their activities and performance. From our attendance at Committee we can confirm that members actively scrutinise performance.
95. The Pension Fund Manager and Chief Finance Officer regularly meet with investment managers to discuss performance and investment strategy. In addition, the Fund has a Resourcing Agreement with Lothian Pension Fund and this provides additional support in the areas of investment manager monitoring and performance.
96. Overall, we concluded that the Fund has good performance management arrangements in place.

## Investment performance

97. In recent years there has been considerable volatility in the financial markets which has affected investment return particularly in the wake of the global financial crisis of 2008/09 and more recently within the Eurozone due to the threat of 'Grexit'.
98. The Fund's performance has remained positive over the short, medium and longer term as illustrated in the table overleaf.

**Table 2: Investment performance**

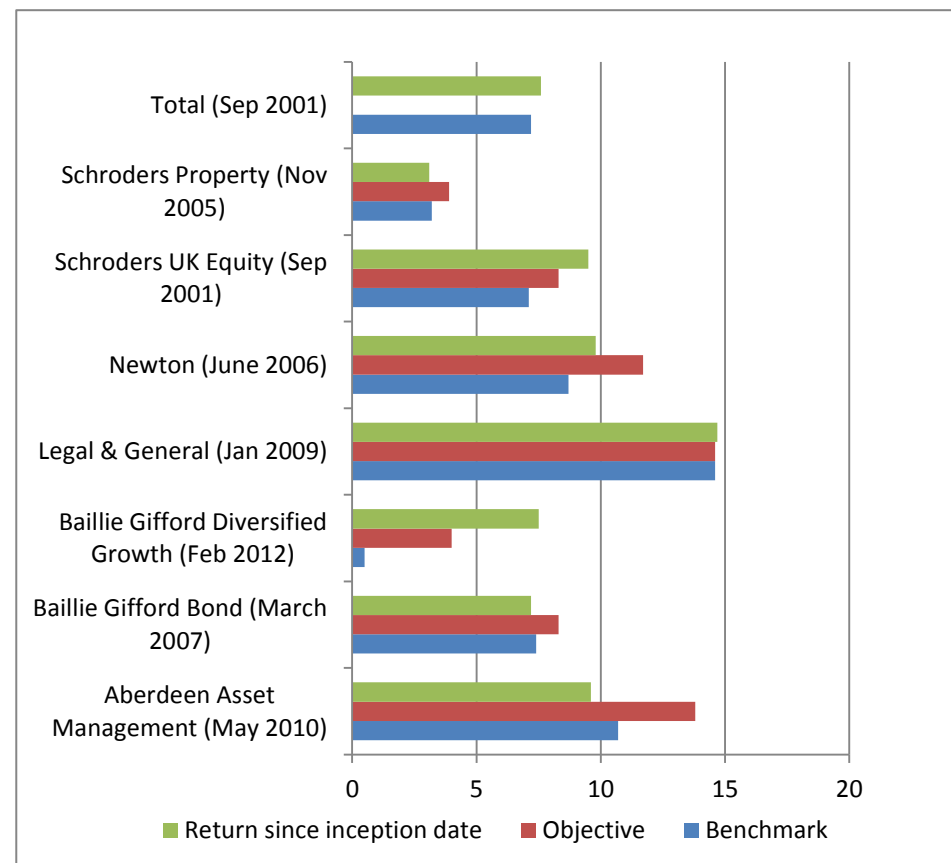
	2014/15 % per annum	3 years % per annum	5 years % per annum
<b>Fund return</b>	13.4	12.0	9.7
<b>Benchmark return</b>	12.1	9.8	7.9
<b>Excess</b>	1.3	2.2	1.8

Source: Falkirk Council Pension Fund Annual Report & Accounts 2014/15

## Fund manager performance

99. All fund managers returned positive absolute returns in 2014/15 helped by the strong performance from equities and bonds. However, performance against benchmark has been more varied.
100. Most investment managers achieved their benchmark performance in 2014/15. Three fund managers failed to achieve their benchmark although in two cases only marginally. However, one manager (Aberdeen Asset Management) disclosed a significant level of underperformance as was the case last year.
101. A recent presentation from Aberdeen Asset Management to the joint meeting of the Pension Board and Pensions Committee failed to adequately address all members' concerns. We have been advised that this manager continues to be placed 'on watch' to ensure better performance in future.

102. Fund managers performance varies against different performance standards with only two fund managers exceeding their specified objectives as illustrated below.

**Graph 1: Fund manager performance**

Source: Falkirk Council Pension Fund - Pension Committee June 2015

- 103.** The Fund takes a long-term view of its investments and it expects fund managers to achieve their prescribed targets over longer periods of time. The Pensions Manager liaises closely with fund managers to monitor performance. Any significant risks or concerns about fund managers not being able to meet their objectives in the longer term would be raised with the Pensions Committee.

### Administration performance

- 104.** The Pensions Manager has developed a range of service standards to monitor administration performance. These are monitored on a regular basis and are reported to the Pensions Committee annually. Work is in progress to ensure that similar performance reports can be generated on the new pension administration system (Altair).
- 105.** The main indicators used to monitor and review administration performance are summarised in the following table covering the last three years.

**Table 2: Administration performance 2012/13 to 2014/15**

Standard	Target	2012/13	2013/14	2014/15
<b>Annual admin. cost per member</b>	Under £25 per member	£14.50	£15.77	£23.51
<b>Staff / member ratio</b>	1:2500 to 1:3200	1:2972	1:3237	1:3307
<b>No. of complaints received</b>	Zero	1	3	4
<b>Answer ad hoc queries in 14 days</b>	70%	73%	73%	65%

*Source: Falkirk Council Pension Fund Annual Report & Accounts 2014/15*

- 106.** The increase in administration costs per member is primarily due to the implementation of the Altair system. It was introduced to help cope with the administrative demands of the career average pension scheme from 1 April 2015. Further costs will be incurred in 2015/16 as additional modules of Altair are implemented.
- 107.** Performance in responding to ad hoc queries within the 14 days has deteriorated against the 14 day performance standard as outlined in table 2 above. This is due primarily to above average workflow in year and staff being involved in other tasks e.g. preparation for the implementation of Altair. The situation has been exacerbated by staff absences as a result of maternity leave and long term sickness absence. This has caused an additional

burden on remaining pension administration staff and is reflected in the higher staff / member ratio as outlined in table 2.

108. A representative from Heywood (provider of Altair) will be providing additional support to staff to aid IT processing difficulties throughout 2015. This should help to improve administration performance. In the meantime administration staff are prioritising their work to ensure that there is minimal impact on essential tasks.
109. Administration performance has deteriorated due to a combination of circumstances. Additional resources are to be made available to improve performance. At the same time administration staff have focussed on core business to minimise the impact on service delivery although some backlogs are inevitable.

## National performance audit reports

110. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15 there were no reports issued which were directly related to pension funds.
111. A number of local government reports were issued during the year and some of the topics covered may be of general interest to members i.e.
- Scotland's public finances – a follow-up :progress in meeting the challenges (June 2014)
  - Update on developing financial reporting (March 2015)

- An overview of local government in Scotland (March 2015)

112. These and other performance audit reports are readily accessible on Audit Scotland's website ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)).

## Outlook

113. There is considerable pressure on public bodies to make savings with many reducing their workforce through voluntary severance and as a consequence a large number of member and employer retirement estimates can be expected. There is a risk that these pressures may prompt some employers to leave the scheme.
114. Low interest rates combined with a relaxed monetary policy have resulted in high equity valuations and low yields on fixed interest securities. Against this background, investment managers are going to find it difficult to achieve positive returns in 2015/16.
115. Continued turmoil in the Middle East and Ukraine together with persistent weaknesses in the Eurozone economies creates uncertainty in the financial markets. Also, the UK government's commitment to hold a referendum on continued membership of the European Union is adding to this uncertainty and there is the risk that these factors could have a negative impact on asset valuations.

# Appendix I – Significant audit risks

The table below sets out the financial statement audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
<b>Risk of material misstatement in the financial statements</b>		
<p><b>Accountancy staff</b></p> <p>At the time of submitting our Annual Audit Plan to the Pensions Committee there was no pension fund accountant in post. There was a risk of the financial statements being submitted to external audit late and there was also an increased risk of errors within the accounts due to a lack of specialist accounting knowledge and support.</p>	<ul style="list-style-type: none"> <li>• Update provided to the external audit team on filling the accountant post</li> <li>• The financial statements and working papers were provided to the external audit by 30 June 2015.</li> </ul>	<p>An accountant was seconded to the pensions section in April 2015. The Pension Fund Annual Report and Accounts were prepared on time for audit and there were no significant issues arising from the audit.</p>

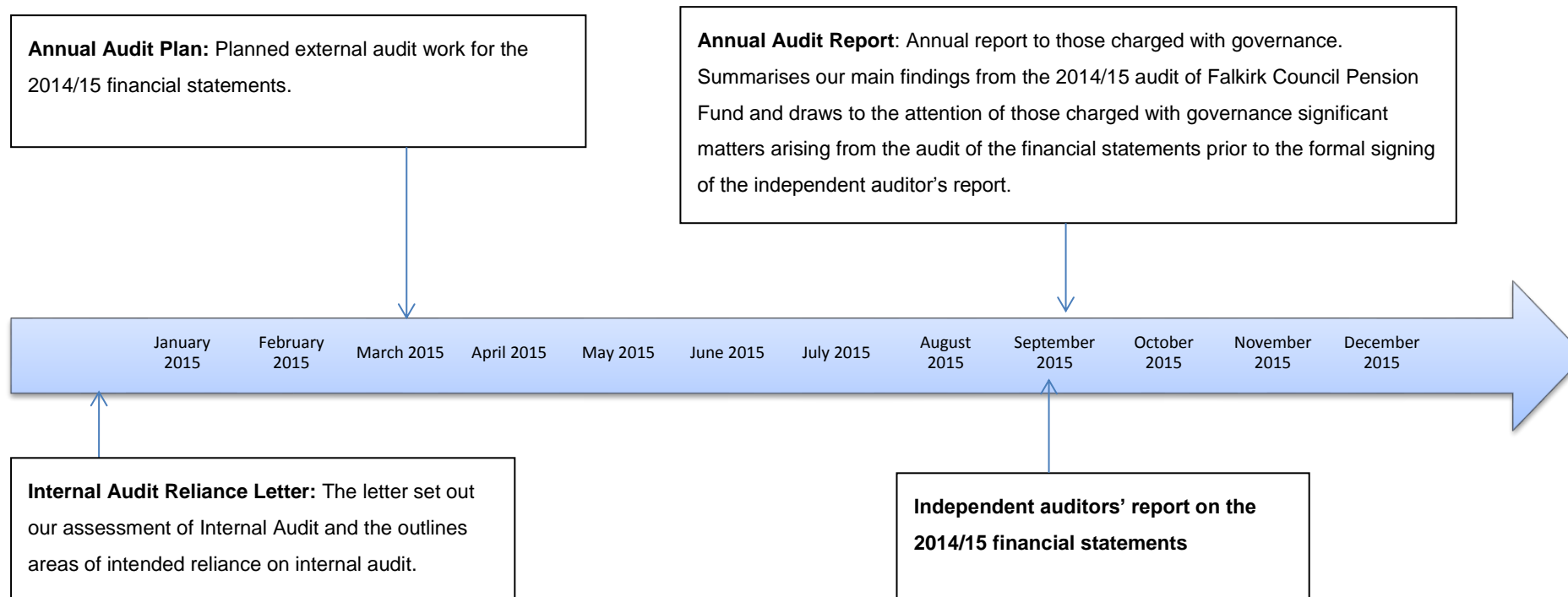
Audit Risk	Assurance procedure	Results and conclusions
<p><b>Annual Governance Statement (AGS)</b></p> <p>From 2014/15 Pension Funds are required to include an Annual Governance Statement in their accounts. This is in addition to the Governance Compliance Statement (GCS) already required under pension administration regulations. The 2014 Accounts also require the Fund to undertake an annual review of system of control and report this in the AGS or combined AGS and GCS. Internal audit's plan for 2014/15 did not include any specific work on the Fund. This could affect the level of assurance given on the review of internal controls while there is also the risk of AGS disclosures being incomplete.</p>	<ul style="list-style-type: none"> <li>• The Fund prepared an Annual Governance Statement.</li> <li>• Regular reporting of financial information including accounts and investment performance to the Pensions Committee.</li> <li>• Previous years' work carried out by external audit including remedial actions taken in response to recommendations.</li> <li>• Internal audit testing of pensions' transactions relating to 2014/15 is scheduled for 2015/16.</li> <li>• Participation in the National Fraud Initiative.</li> <li>• The Pensions Section is subject to the council's wider framework of control including Financial Regulations, Codes of Conduct and Schemes of Delegation.</li> </ul>	<p>We carried out the assurance procedures as planned and we asked for amendments to the AGS included in the unaudited accounts. A revised AGS was received and we concluded that this reflected the Fund's governance arrangements and was consistent with our knowledge of its control environment.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p><b>Investment Management Expenses</b></p> <p>Accurate presentation and disclosure of investment management costs has been a contentious issue for pension funds. There is a risk that these will not be presented correctly in the financial statements and members may not be able to gauge whether best value is being achieved.</p>	<ul style="list-style-type: none"> <li>• The Fund followed, as far as practical, Cipfa's newly published guidance which sets out a framework for the consistent disclosure of expenses.</li> <li>• Consulted with other pension funds and practitioners, as appropriate, on disclosures</li> </ul>	<p>We carried out the assurance procedure as planned and concluded that the accounting and disclosure of management expenses was more transparent and in line with extant guidance issued by the Chartered Institute of Public Finance &amp; Accountancy (Cipfa).</p>
<p><b>Management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> <li>• Quarterly performance reports from Fund Managers.</li> <li>• Reports from the Pension Fund Custodian.</li> <li>• Scrutiny of accounts and performance by the Pensions Committee.</li> </ul>	<p>We carried out the assurance procedures as planned and did not identify any instances of management override of controls.</p>



# Appendix II – Summary of local audit reports 2014/15

## Summary of Falkirk Council Pension Fund local audit reports 2014/15



# Appendix III – Action plan

## Action plan

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
1 19 / 73	<p><b>Issue</b></p> <p>Internal audit plans, while submitted to the council's Audit Committee, are not presented to the Pensions Committee for consideration.</p> <p><b>Risk</b></p> <p>The internal audit plan may not cover all the areas required by members in carrying out their annual review of the Fund's governance and internal control environment.</p> <p><b>Recommendation</b></p> <p>Internal audit plans should be presented to the Pensions Committee for consideration.</p>	From 2016/17, Internal Audit Plans will be presented to the Pensions Committee for consideration.	Internal Audit Manager	March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
2 20 / 78	<b>Issue</b> The Pensions Committee did not receive an Annual Assurance Report from Internal Audit when conducting their review of the governance and internal control framework of the Pension Fund	A summary of Internal Audit's findings on Pensions Governance and Transactional Testing work is to be included in a report to the 24 September meeting of the Pensions Committee.	Internal Audit Manager	September 2015
	<b>Risk</b> The Pensions Committee may not have all the information available to them to undertake their annual review of systems of internal control as required by the 2014 Accounts Regulations.	From 2015/16, the Internal Audit Manager will present an Annual Assurance Report to the Pensions Committee.	Internal Audit Manager	April 2016
	<b>Recommendation (2)</b> The Pensions Committee should receive an Annual Assurance Report from the Internal Audit Manager on the work carried out by internal audit on the systems of control.			

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
3 21 / 89	<p><b>Issue</b></p> <p>At present the Pensions Section is not sufficiently resourced to be fit for purpose. In particular, there is no clear timeframe for appointing a permanent pension fund accountant.</p> <p><b>Risk</b></p> <p>The council is unable to fulfil its responsibilities as Fund Administrator.</p> <p><b>Recommendation (3)</b></p> <p>The council needs to ensure that sufficient and appropriate resources are in place to administer the Pension Fund effectively. Priority should be given to appointing a permanent Pension Fund Accountant.</p>	<p>The Section has faced a “perfect storm” of staff absences due to long term sickness, maternity leave and departures allied with concurrent diverse and significant developments relating to Pensions.</p> <p>Interim arrangements were put in place to deal with the accountant vacancy and a permanent recruitment will take place aligned with the return to work of the Pensions Manager.</p> <p>The developing relationship with Lothian provides additional support and resilience.</p> <p>The staffing position will be kept under review.</p>	Chief Finance Officer	December 2015

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Falkirk Council Pension Fund  
Pensions Committee

24 September 2015

## Falkirk Council Pension Fund Annual Audit Report

1. International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires auditors to report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action. We are drawing to your attention matters for your consideration before the financial statements are approved and certified. We also present for your consideration our draft annual report on the 2014/15 audit which identifies significant findings from the financial statements audit. The section headed 'significant findings' in the attached annual audit report sets out the issues identified. This report will be issued in its final form after the financial statements have been certified
2. Our work on the financial statements is now substantially complete. Subject to the satisfactory conclusion of any outstanding matters and receipt of a revised set of financial statements for final review, we anticipate being able to issue an unqualified independent auditor's report on 24 September 2015 (the proposed report is attached at Appendix A). There are no anticipated modifications to the auditor's report.
3. In presenting this report to the Pensions Committee we seek confirmation from those charged with governance of any instances of any actual, suspected or alleged fraud; any subsequent events that have occurred since the date of the financial statements; or material non-compliance with laws and regulations affecting the entity that should be brought to our attention.
4. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature and request that these misstatements be corrected. We have no unadjusted misstatements to bring to your attention.
5. As part of the completion of our audit we seek written assurances from the Chief Finance Officer on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at Appendix B. This should be signed and returned by the Chief Finance Officer with the signed financial statements prior to the independent auditor's opinion being certified.

## **Appendix A: Proposed 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 2015 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 2014/15 (the 2014/15 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 2014/15 Code of the financial transactions of the fund during the year ended 31 March 2015, 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 2014/15 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 am 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 Services)  
Audit Scotland  
4th Floor, South Suite  
Athenaeum building  
8 Nelson Mandela Place  
Glasgow  
G2 1BT

24 September 2015

## Appendix B: ISA 580 - Letter of Representation

<signed copy to be provided on headed paper>

Fiona Mitchell Knight  
Assistant Director of Audit  
Audit Scotland  
4th Floor, South Suite  
The Athenaeum Building  
8 Mandela Place  
Glasgow  
G2 1BT

24 September 2015

Dear Fiona,

### **Falkirk Council Pension Fund Annual Accounts 2014/15**

1. This representation letter is provided in connection with your audit of the financial statements of Falkirk Council Pension Fund for the year ended 31 March 2015 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of Falkirk Council Pension Fund, as at 31 March 2015 and its income and expenditure for the year then ended.
2. I confirm to the best of my knowledge and belief, and having made appropriate enquiries of the Pensions Manager and the Pension Accountant, the following representations given to you in connection with your audit of Falkirk Council Pension Fund for the year ended 31 March 2015.

### **General**

3. I acknowledge my responsibility and that of Falkirk Council Pension Fund for the financial statements. All the accounting records requested have been made available to you for the purposes of your audit. All material agreements and transactions undertaken by Falkirk Council Pension Fund have been properly reflected in the financial statements. All other records and information have been made available to you, including minutes of all management and other meetings.
4. The information given in the Annual Report to the financial statements, including the Management Commentary, presents a balanced picture of the Falkirk Council Pension Fund and is consistent with the financial statements.
5. I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those identified in the auditor's report to those charged with governance (ISA260).



## **Legality of Financial Transactions**

6. The financial transactions of Falkirk Pension Fund are in accordance with the relevant legislation and regulations governing its activities.

## **Financial Reporting Framework**

7. The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 and in accordance with the requirements of Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014 and the Local Government in Scotland Act 2003 including all relevant presentation and disclosure requirements.
8. Disclosure has been made in the financial statements of all matters necessary for them to show a true and fair view of the transactions and state of affairs of Falkirk Council Pension Fund for the year ended 31 March 2015.

## **Accounting Policies & Estimates**

9. All material accounting policies adopted are as shown in the Statement of Accounting Policies included in the financial statements. The continuing appropriateness of these policies has been reviewed since the introduction of IAS 8 and on a regular basis thereafter, and takes account of the requirements set out in the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15.
10. The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. There are no changes in estimation techniques which should be disclosed due to their having a material impact on the accounting disclosures.

## **Actuarial Assumptions**

11. The pension assumptions made by the actuary in the IAS19 report on the Fund have been reviewed and I can confirm that they are consistent with management's own view.

## **Fraud**

12. I have considered the risk that the financial statements may be materially misstated as a result of fraud. I have disclosed to the auditor any allegations of fraud or suspected fraud affecting the financial statements. There have been no irregularities involving management or employees who have a significant role in internal control or that could have a material effect on the financial statements.

## **Corporate Governance**

13. I acknowledge, as the officer with responsibility for the proper administration of the Fund's financial affairs under section 95 of the Local Government (Scotland) Act 1973, my responsibility for the corporate governance arrangements and internal controls. I have reviewed the Annual Governance Statement and confirm that it has been prepared in accordance with Delivering Good Governance in Local Government. Also, I have reviewed the Corporate Governance Compliance statement and the disclosures I have made comply with the guidance from the Scottish Ministers. There have been no changes in the corporate governance arrangements or issues identified, since the 31 March 2015 which require disclosure.

## **Related Party Transactions**

14. All transactions with related parties have been disclosed in the financial statements. I have made available to you all the relevant information concerning such transactions, and I am not aware of any other matters that require disclosure in order to comply with the requirements of IAS24, as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15.

## **Management Expenses**

15. I have worked with fund managers and the fund custodian to ensure that pension fund management expenses disclosed in the 2014/15 accounts are in accordance with the Cipfa Guidance Accounting for Local Government Pension Scheme Management.

## **Investment Assets and Current Assets**

16. On realisation in the ordinary course of the Fund's business the investment and current assets in the net asset statement are expected, in my opinion, to produce at least the amounts at which they are stated. In particular, adequate provision has, in my opinion, been made against all amounts owing which are known or may be expected to be irrecoverable.

## **Investment Liabilities and Current Liabilities**

17. All liabilities have been provided for in the books of account as at 31 March 2015.

## **Contractual commitments**

18. All outstanding call payments due to unquoted limited partnership funds have been fully included in the accounts for the period to 31 March 2015.

## **Employer / Employee Contributions**

19. The contribution figures recorded in the accounts represent actual payments made by employing bodies on a monthly basis throughout the year and processed through the ledger. Normally a year-end reconciliation is carried out between the ledger and annual returns from employing bodies to ensure any changes in the year have been correctly accounted for. This provides an additional source of assurance of the total amount of contributions received in the year. The majority of year end returns have now been received and reviewed but the reconciliation has not been completed.

To ensure correct contributions are received from employers/ employees during the year a monthly check is carried between expected contributions based on payroll information and actual payments received. Payments received are posted to the ledger after checking and the ledger figures are used in preparing the accounts. The year-end reconciliation between the annual returns from admitted bodies and the ledger is an additional check. All the main admitted bodies have submitted their annual returns and any variances highlighted by the reconciliation are not material. We will continue to remind all admitted bodies of the need to submit their annual returns timeously and investigate the reasons for variances.

## **Bank Account**

20. The fund maintains a separate bank account but some payments are initially processed through the Council's bank accounts. The transactions for the fund processed through the Council's bank

accounts are promptly repaid or transferred and consequently the balance owed to or due by the Council at any time is not significant

### **Events Subsequent to the Net Asset Statement**

21. There have been no material events since the date of the Net Assets Statement which necessitate revision of the figures in the financial statements or notes thereto including contingent assets and liabilities.
22. Since the date of the Net Assets Statement no events or transactions have occurred which, though properly excluded from the financial statements, are of such importance that they should be brought to your notice. Global equity markets experienced sharp declines in August 2015 (FTSE100 declined by 9%). However, this market volatility falls within the bounds of expectation as highlighted in the note 18 of the Annual Report and Accounts. Potential price movement in equities (developed markets) is expected at 20%. 9% fall is in line with expectation.

Yours sincerely

Bryan Smail  
Chief Finance Officer



**FALKIRK COUNCIL**

**Subject: INVESTMENT STRATEGY REVIEW – PROGRESS UPDATE**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE & PENSION BOARD**  
**Date: 24 SEPTEMBER 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 The purpose of this report is to give the Committee and Board an update on the work of the Sub Group reviewing Investment Strategy. This is consistent with the report agreed at the Committee and Board meeting on 26 June 2015. Copies of the minutes of the three meetings held to date are appended.

**2. BACKGROUND**

- 2.1 The Pensions Committee, following consideration of several reports and presentations, agreed that a sub-group should be formed to take forward a de-risking plan within the context of a wider review of the Fund's Strategy. The sub-group will make recommendations to the Pensions Committee.
- 2.2 The sub-group comprise several members of the Pensions Committee, together with several Board members and is supported by officers & Hymans Robertson, the Fund's investment adviser.

**3. PROGRESS STATUS**

- 3.1 Three meetings have been held and they have proved to be very productive and allowed a wide range of inter-related topics to be ventilated and discussed. It did, however, become apparent at the first meeting that the work programme initially profiled over four meetings was too ambitious. To ensure due attention is given to the significant and frequently complex topics, more meetings and an extended time frame will be necessary.

**3.2 Meeting 1 - 11 August 2015**

- 3.2.1 Depute Provost John Patrick was agreed as Convener. The meeting re-affirmed the decision of the Pensions Committee that a de-risking plan be put in place, and there was discussion as to the practicalities of implementation, with an initial 5% to be withdrawn from equities. This discussion was informed by a paper presented by Hymans Robertson.

3.2.2 Contextual papers were also submitted on Risk, Return and Correlation and Fiduciary Duty and Responsible Investment. These facilitated useful discussion and it was recognised this content would resurface as the Review progressed.

3.2.3 Additional information was requested on previous reviews so that the context of this review could be better understood. It was also felt that Manager fee and performance data would help inform the Review. Papers on both these matters were submitted and discussed at Meeting 2.

### 3.3 **Meeting 2 – 27 August 2015**

3.3.1 Following consideration of the two papers noted at 3.2.3, this meeting focused on equities. The primary reference point was a wide ranging paper submitted by Hymans Robertson, supplemented by two focused papers on Private Equity and Smart Beta (rules based investment strategies that avoid using market capitalisation weighting) prepared by officers via the shared services arrangement with Lothian..

3.3.2 The discussion on Active V Passive investment revealed a strong feeling that Smart Beta offered an attractive avenue relative to the market cap approach of conventional indexing. It was noted that Lothian are active in this space in-house.

3.3.3 It was recognised that Private Equity was relatively high risk and Falkirk is aiming to lower risk. Moreover, fees are very high, particularly given the fund of fund route a scheme of Falkirk's scale is obliged to follow, and assessing performance is very difficult. There was consensus that an orderly wind-down of the existing Private Equity mandates was the way forward i.e. as returns came back they would not be re-invested there.

### 3.4 **Meeting 3 – 9 September 2015**

3.4.1 This meeting focused on the remaining primary asset classes namely, Bond/Debt, Property & Infrastructure. The main reference point was the Hymans Robertson paper used at the previous meeting, supplemented by a paper on Infrastructure prepared by officers via the shared services arrangement with Lothian..

3.4.2 The Hymans Robertson paper presented a spectrum of components of Debt, ranging from conventional gilts to mezzanine. In discussing this, there was a common feeling that moving towards the higher risk end of the range, with its more equity like features, was not what the Review was designed to do. There was of course market and timing constraints in moving to the more risk free end of the spectrum.

3.4.3 With respect to Property, Hymans Robertson noted in their paper that there is an attraction in moving to mandates which can provide inflation linked income. Long lease property and residential property offer this credential. There are issues with the current Schroder mandate and this will need to be considered as part of the way forward for this asset class.

3.4.4 There was some lively discussion around Infrastructure and surprise was expressed that there seemed to be so few investment opportunities in Scotland. It is anticipated that the Fund will look to increase its allocation to Infrastructure as part of its de-risking strategy. There are opportunities to do this with the existing manager's (Grosvenor) new Fund and/or through further direct fund exposure via collaboration with Lothian.

- 3.4.5 A paper on Currency Hedging prepared by officers via the shared service arrangement with Lothian explained the options. There was no enthusiasm for taking forward currency hedging at this time, which was in line with Hymans' Robertson's previous recommendation on the matter.

#### **4. SUMMARY AND WAY FORWARD**

- 4.1 It will be evident from the above and attached minutes that the Sub Group is making good progress. The main asset classes have been considered and whilst some clear positions are emerging, further work is required to crystallise positions. The key strands may thus be set out:-
- a) 5% from Equities but how and to where?
  - b) Potentially increase allocation to Property, but with regard to the position with Schroders
  - c) Pursue Smart Beta mandate but to what extent? This would involve Manager search with one possibility being an in-house option via an extension of the shared service arrangement with Lothian
  - d) Increase Infrastructure allocation, probably via Grosvenor's new Fund and/or further direct fund exposure via collaboration with Lothian
  - e) Passive wind-down of Private Equity
  - f) Reluctance to pursue Bond/Debt at this time.
- 4.2 There are significant work elements to be addressed beyond the above e.g. approach to Environmental, Social and Governance (ESG) issues, at future meetings of the Sub Group.

#### **5. RECOMMENDATION**

- 5.1 The Committee and Board are invited to note the report.

**pp Director of Corporate & Housing Services**

**Date: 11 September 2015**

**Contact Officer: Bryan Smail**

#### **LIST OF BACKGROUND PAPERS**

NIL

## FALKIRK COUNCIL

**MINUTE of MEETING of the PENSIONS COMMITTEE INVESTMENT REVIEW  
SUB GROUP in the MUNICIPAL BUILDINGS, FALKIRK on TUESDAY 11 AUGUST  
2015 at 10.00 A.M.**

**SUB GROUP  
MEMBERS:**

Committee:  
Councillor Tom Coleman  
Andrew Douglas, Unison  
Depute Provost John Patrick (Convener)

Officers:  
Bruce Miller, Investment Manager, Lothian Pension Fund  
Bryan Smail, Chief Finance Officer

**ATTENDING:**

Pensions Board:  
Councillor Archie Drummond, Clackmannanshire Council  
Sandy Harrower, UCATT  
Jennifer Welsh, SEPA

**ALSO ATTENDING:**

Linda Selman, Hyman Robertson  
Antonia Sobieraj, Committee Services Officer

**INV1. APOLOGIES**

Apologies were intimated on behalf of Councillor Colin Campbell, Stirling Council and Alastair McGirr, Pensions Manager.

**INV2. DECLARATIONS OF INTEREST**

No declarations were made.

**INV3. APPOINTMENT OF CONVENER**

In terms of the Terms of Reference of the Sub Group, the Clerk invited nominations for Convener from the Group's membership.

Councillor Callum Campbell had submitted apologies for the meeting but had advised the Clerk prior to the meeting of his willingness to serve as Convener. A further nomination was submitted at the meeting on behalf of Depute Provost John Patrick.

The votes cast were as follows:-

- Councillor Callum Campbell - No votes; and
- Depute Provost John Patrick - 2 votes.

Depute Provost John Patrick was duly elected as Sub Group Convener.



## **Decision**

**The Sub Group agreed that Depute Provost John Patrick duly serve as Sub Group Convener.**

Depute Provost John Patrick then took the Convenership for the remainder of the meeting.

## **INV4. STRATEGY REVIEW OVERVIEW**

The Sub Group considered a report by the Director of Corporate and Housing Services on the establishment of a Sub Group to review the Fund's investment strategy.

The Pensions Committee had agreed on 26 June 2015 to the establishment of the Group to review the Fund's investment strategy and to make recommendations to the Pensions Committee on all investment strategy issues. This included:-

- the Fund's investment objectives and the associated strategy;
- the level of investment-related risk which was consistent with the Fund objectives;
- the identified possible asset classes and agreeing the appropriateness for the Fund;
- the appropriate investment management structure required to implement the Fund's investment strategy;
- the appropriate benchmarks for individual mandates/managers;
- the implementation plan for the investment strategy; and
- the parameters within which the Chief Finance Officer could implement the strategy under delegated authority.

The Sub Group at this meeting would aim primarily to reach a position on the implementation of a de-risking plan.

The proposed framework of the review of the investment strategy and the associated work to be undertaken at future meetings was as undernoted:-

### **Meeting 2 - 27 August 2015**

The main objective of the meeting was to agree a mix of assets and asset allocations and the expected issues to be considered included:-

- Active versus Passive;
- Smart Beta passive versus Market Cap passive;
- Currency Hedging;
- Future private equity commitments;
- Infrastructure;
- Private debt;
- Nature of Bond portfolio; and
- Property including social, affordable and residential.

Meeting 3 - date to be determined

The primary objective would be to consider whether to continue with existing Fund managers or make changes. The undernoted topics would be considered:-

- Reviewing manager appointments, including styles and philosophies;
- Costs of realignment;
- Considering manager environmental, social and governance (ESG) issues;
- Determining manager benchmarks;
- Opportunities for collaboration;
- Considering Tactical versus Strategic asset allocation; and
- Delegated power - authorising the Chief Finance Officer to act when triggers were met.

Meeting 4 - date to be determined

The meeting would be expecting to draw the work strands together and effectively have a strategy in place to recommend to the Committee. Focus would be directed to:-

- Agreeing acceptable tolerances across asset classes;
- Agreeing delegation to the Chief Finance Officer to authorise re-balancing; and
- Updating the Statement of Investment Principles.

In addition, periodic progress reports would be presented to Pensions Committee and Board.

### **Decision**

**The Sub Group noted the report.**

## **INV5. ORDER OF BUSINESS**

Depute Provost Patrick agreed to a variation to the order of business from that detailed on the agenda for the meeting. The following items have been recorded in the order that they were taken.

## **INV6. RISK, RETURN AND CORRELATION**

The Sub Group considered a report by the Director of Corporate and Housing Services on the risk and return characteristics of various potential asset classes and the correlations amongst classes.

The information referred to included:-

- the expected returns in terms of the expectations of Baillie Gifford's Diversified Growth Investment Managers from each asset class at 31 December 2014;
- the actuary's valuation of the Fund's liabilities using a discount rate of 1.6% over the gilt yields and the assessment of the level of employer contributions;

- the long term overall level of investment return being expected to exceed the rate of return assumed by the actuary in valuing the Fund;
- the volatility being the degree of variation of the prices of the assets over time and the typical volatility estimates for the range of assets in which the Fund; and
- the reduction of risk by investment diversification and the correlations between asset classes.

The Fund currently diversified investments and the Sub Group would consider how to diversify risk, whilst still generating an adequate return to meet the Fund's liabilities. This work should take into account that the expected returns, expected risk as measured by volatility and the correlations between them were not static and varied over time.

The correlations of asset classes over the last 10 years were detailed. The report also confirmed the benefits from diversification from mixing positively correlated assets but highlighted that greater benefit resulted from mixing classes with a negative correlation. Further information was provided on the traditional "alternatives", such as private equity and infrastructure which had often been highly correlated.

The Statement of Investment Principles detailed the various types of investment in which the Fund had invested and the source of returns from these investments. The major types of investment and their characteristics were as undernoted:-

- UK Equities;
- International Equities;
- Bonds;
- Index Linked Bonds;
- Property;
- Cash; and
- Alternatives describing asset classes known as diversified growth, private equity, and infrastructure and credit markets.

The Fund was also required to comply with the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 and the issue of liquidity whereby the overall liquidity of assets must be considered in the light of potential demands for cash.

Detailed discussion included the importance of examining historical information, for the purposes of comparison, on the findings of the last review, the associated growth figures and the real returns as well detailed information on the benchmarks currently being used and the projections for the future.

## **Decision**

**The Sub Group noted the report.**

**The Sub Group agreed the information presented to the next meeting would include the findings of the last review, the historical growth figures for the Fund, the real returns and the performance data on equity managers.**

## **INV7. DE-RISKING FRAMEWORK**

The Sub Group considered a report by Hymans Robertson on the recent modelling and analysis exercise undertaken in line with the Fund's long term and short term objectives, the framework for the future management of the Fund's investment strategy, and an exploration of the mechanisms for changing the investment strategy.

The information provided included:-

- the current asset allocation where the Fund's current benchmark asset allocation was 90% growth assets and 10% matching assets;
- the Fund having a relatively high reliance on equity assets which account for around 80% of the Fund's expected return despite only accounting for 60% of total assets;
- the Fund's investment objectives, the Statement of Investment Principles and the refined objectives for the long and short terms;
- the purpose of the adoption of the objectives to help set an appropriate investment strategy over time and the issues to be addressed by the Sub Group;
- the analysis of modelling;
- the objectives-driven investment;
- the steady state portfolio;
- the options for de-risking;
- the key risks for the Fund and associated strategies;
- the trigger points for change; and
- and the way forward.

Detailed discussion included:-

- the importance of making real decisions based on real information underpinned with theoretical information;
- the steady state;
- the Consumer Price Index (CPI);
- the Fund's risk and return target;
- the equity exposure levels;
- the options for de-risking the Fund;
- the Fund manager fees and costs;
- the options for the initial reduction in risk in relation to equities currently held by the Fund;
- the opportunities for diversification and cash; and
- the opportunities for a fully funded Fund by 2035.

### **Decision**

**The Sub Group noted the report.**

**The Sub Group agreed:-**

- (1) to the initial reduction in risk by 5% in relation to equities currently held by the Fund; and
- (2) that the report submitted to the next meeting would provide information on the monitoring arrangements and the opportunities for further action as required over time.

## **INV8. FIDUCIARY DUTY AND RESPONSIBLE INVESTMENT**

The Sub Group considered a report by Director of Corporate and Housing Services on the responsibilities of the Committee and the Fund in relation to Fiduciary Duty and responsible investment.

Fiduciary obligations ensured that those managing other people's money acted responsibly in the interests of beneficiaries rather than serving their own interests. The Pension Committee had a fiduciary obligation and was referred to in the Fund's Statement of Investment Principles (SIP).

The Fiduciary was expected to be loyal to the person to whom they owed the duty and the responsibility included:-

- not putting personal interests before the duty;
- avoiding conflicts as far as possible;
- where conflicts could not avoided they should be minimised, disclosed and carefully managed to prevent any breaches of loyalty obligations; and
- ensuring the duty did not conflict with other legal duties or their own interests, and should not profit unreasonably from their fiduciary position.

The influencing documents providing clarification of the duty included:-

- the Local Government Association (England and Wales) on behalf of the Local Government Pension Scheme (LGPS) Shadow Scheme Advisory Board obtained legal opinion legal in April 2014 providing clarification on the duty of the Committees to the Fund members, employers and the taxpayer and the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the Fund;
- the Law Commission (England and Wales) report on "Fiduciary Duties of Investment Intermediaries" in 2014;
- the UK government consultation on the Occupational Pension Schemes (Investment) Regulations ("The Investment Regulations") and the Government response during 2015; and
- the workplan for the LGPS Scheme Advisory Board in Scotland includes consideration of fiduciary duty.

In terms of the Fiduciary duty and responsible investment, the Fund's primary approach was to appoint investment managers who were expected to judge each investment on a number of factors including risk, return, environmental, social and governance (ESG). As regarded divestment and exclusion, the Fund appointed

managers to invest in companies using a number of different investment strategies in order to achieve good diversification.

The Fund's approach was consistent with the principles of the UK Stewardship Code published by the Financial Reporting Council and consistent with the Fiduciary responsibilities. The Fund would continue to monitor developments in the interpretation of Fiduciary duty and the potential changes to investment regulations.

### **Decision**

**The Sub Group noted the report.**

### **INV9. DATE OF NEXT MEETING**

The Sub Group noted that the next meeting would take place at 10 a.m. on Thursday 27 August 2015.

## **FALKIRK COUNCIL**

**MINUTE of MEETING of the PENSIONS COMMITTEE INVESTMENT REVIEW SUB GROUP in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 27 AUGUST 2015 at 10.00 A.M.**

**SUB GROUP MEMBERS:**

Committee:  
Councillor Tom Coleman, Falkirk Council  
Councillor Callum Campbell, Stirling Council  
Andrew Douglas, Unison  
Depute Provost John Patrick, Falkirk Council (Convener)

Officers:  
Bruce Miller, Investment Manager, Lothian Pension Fund  
Bryan Smail, Chief Finance Officer

**ATTENDING:**

Pensions Board:  
Councillor Archie Drummond, Clackmannanshire Council  
Sandy Harrower, UCATT

**ALSO ATTENDING:**

Simon Jones and Linda Selman, Hymans Robertson  
Antonia Sobieraj, Committee Services Officer

### **INV10. APOLOGIES**

Apologies were intimated on behalf of Jennifer Welsh, SEPA.

### **INV11. DECLARATIONS OF INTEREST**

No declarations were made.

### **INV12. MINUTE**

#### **Decision**

**The minute of the meeting of the Pensions Committee Investment Review Sub Group on 11 August 2015 was approved.**

### **INV13. PREVIOUS FUND REVIEW**

The Sub Group considered a report by the Director of Corporate and Housing Services providing information on the previous investment review to provide context to the current review exercise.

The previous full Asset Liability Management study (ALM) was completed in early 2009 and broadly concluded:-

- That there was no strong case for a radical change in investment strategy at the current time;
- That in the long term it would be desirable to reduce the current high level (75%) of equities (which is typical of many LGPS) when the funding level improves, and
- That it would be sensible to consider some diversification within the equities allocation, including exploiting short-term opportunities resulting from current market conditions, and longer term opportunities offered by the broad range of “alternative” assets.

The actions which followed included:-

- The reorganisation of the equity portfolio; - all equity assets were removed from capital international due to underperformance;
- That passive management was increased;
- That Aberdeen Asset Management were awarded in March 2010 a £150m mandate following a full manager search process;
- That the Baillie Gifford bond mandate was adjusted to increase exposure to corporate bonds and allow the advantage of opportunities in credit;
- That 2% of the Fund was allocated to the M&G Financing Funds;
- That diversification was increased by the introduction of infrastructure and Baillie Gifford's Diversified Growth Fund (both after manager selection exercises) in 2011; and
- That currency hedging was reviewed but no action taken.

Although there had been no asset/liability review at the subsequent valuation, Hyman's Robertson had highlighted the need to maintain a high level of return and suggested the following options for consideration:-

- The dividend approach to investing in equities;
- The introduction of a fundamental indexation mandate, implemented passively, to complement the market cap approach already in place;
- The widening of the investment universe for the bond mandate to exploit the illiquidity premium; and
- The further diversification but being wary of timing and cost of implementation.

Since the above work the introduction of Social Housing within the portfolio resulting in the main change in the Strategy having taken significant Committee and Officer time in terms of implementation. There was also the implementation of a further segment of infrastructure investment with the Lothian Fund. This had resulted in the Hyman's Robertson issues for considerations not as yet having been pursued.

## **Decision**

**The Sub Group noted the report.**



## **INV14. FALKIRK COUNCIL PENSION FUND - INVESTMENT MANAGEMENT EXPENSES**

The Sub Group considered a report by the Director of Corporate and Housing Services on investment management expenses for the Fund.

The Fund's annual report 2014/15 had identified £11.7 million (£10.6m in 2013/14) of management expenses, of which £10.6 million (£9.9m in 2013/14) were designated as investment management expenses. Investment costs represented by far the largest proportion of the Fund's total expenses.

The Appendix to the report provided an update of cost data and the key points included:-

- The alternative assets (private equity, private debt, infrastructure and social housing) made up 8% of the value of the Fund, but account for 36% of the Fund's expenses;
- The private equity funds had performance related elements, but neither manager has reached the return hurdle to trigger payments; and
- That of the Fund's £10.2m of investment expenses, £3.7m related to the underlying costs of Fund of Fund structures.

In 2013 the Fund contributed to the CEM Investment Cost Benchmarking Analysis global database. It was currently in the process of contributing to the current year's data. The database comprised 357 Funds representing, £5.0 trillion in assets, three fifths of which were based in North America. This included 35 UK Pension Funds with aggregate assets of £196bn. Fund sizes ranged between £30 million and £510 billion. The median Fund size was £2.9bn, which compared with the Falkirk Fund assets of £1.6bn at 31 December 2013. The database, although providing comparable data, was unable to capture all investment costs from all Funds. It accordingly excluded transaction costs and private asset performance fees from its analysis.

The information relating to the Falkirk Fund included:-

- The calculation of the actual cost of the Fund of approximately 0.60% below the benchmark cost of 0.67%, a 0.07% difference amounting to approximately £1 million per year;
- The actual cost comprised asset management fees and costs plus oversight, custodial and other costs whilst excluding transaction costs, private asset performance fees and non-investment costs, such as actuarial and benefit administration costs;
- That 79% of the Fund was externally managed as compared to the global average of 68%;
- The use of the Fund of Funds for 93% of the real estate and private market investments compared with the global universe average of 58%;
- The products achieving a lower than average cost included UK active equities, global diversified growth and Fund of Funds; and
- The custodial and other investment costs of 0.03%, being 0.02% lower than the global median and amounting to £310,000.

CEM highlighted that investment costs should be taken in the context of a Fund's long term net returns and that the sufficient value for the costs incurred in the long term net of costs.

Discussion included the undernoted issues:-

- The reduction in risk through diversification;
- The opportunities from non correlation;
- The modelling of future outcomes and projections;
- The risks associated with the Fund;
- The costs associated with internal and external management;
- The Fund's performance and the benchmark;
- The operation of the Fund of Funds; and
- The importance of the long term approach to investment.

### **Decision**

**The Sub Group noted the report.**

The following reports were considered in conjunction prior to a decision being taken.

## **INV15. REVIEW OF EQUITY CLASS OPTIONS**

### **(a) DEVELOPMENT OF INVESTMENT STRATEGY**

The Sub Group considered a report by Hymans Robertson on the development of the Investment Strategy on the monitoring arrangements and the opportunities for future action.

The information provided included:-

- The issue of active and passive management, particularly in relation to equity investment and also introduce the concept of passive management against equity indices that are not constructed by reference to the market capitalisation of the underlying stocks;
- The consideration of the Fund's equity portfolio in more detail, particularly exploring the overall characteristics of the combined portfolio and considering the impact on the portfolio of the proposed equity derisking. This provides some "scene setting" for the future exploration of changes to the structure of the overall equity portfolio; and
- The next steps for the Sub Group and discussion of the various strategies including equity structure, in order to further explore the potential benefits of a Smart Beta Strategy.

**(b) SMART BETA (NON-MARKET CAPITALISATION WEIGHTED, SYSTEMATIC STRATEGIES)**

The Sub Group considered a joint report by the Investment Manager and Portfolio Manager, Lothian Pension Fund on Smart Beta Non-Market Capitalisation Weighted, Systematic Strategies.

Smart Beta investment was described as a category of valuation-indifferent strategies that consciously and deliberately broke the link between the price of an asset and its weight in the portfolio, seeking to earn excess returns over the cap-weighted benchmark by no longer weighting assets proportional to their popularity, while retaining most of the positive attributes of passive investing.

Smart Beta aimed to be low cost, transparent and systematic. It was a lower cost than active management due to less day-to-day manager decision making for the manager. It had however higher trading costs than traditional passive management and was a more expensive option when externally managed.

The investment industry had historically used market capitalisation weighted indices to measure the performance of managers. The benchmarks for all Falkirk's equity managers were market capitalisation weighted and the rationale had been increasingly challenged in recent years. Benchmark indices for all asset groupings or mandates are imperfect and require to be selected carefully. This paper focuses on equity strategies, but the simple example of bond indices makes the point: these are often highly weighted to the largest borrowers, who may not always be the best credits.

The most important component of any Smart Beta Strategy was to break the link with price. It should retain some of the benefits of passive investing and take cognizance of the following:-

- Transparency - the portfolio construction and sources of excess return should be clear and easy to understand;
- Being rules-based – the methodology should be disciplined, systematic and mechanically executed; and
- Being low cost - achieved through either lower fees, lower due diligence/monitoring costs or lower trading/implementation costs.

The Smart Beta Strategy should complement the characteristics of the other equity mandates within the Fund and be able to generate similar returns to the market cap weighted benchmark indices with lower risk, or higher returns with similar risk. The Lothian alternative model to RAFI Smart Beta was noted.

**(c) PRIVATE EQUITY**

The Sub Group considered a joint report by the Investment Manager and Finance Manager, Lothian Pension Fund on characteristics of Private Equity.

The characteristics included:-

- The higher leverage than listed equity and the high correlation;
- The requirement for active management;
- The high level of management fees being a standard annual rate of 2%;
- The difficulty in assessing performance as return information was not known until the return of all cash and the winding up of the Fund;
- The relatively high risk (high leverage and high valuation) and current valuations had revealed them to be cyclically high and expensive;
- The expectation of the delivery of equity-linked returns over the long-term;
- The differences between venture capital funds and buy-out funds;
- The structure as a partnership and the governance by a limited partnership agreement with limited partners having little management control;
- The illiquidity of the investment through the fixed life and closed end structure; and
- The typical fund being of a 10 year term with the option for extension of usually three years.

The Falkirk Fund was aiming for lower risk and it may be appropriate to consider reducing the risk by reducing investment in Private Equity. This measure could be easily implemented by ceasing to make future commitments and allowing the allocation to fall over time.

The Falkirk Fund's use of the Fund of Funds was deemed an expensive way of accessing private equity opportunities. Should a reduction in the private equity allocation to take place lower equity risk would be achieved.

During discussion of the three reports at paragraphs INV15 (a), (b) and (c) above, consideration took place of the merits of active versus passive management, risk, private equity investment, the benefits of Smart Beta growth and value oriented investments and the opportunities for growth of the Fund against a background of financial pressures. The potential to redirect resources to Smart Beta for cash and an equal sum from each existing equity manager was noted.

## **Decision**

The Sub Group noted the reports at INV15 (a), (b) and (c) above.

The Sub Group agreed:-

- (1) the running down of private equity investment;
- (2) to progress some form of Smart Beta investment financed from cash resources and also potentially taking equal amounts from equity;
- (3) the subjects to be covered at future meetings would be reviewed to allow sufficient time at each meeting for appropriate consideration of each area; and
- (4) that following consideration of the remaining asset classes and currency, the next meeting would include consideration of (a) the

asset classes for investment; (b) the reconfiguration of the Fund and the equity structure, and (c) the initial reduction in risk by 5% in relation to equities currently held by the Fund.

#### **INV16. DATE OF NEXT MEETING**

The Clerk to the Sub Group would email all members and seek availability on the optional dates for the next meeting as discussed during the meeting and confirm the date as soon as possible.

**FALKIRK COUNCIL**

**MINUTE of MEETING of the PENSIONS COMMITTEE INVESTMENT REVIEW  
SUB GROUP in the MUNICIPAL BUILDINGS, FALKIRK on WEDNESDAY 9  
SEPTEMBER 2015 at 2.00 P.M.**

**SUB GROUP  
MEMBERS:**

Committee:  
Councillor Tom Coleman, Falkirk Council  
Councillor Callum Campbell, Stirling Council  
Andrew Douglas, Unison

Officers:  
Bruce Miller, Investment Manager, Lothian Pension Fund  
Bryan Smail, Chief Finance Officer

**ATTENDING:**

Pensions Board:  
Councillor Archie Drummond, Clackmannanshire Council  
Sandy Harrower, UCATT

**ALSO ATTENDING:**

Simon Jones, Hymans Robertson  
Antonia Sobieraj, Committee Services Officer

**INV17. CONVENERSHIP OF MEETING**

The Clerk presided at the start of the meeting in the absence of the Convener and invited a member of the Committee to take the Chair for the duration of the meeting. Councillor Callum Campbell, Stirling Council thereafter took the Chair with the consent of members present.

**INV18. APOLOGIES**

Apologies were intimated on behalf of Depute Provost John Patrick, Falkirk Council and Linda Selman, Hymans Robertson.

**INV19. DECLARATIONS OF INTEREST**

Councillor Callum Campbell, Stirling Council declared a non financial interest in the items on the agenda, in consequence of him being Chair of Stirlingshire Enterprise Park Ltd (STEP), but did not consider that this required him to recuse himself from consideration of the item, having regard to the objective test in the Code of Conduct.

## **INV20. MINUTE**

### **Decision**

The minute of the meeting of the Pensions Committee Investment Review Sub Group on 27 August 2015 was approved subject to amendments (i) at paragraph INV15. (b) last sentence of third paragraph to be added 'when externally managed'; and (ii) at paragraph INV15. (c) (2) to read 'to progress some form of Smart Beta equity investment financed from cash resources and also potentially taking equal amounts from equity.'

## **INV21. REVIEW OF EQUITY CLASS OPTIONS - DEVELOPMENT OF INVESTMENT STRATEGY**

The Sub Group considered a report by Hymans Robertson on the development of the Investment Strategy on the monitoring arrangements and the opportunities for future action.

Following on from discussions at the meeting on 27 August 2015, the Sub Group continued consideration of the report in relation to:-

- The consideration of investment in bonds, including both private and public debt markets. Bank de-leveraging has provided an opportunity for institutional investors and given the low level of long-term interest rates, we see particular attraction in floating rate strategies at this time; and
- The exploration of investment in commercial and residential property. Although property is primarily a growth asset within the current strategy, certain property strategies can offer a long-term real income stream that would sensibly form a component of the lower risk portfolio.

### **Decision**

The Sub Group agreed to:-

- (1) defer further consideration of bonds in view of concerns that yield pick-up would require investing in bonds of lower quality; and
- (2) review how best to invest in property giving consideration to an increased allocation over time.

Bryan Smail left the meeting during consideration of the foregoing item of business.

## **INV22. INFRASTRUCTURE**

The Sub Group considered a report by the Director of Corporate and Housing Services providing information on infrastructure investments.

The report highlighted that infrastructure investments were typically equity-type investments, often with low risk characteristics. They could, however, also be debt related.

The main attractions for the Fund included:-

- project returns often being linked to inflation, directly or indirectly, and so, were more closely aligned with the liabilities of the Fund than some other asset returns;
- asset returns were often lower risk, due to the predictability of their cash flows (and inflation linkage) and of longer duration than other assets (depending on deal structure); and
- notwithstanding a fairly high fee structure, prospective returns for the asset class appeared relatively attractive and publically listed funds promised returns of around 3.5% above inflation.

The Falkirk Fund's current infrastructure exposure comprised:-

- the global infrastructure commitment of \$80m (£51m) to the Customised Infrastructure Strategies (CIS) Fund managed by the Grosvenor Capital Customised Fund Investment Group (CFIG) - 95% funded with distributions of 35%; and
- the UK and Scottish infrastructure commitment of £30m in a shared service arrangement with Lothian Pension Fund.

The current use of Fund of Funds related to the function of the Fund's size and governance structure. It was an expensive way of accessing investments. The arrangement with Lothian Pension Fund helped to limit exposure to the Fund of Funds, reduce fee drag and diversify manager and asset exposure.

There were opportunities to aid the Fund in its diversification and risk reduction efforts by increasing the allocation to infrastructure.

## **Decision**

**The Sub Group noted the report.**

**The Sub Group agreed:-**

- (1) to make an allocation to the existing external manager's new fund of funds, subject to completion of due diligence; and
- (2) to explore further collaborative opportunities with Lothian Pension Fund.



## **INV23. CURRENCY HEDGING**

The Sub Group considered a report by the Director of Corporate and Housing Services on hedging the currency exposure in overseas assets into sterling.

Currency hedging had the potential to protect the Fund from changes in currency exchange rates.

Active currency hedging (to make a profit) was not regarded as an appropriate strategy for the Fund. Passive currency hedging (to reduce risk) was regarded as more appropriate. The timing of placing currency hedges (the purchase of currency forward contracts) however was important due to their being potentially negative cash flow implications of hedging. In addition, there were relatively long periods when hedging could be detrimental to returns.

The report highlighted that Lothian Pensions Fund's currency approach was focused on risk minimisation by not hedging those currencies with returns tending to be negatively correlated with equities (which offset fund risk) and hedging those currencies with returns tending to be positively correlated with equities (which compounded fund risk).

The introduction of a hedging programme could potentially reduce risk slightly for the Fund but it was recognised that a suitable governance structure would be required to implement the hedging process. The report concluded that there was no need to expedite a hedging programme at this time.

### **Decision**

**The Sub Group noted the report.**

## **INV24. REVIEW OF ASSET CLASS OPTION**

The Sub Group received an update from Simon Jones, Hymans Robertson on the work covered to date in relation to asset class options.

The Group had agreed on 11 August 2015 to the initial reduction in risk by the sale of 5% of equities from the Fund.

At the meeting on 27 August 2015 the decision was taken to commit no further capital to private equity, which would reduce the allocation, and to progress some form of Smart Beta equity investment financed from cash resources and also potentially taking equal amounts from equity managers.

At this meeting the Group agreed to defer consideration of investment in bonds and review how best to invest in property. Discussion also included the possibility of progressing investment where possible into local social housing, researching investment opportunities within the private rental sector and reviewing responsible investment practice.

## **Decision**

**The Sub Group agreed to progress further discussions on asset class investment at future meetings.**

## **INV25. THE NEXT MEETING**

The Sub Group received an update from the Clerk confirming that the subjects covered at the next meeting (meeting 4) would be those issues originally suggested at the first meeting for consideration at meeting 3. These were as follows:-

- Reviewing manager appointments, including styles and philosophies;
- Costs of realignment;
- Considering manager environmental, social and governance (ESG) issues;
- Determining manager benchmarks;
- Opportunities for collaboration;
- Considering Tactical versus Strategic asset allocation; and
- Delegated power - authorising the Chief Finance Officer to act when triggers were met.

A progress report on the work of the Sub Group would be presented to the meeting of the Pensions Committee/Board on 24 September 2015.

## **Decision**

**The Sub Group noted the information presented.**

## **INV26. DATE OF NEXT MEETING**

The Clerk would email all members and seek availability on the optional dates during early October 2015 for the next meeting as discussed during the meeting and confirm the date as soon as possible.

**FALKIRK COUNCIL**

**Subject: FUND MANAGER PERFORMANCE REVIEW**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 24 SEPTEMBER 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 The Local Government Pension Scheme Regulations require that Falkirk Council, as administering authority for the Pension Fund, review the investments of its managers at least once every three months, which includes an analysis of returns and risk. This paper reports on performance for the overall Fund and reviews individual manager performance and developments.
- 1.2 The rates of return achieved by our fund managers are measured against pre-determined benchmarks. This service is provided by the Fund's custodian, Northern Trust.
- 1.3 The undernoted benchmarks are in place to measure the performance of each Manager:
  - Aberdeen Asset Management (AAM) – MSCI All Countries World Index
  - Baillie Gifford Bonds (BGB) – a customised benchmark comprising UK Fixed Interest and UK Index Linked Bonds
  - Baillie Gifford Diversified Growth (BGDG) – UK base rate
  - Legal & General (L&G) – a customised benchmark comprising UK and Overseas Equities
  - Newton Investment Management (NIM) – the FTSE All World Index
  - Schroder Investment Management (SIM)
    - (i) UK Equities – the FTSE All Share Index
    - (ii) Property – HSBC/APUT Pooled Property Fund Indices
- 1.4 Full details of each Manager's portfolio activity and any engagement with companies on corporate governance issues are recorded in their individual quarterly investment reports, which are enclosed.

**2. MARKET REVIEW AND OUTLOOK**

- 2.1 Over the period both developed and emerging equity markets were largely directionless. This does not mean that the quarter was uneventful - far from it. Not only did the Greek government threaten to default on its debts and leave the Eurozone, but the Chinese equity market was also highly volatile and investors became increasingly pessimistic on the prospects for Chinese economic growth.
- 2.2 However, the general outlook for asset markets and the world economy remained broadly positive, which meant that equities were able to take this bad news comfortably in their stride. Moreover, the global policy backdrop is favourable,

with most central banks continuing to implement programmes that support economic growth.

- 2.3 The US market (the largest in the world) declined marginally in the second quarter. Notable features were the out-performance of small cap stocks over their larger counterparts, and a high level of merger and acquisitions activity. The Federal Reserve meeting in June indicated that economic growth was slower than expected, but the economic expansion continues to make progress despite the disruption caused by harsh winter weather. Of particular note are the improvements in wages, consumer confidence and house prices.
- 2.4 The Japanese market was the best performer: not only are corporate profits recovering well after several years in the doldrums, but government policies to reform the economy and raise rates of economic growth and inflation seem to be bearing fruit.
- 2.5 The UK market also performed well as the potential uncertainty of a hung parliament was removed by the result of the May General Election.
- 2.6 The Chinese stock market was very volatile: it rose by almost two thirds to its peak in mid-June, and subsequently fell sharply. Chinese authorities introduced a broad range of measures to moderate equity market volatility. Chinese growth is slowing, but it remains enviably high relative to all other major economies. Longer term economic expansion will be supported by looser monetary policy, and a switch in focus from investment-driven to consumer-driven growth.
- 2.7 European stock markets initially pushed ahead, but retreated at the end of June when the Greek crisis flared up. The European economy is showing encouraging signs of gentle recovery, profits are improving and there is a strong commitment to keeping the Eurozone intact.
- 2.8 Bond prices were volatile, with long bond yields rising in most developed markets. German bond yields spiked from almost zero in March to 1%, after which they eased back to 0.7%.
- 2.9 All eyes are on the direction of monetary policy in the USA. It is the only major country where economic conditions appear robust enough to warrant an increase in interest rates in the near term. However, the Federal Reserve remains relatively dovish, and has reassured investors that the pace of rate increases should be gradual compared to previous cycles. Higher interest rates could be expected to cause the US dollar to strengthen further.

### 3. ANALYSIS OF PERFORMANCE RESULTS

- 3.1 The total fund and individual external manager returns are shown in the table in Appendix 1. The returns for the quarter ending 30 June 2015 are shown, but this is a very short period to measure performance. It simply reflects the regular reporting cycle. Each manager has been set its own individual investment objective, which depends on the type of mandate awarded. Each active manager is tasked with outperforming its benchmark over either three or five year periods. The table in Appendix 1 incorporates the relevant return and benchmark data and the excess return relative to the manager's benchmark and outperformance objective. More detail on individual manager mandates and objectives can be found in Appendix 2.
- 3.2 Global equity market indices returned -5.2% in sterling terms over the second quarter of 2015. Returns were negatively influenced by the strength of sterling. The FTSE All Stock gilt index fell 3.4% and the FTSE Index Linked gilt index returned -2.7%. The Fund's UK commercial property benchmark index rose +3.3%.
- 3.3 The overall Fund's return of -2.6% over the quarter was behind the benchmark return by -0.3%. Over the 3 year period the Fund benefited from equity market strength, NIM's outperformance in global equities, SIM's outperformance in UK equities and Baillie Gifford's outperformance of its Diversified Growth Fund cash benchmark. It rose +11.4% per annum compared with the benchmark return of +9.6% per annum, an excess return of +1.8% per annum. Long term return data shows Fund appreciation of +10.6% per annum over 5 years and +7.3% per annum since September 2001. These long term returns are above the benchmark returns.
- 3.4 Over the second quarter of 2015, the returns of the Fund's three active equity managers ranged from -1.7% to -6.6%. AAM and SIM underperformed their respective benchmarks, while NIM outperformed. The Fund's passive equity manager, L&G, produced a return of -3.9%, in line with its benchmark return, and so consistent with its mandate.

Aberdeen proposed temporary fee adjustment for the period of 12 months between 1 October 2015 – 30 September 2016 from current fee of 0.55% on the first £100m and 0.50% thereafter to flat fee of 0.4% per annum. Temporary fee adjustment was accepted in August 2015.

The return from BG's bond mandate was -3.9%, behind its benchmark by -0.3%. BG's other mandate, the Diversified Growth portfolio, fell -0.6%, behind its benchmark by -0.8%.

The property portfolio managed by SIM rose +2.8%, but lagged its benchmark by -0.3%.

- 3.5 Longer term return data shows that SIM's UK equity portfolio is comfortably ahead of its objective of +1.25% per annum above the benchmark over the 3 year period and since inception.

NIM's global equity mandate stipulates an objective of +3% per annum above the benchmark over 5 year rolling periods. Returns over the past 5 years and since inception have beaten the benchmark, but they have not achieved the objective.

The AAM mandate's objective is +3% per annum outperformance over 3 year rolling periods. Performance is lagging the benchmark and the objective by a wide margin over 3 years and since inception.

The performance of BG's bond mandate is essentially in line with its benchmark since inception in 2007, but the 3 and 5 year performance have been strong. The excess return over the benchmark of +0.9% per annum is in line with the objective of +0.9% per annum over rolling 3 year periods.

SIM's property performance has been disappointing in recent years, and this has reversed positive results in the early years of the mandate. Since inception in 2005, a period of low returns for commercial property owners, the portfolio has performed broadly in line with its benchmark, but has fallen short of the objective by 0.9% per annum. It should be noted that there has been a significant staffing change on this mandate and this can be explored when Schroders present later in the meeting.

#### **4. CONCLUSION**

- 4.1 The second quarter experienced several developments. Europe was dominated by Greek government threat to default on its debt and exit Eurozone. Chinese market was highly volatile. However general outlook for the world economy remained positive. UK market performed well, as uncertainty over General Election results was removed. Increased likelihood of rise in US interest rates may strengthen US dollar further, but with particular consequences for emerging markets.
- 4.2 The Fund achieved a return of -2.6% during the quarter, -0.3% behind the benchmark. Aberdeen and Schroders underperformed their respective benchmarks, while Newton outperformed. Both Baillie Gifford mandates – Bonds and Diversified Growth fell short of achieving quarterly benchmarks. Schroders Property performance improved, but still fell behind its benchmark.

#### **5. RECOMMENDATIONS**

- 5.1 The Committee and Board are asked to note:-
  - (i) the Managers' performance for the period ending 30 June, 2015; and
  - (ii) the actions taken by Managers during the quarter to 30 June, 2015 in accordance with their investment policies.

pp **Director of Corporate & Housing Services**  
**Date : 11 September 2015**  
**Contact Officer: Bryan Smail, Bruce Miller**

### **LIST OF BACKGROUND PAPERS**

1. The Northern Trust Company – Fund Analytics 30 June 2015

Any person wishing to inspect the background papers listed above should telephone 0131 469 3866 and ask for Bruce Miller

## APPENDIX 1 – PERFORMANCE MEASUREMENT (RATES OF RETURN)

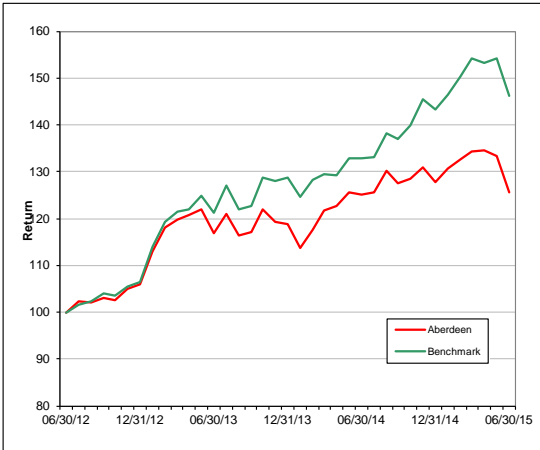
Rates of Return by Manager with Excess Returns - 30 June 2015							
Manager	Market Value £	Weight	Returns				Inception Date
			3 months	3 year	5 year	Since inception	
<b>Aberdeen Portfolio</b>	218,919,995	12.6%	-6.6%	<b>7.9%</b>	9.3%	<b>7.6%</b>	May-10
Benchmark			-5.1%	<b>13.5%</b>	11.4%	<b>9.0%</b>	
Excess Versus Benchmark			-1.5%	<b>-5.7%</b>	-2.1%	<b>-1.4%</b>	
Excess Versus Objective			-	<b>-8.7%</b>	-5.1%	<b>-4.4%</b>	
<b>Baillie Gifford Bond Portfolio</b>	149,310,353	8.6%	-3.9%	<b>6.5%</b>	8.2%	<b>6.5%</b>	Mar-07
Benchmark			-3.6%	<b>5.7%</b>	7.1%	<b>6.7%</b>	
Excess Versus Benchmark			-0.3%	<b>0.9%</b>	1.2%	<b>-0.2%</b>	
Excess Versus Objective			-	<b>0.0%</b>	0.3%	<b>-1.1%</b>	
<b>Baillie Gifford Diversified Growth</b>	204,727,436	11.8%	-0.6%	6.9%	-	<b>6.7%</b>	Feb-12
Benchmark			0.1%	0.5%	-	<b>0.5%</b>	
Excess Versus Benchmark			-0.8%	6.4%	-	<b>6.2%</b>	
Excess Versus Objective			-	-	-	<b>2.7%</b>	
<b>Legal &amp; General</b>	362,996,452	20.9%	-3.9%	13.2%	11.5%	13.4%	Jan-09
Benchmark			-3.8%	13.1%	11.4%	13.3%	
Excess Versus Benchmark			0.0%	0.1%	0.1%	0.1%	
Excess Versus Objective			<b>0.0%</b>	<b>0.1%</b>	<b>0.1%</b>	<b>0.1%</b>	
<b>Newton</b>	265,800,441	15.3%	-3.5%	14.7%	<b>12.8%</b>	<b>9.1%</b>	Jun-06
Benchmark			-5.0%	13.6%	<b>11.4%</b>	<b>7.8%</b>	
Excess Versus Benchmark			1.6%	1.1%	<b>1.4%</b>	<b>1.3%</b>	
Excess Versus Objective			-	-	<b>-1.6%</b>	<b>-1.7%</b>	
<b>Schroders UK Equity</b>	236,935,637	13.6%	-1.7%	<b>17.1%</b>	13.8%	<b>9.2%</b>	Sep-01
Benchmark			-1.6%	<b>11.0%</b>	10.7%	<b>6.8%</b>	
Excess Versus Benchmark			-0.2%	<b>6.1%</b>	3.0%	<b>2.4%</b>	
Excess Versus Objective			-	<b>4.9%</b>	1.8%	<b>1.1%</b>	
<b>Schroders Property</b>	133,037,136	7.7%	2.8%	<b>9.9%</b>	7.6%	<b>3.3%</b>	Nov-05
Benchmark			3.3%	<b>10.6%</b>	8.5%	<b>3.4%</b>	
Excess Versus Benchmark			-0.5%	<b>-0.7%</b>	-0.9%	<b>-0.1%</b>	
Excess Versus Objective			-	<b>-1.4%</b>	-1.7%	<b>-0.9%</b>	
<b>Total Fund</b>	1,736,640,140	100.0%	-2.6%	11.4%	10.6%	7.3%	Sep-01
Benchmark			-2.3%	9.6%	9.0%	6.9%	
<b>Excess Return</b>			<b>-0.3%</b>	<b>1.8%</b>	<b>1.5%</b>	<b>0.4%</b>	

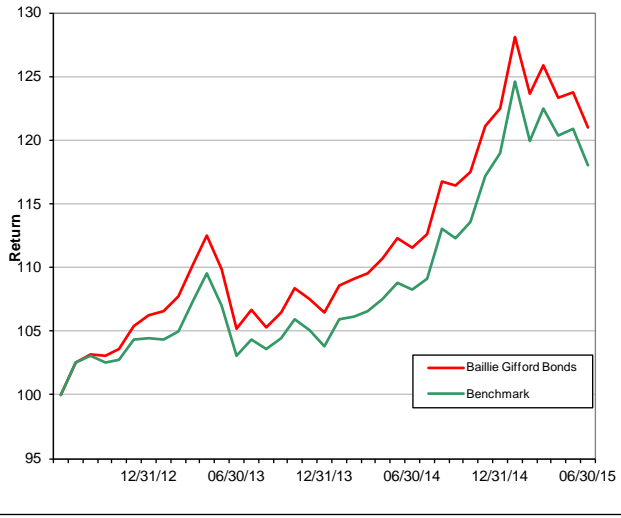
\* Note that objectives vary and are set over 3 or 5 year periods highlighted in bold for each manager.

There are small rounding effects in the table above.



## APPENDIX 2 - INVESTMENT MANAGER COMMENTS

<p><b>Aberdeen Global Equity</b> (12.6% of Total Fund)</p> <p><b>Investment Approach:</b> High conviction, research-driven house. Only invest in companies they have met. Regional teams produce Global buy list of 330 stocks. Global team carries out comparative analysis and produces model portfolio of 50 stocks from which team must build portfolio. Long-term horizon, trading highly price-sensitive.</p> <p><b>Investment Objective:</b> To outperform the MSCI AC World Index in sterling by 3% per annum, gross of fees, over rolling 3 year periods (inception date 16 May 2010)</p>	<p><b>3 Year Performance to 30 June 2015</b></p>  <p>Q2 2015 : -1.5% excess return 3 Years : -5.7% excess return Since inception : -1.4% p.a. excess return</p>
<p><b>Summary</b></p> <p>Very poor 3 year performance is worsening and significant outflows continue. Since inception performance is below benchmark and objective.</p>	
<p><b>Portfolio</b> A concentrated portfolio of 50 stocks should be able to achieve its objectives - it is largely unconstrained. No single investment more than 5% of the portfolio is allowed, but sector and country limits are wide (+/-15% for sectors and +/- 35% for countries allowed). Cash has risen to 3.9%.</p> <p>Sector and country positioning remains defensive. N. America represents 55% of the benchmark, but the portfolio is u/w by 19%. The fund is o/w the UK (+8%), Europe ex-UK (+4%, with Switzerland +8%), and LatAm (+4%). By sector, the portfolio remains o/w consumer staples (+9%), and has high relative exposure to cyclical sectors such as materials (+4%), energy (+3%) and industrials (+3%) (in contrast to 2 years ago), although exposure to consumer discretionary remains very low (-10%). The underrepresentation of financials has grown (-7%). The portfolio continues to perform poorly and its defensive tilt failed to protect it in the recent quarter when equity markets fell. Aberdeen's views remain ever cautious, especially on US market valuations although the US weight is now the highest in several years. One new buy: German detergents/adhesives manufacturer Henkel.</p> <p>In Q2, the portfolio lagged the index return by a meaningful 1.5%, due to poor stock selection in most regions and despite a positive benefit from regional allocation. By sector, the underperformance was attributable to poor stock selection in industrials (Canadian National Railway, Atlas Copco), technology (Ericsson, Samsung Electronics, Oracle) and energy (EOG Resources, Royal Dutch Shell), partially offset by positive selection in staples (Japan Tobacco, Philip Morris). There was also a small drag from the underweight position in financials but otherwise sector allocation was largely neutral. Cash was a small positive given the weak markets in the quarter.</p> <p>Aberdeen continue to follow their process investing in good quality companies with lower than average levels of debt and relatively stable earnings/cash flows. However, poor (and deteriorating) 3 year performance means there is a heightened risk of flows turning decisively negative, not least because consultants may well revisit Aberdeen's position on their 'buy' lists. We estimate that Aberdeen's Global strategies have already "lost" 30% of their performance-adjusted AuM over the last 2 years and arguably outflows are now driving (or at least exacerbating) the underperformance. Long term investors have remained loyal so far. Aberdeen have reduced the fee at Falkirk's request.</p> <p><b>Key considerations/developments</b> <b>Ownership</b> has not changed; the <b>client base</b> looks stable due to segregated fund client inertia yet AuM has declined ~30% over last 2 years as pooled fund assets steadily withdrawn (£1.8bn lost in Q2); the <b>investment process</b> has not changed/is standardised across equity products although relies on country/regional team picks for opportunity set. Recent promotion of Devan Kaloo as Head of Equities likely to mean renewed focus on ESG at earlier stage of process. Cross-fertilisation of ideas and team-led approach key selling points. Stable, well-resourced and experienced <b>investment team</b> (6 most senior team members average &gt;20 years in industry and &gt;13 years at Aberdeen), backed up by extensive and experienced regional teams.</p>	
<p><b>Baillie Gifford Bonds</b></p>	<p><b>3 Year Performance to 30 June 2015</b></p>

(8.6% of Total Fund)	
<b>Investment Approach:</b>  Baillie Gifford employs fundamental analysis to identify sustainable trends. It believes that there are inefficiencies that can be exploited in the areas of stock selection and interest rate and currency strategies.	
<b>Investment Objective:</b>  To outperform a customised benchmark comprising index-linked gilts, conventional gilts and investment grade bonds by 0.9% per annum net of fees over rolling 3 year periods (inception date 30 March 2007).	
<b>Summary</b>	
	With a further weak quarter, the 3 year performance is now in line with the objective before fees, but the 5 year performance remains above the target
<b>Portfolio</b>	
<p>The portfolio has a customised benchmark (20% FT-Actuaries Over 5 Years Index Linked Gilt Index, 30% FT-Actuaries All Gilts, 50% Merrill Lynch Sterling Non-Gilt Index). Baillie Gifford (BG) invests in three BG Funds on a no-fees basis to achieve the appropriate exposure.</p> <p>Q2 was a complete reversal of Q1. Concern over the possibility of a Greek exit from the Euro replaced the optimism over low oils prices and inflation. Index Linked Gilts returned -3.3% (Q1:+3.3%), Conventional Gilts -3.4% (Q1:+2.2%) and Corporate Bonds -3.9% (Q1:+3.3%) as the narrowing of spreads in Q1 was almost completely unwound.</p> <p>The 3 year relative performance dropped from 1.2%p.a. to 0.9% p.a. over the quarter as a quarter of good performance dropped out of the numbers. So, the portfolio is above benchmark and in line with objective before fees over the latest 3 year period. The main negative relative contribution was from Asset Allocation where the 5% underweight position in government bonds hurt as credit spreads increased.</p> <p>Although the overweight USD and MXN position contributed negatively for the quarter, the currency positions as a whole were a small positive with some of the short positions, such as NZD, performing better. The portfolio’s largest positions are now 5.7% long US Dollar and 2.7% long Mexican Peso offset by a 3.5% short position in the Euro.</p> <p>Stock selection was marginally positive over the quarter but contributed over +0.4% for the year. As noted last quarter, the manager no longer holds any positions in Emerging Market Credit. They consider that Q4 2014 demonstrated that the sound fundamental positions could be “swamped” by wider country and geo-political considerations.</p> <p>Nevertheless, they have taken a new position in Columbian Index Linked Bonds where they are actively seeking to take the Country risk, although the Brazilian and Columbian index-linked positions together only total 0.8% of the fund.</p> <p>The tracking error dropped marginally from 0.88% to 0.85%, with Stock Selection accounting for 62% (Q1:58%) of the risk relative to the benchmark. Currency has remained at 20% of the portfolio risk.</p>	
<b>Key considerations/developments</b>  Baillie Gifford is a long established, reputable partnership; the client base is stable and the investment process has not changed. Assets under management in the sterling aggregate product decreased from £684m to £668m over the quarter as the drop in bond prices outweighed a £10m inflow resulting from an existing client re-balancing their fund.	

## Baillie Gifford Diversified Growth (11.8% of Total Fund)

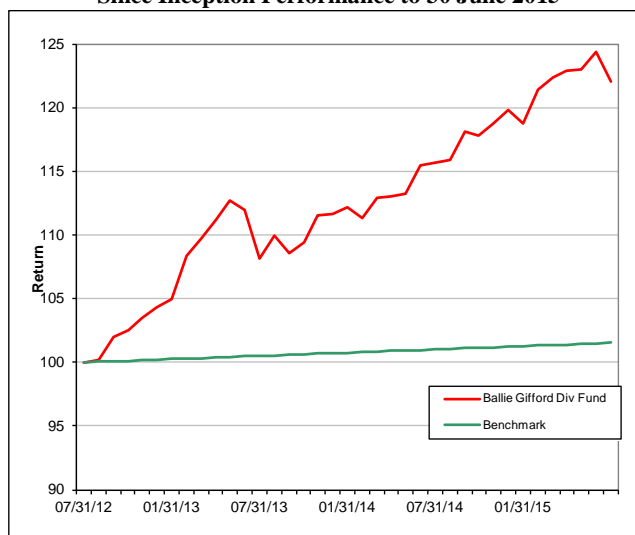
### Investment Approach:

Baillie Gifford invests in a broad range of traditional and alternative asset classes, such as equities, bonds, property, private equity, infrastructure, commodities and currencies, adjusting portfolio weightings to reflect the relative attractiveness of the individual assets.

### Investment Objective:

Objective: to outperform the UK base rate by at least 3.5% per annum (*after fees*) over rolling five year periods with an annual volatility of less than 10%. (Inception date 2 February 2012)

Since Inception Performance to 30 June 2015



Q2 2015 : -0.8% gross relative to base rate  
 3 Year : +6.4% gross relative to 0.5% base rate  
 Since inception : +6.2% gross relative to 0.5% base rate

### Summary

Co-head of team resigned Jan 2015. As ex Head of Risk at BG, this is a concern as the target return from here may be too high and estimated risk may be too low - notably "Active Currency" at minus "-0.1% of predicted volatility".

### Portfolio

"Active Currency" risk is now stated at "0.5% of assets" and "-0.1% of predicted volatility" – still very low given that it was the biggest positive contributor to return in Q2 (and the biggest contributor in Q4 and Q3 and the second biggest in Q1). The net long and short FX positions are both around 40% of the fund, so total FX exposure is around 80% of the fund – again by far the largest asset exposure. Q2 trading was £130m equity, £12m bonds and £14,682m FX forwards. The stated risk underestimates possible FX losses/gains.

Insurance Linked bonds are 4.5% of the fund but are quoted at "0.3%" of the risk. This also seems an extraordinarily low figure for what is essentially writing "catastrophe" insurance. The manager claims not to have major exposure to any one catastrophe risk.

The stated predicted volatility is now 6.2% with 57% of this from (listed and private) equities, which are 23% of fund. Targeted maximum volatility is 10%. (Global equities are 16.9%).

### Key considerations/developments

Mike Brooks – ex co-head of team – resigned 21<sup>st</sup> January and left the firm in March. Felix Amoako has been named as a (replacement) fund manager. But he has been an analyst on Diversified Growth since 2013 after joining BG as a graduate in 2011. They plan to recruit a new external analyst in September.

After 0.7% charges, none of the manager's 10-year expected returns on any asset class now meet the net fund performance target of cash plus 3.5% net.

Baillie Gifford announced "closure" in the strategy in Q4 2012 at £2.8bn, reflecting £5bn "capacity" and "closure to all new clients" in June 2013. Yet even now they "will continue to accept routine cashflows from clients". In Q2 they had another £16m more net inflows. Assets were £5.94bn - £1,006m net inflows since this "closure". Capacity management is under scrutiny given the size of the firm. Interestingly, the "Multi-Asset Team" is to launch a similar fund this September "to enable more capacity", with "the same process run by the same people" (excluding c5% in Insurance-Linked Securities) with "£5-10bn capacity".

# Newton Global Thematic Equity

(15.3% of Total Fund)

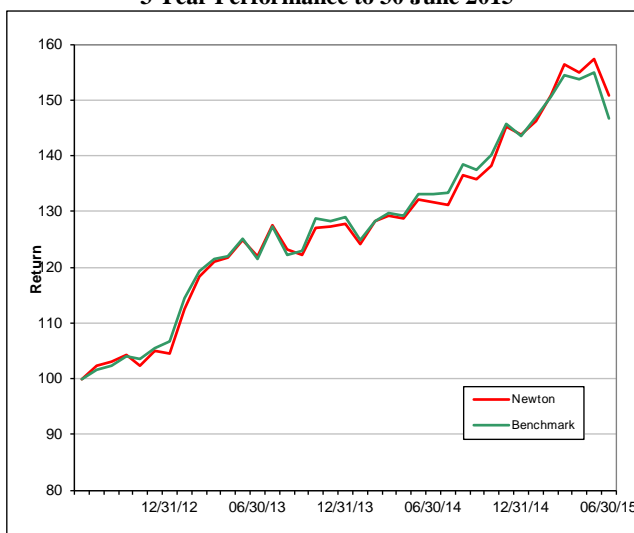
## Investment Approach:

Newton identifies structural trends to gain perspective on the important risks and opportunities in investment markets. This thematic framework drives stock selection, which results in a concentrated portfolio.

## Investment Objective:

To outperform FTSE All World Index by 3% per annum (net of fees) over rolling 5 year periods (inception date 30 June 2006)

3 Year Performance to 30 June 2015



Q2 2015 : +1.6% excess return  
 5 Years : +1.4% p.a. excess return  
 Since inception : +1.3% p.a. excess return

## Summary

Another strong quarter. Portfolio ahead of benchmark since inception, but still short of objective, especially net of fees. It is creditable that the portfolio has beaten the index return over the 5 year bull market as it has been constructed to take advantage of weak markets.

## Portfolio

The portfolio is concentrated in just 41 stocks, indicating that it should be able to achieve its objectives. This is an equity portfolio, but the manager is able to hold up to 10% in cash. The manager continues to take a very defensive stance and cash (mostly short term US Treasuries) was 9.8% at quarter end.

Stock ideas flow from Newton's themes, which include deleveraging, financial concentration and growing Chinese influence. The portfolio is characterised by companies with stable earnings, strong cash flows, competitive advantages, inflation linkage, innovation, exposure to growth economies, good management & governance and attractive valuation.

Little change to geographic or sector positioning. The portfolio remains overweight Europe/UK (+8%) equities and cash (+10%), and underweight all other regions. It continues to have high exposure to companies in the consumer services sector (+9%), while financials (-11%) and oil & gas (-5%) companies are still significantly under-represented. The portfolio's high cash position should continue to protect it if equity markets fall, but there is less of a defensive tilt due to the underrepresentation of cyclical stocks in the portfolio than previously.

The portfolio beat its benchmark again in Q2, mainly due to positive stock selection in the US and UK. The key positive contributors included stock selection in Consumer Services (Yum Brands, Discovery Communications), Utilities (Centrica) and Consumer Goods (Japan Tobacco). Stock selection within industrials (CH Robinson, Trimble Navigation) and healthcare (Medtronic, Teva) detracted from relative performance. During the quarter, there were no new additions to the portfolio, although allocations to stocks such as CH Robinson and TripAdvisor were increased. The stock count continues to fall (now 41) with the outright sales of AGCO, Renaissance Re and Vallourec. The cash/bonds position added mildly to relative performance.

## Key considerations/developments

Newton remains one of Bank of New York Mellon's asset management subsidiaries based in London; the investment process is unchanged since a review in 2011/12 when personnel changes were made; the client base is stable (no flows in or out).

## Schroders UK Equity

(13.6% of Total Fund)

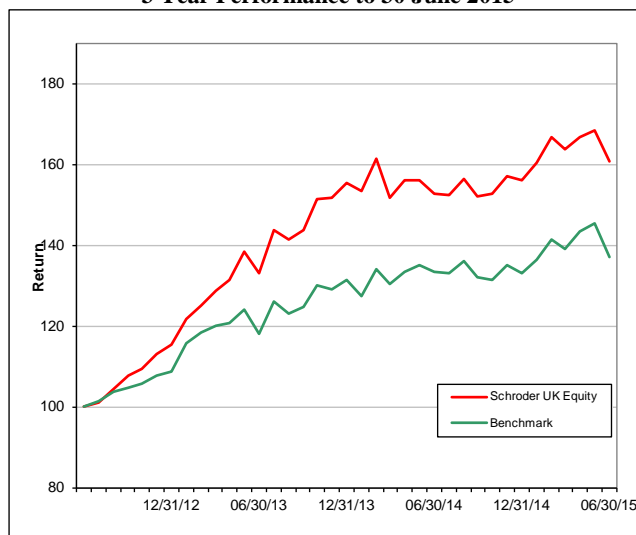
### Investment Approach:

Schroder seek to identify stocks which trade at a substantial discount to their intrinsic value and where they believe that profits will surpass expectations. The investment style can be categorised as “value”.

### Investment Objective:

To outperform FTSE All Share Index by 1.25% per annum (net of fees) over 3 year rolling periods (inception date 30 September 2001)

### 3 Year Performance to 30 June 2015



Q2 2015	: -0.2% excess return
3 Year	: +6.1% p.a. excess return
Since inception	: +2.4% p.a. excess return

## Summary

Slightly below index performance in Q2, but the manager is comfortably ahead of the objective over 3 years. Clearly articulated strategy with stable ownership, client base and investment team.

## Portfolio

The portfolio of 36 stocks deviates from the benchmark meaningfully, which means that the objective should be achievable, but the return profile is likely to be highly variable. Active sector positions are very similar to last quarter. The portfolio retains an overweight position in the food & drug retailers and life insurance sectors. Tobacco & beverages are the largest underweight sectors and are both zero weighted.

Rentokil Initial and Debenhams were the biggest positive contributors to relative returns in the quarter while positions in Aviva, BAE Systems and GlaxoSmithKline were the biggest detractors, alongside the underweight exposure to BG Group.

Nick highlighted that the impact of QE has created “complacency in some areas”. He suggested bond proxies, or low volatility equities with strong balance sheets have become expensive. Examples of this are beverage and tobacco names, hence the zero weighting. Companies newly entering their valuation screens are “almost entirely” within the mining space. Having added to Anglo American in the quarter they have yet to invest in other names within the sector but noted that there are prices at which that might change. As prices fall, they are likely to add.

The number of holdings has fallen to 36. This downward trend has been fairly consistent as the team continue to take profits in names that have done very well for them over the last few years. Cash remains elevated at 6.8% (including accruals) as the team continue to be in a position where they are happy to take profits in existing names but struggle with the risk and reward balance of new opportunities.

In terms of activity, the team reduced their holding in BAE Systems and added to holdings in Anglo American, Drax and Home Retail Group. The combination of Aviva and Friends Life has resulted in Aviva being a modest outlier in terms of position size (6.1%). The team are in the process of reviewing this currently.

### Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the client base is fairly stable and investment process has not changed. UK Value product, in which Falkirk is invested, runs approximately £5.8bn in assets split roughly 1/3rd institutional and 2/3rd retail. Stable investment team, demonstrates conviction in its investment approach. The team continue to be cautious on the UK market given elevated market levels.

## Schroders Property Multi-Manager

(7.7% of Total Fund)

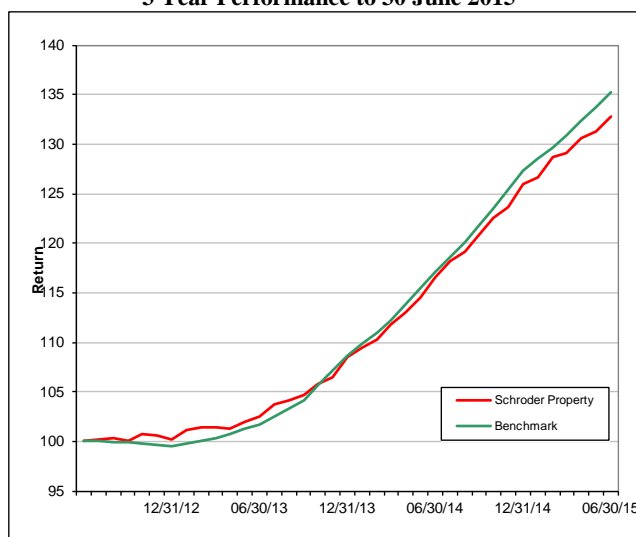
### Investment Approach:

Schroders runs a segregated mandate providing a multi-manager portfolio of property funds. The manager seeks to identify attractive property markets and property funds with skilled managers, some of which are sector specialists.

### Investment Objective:

To outperform IPD UK Pooled / Quarterly Property All Balanced Funds Weighted Average Index by 0.75% per annum (net of fees) over 3 year rolling periods (inception date 30 November 2005)

### 3 Year Performance to 30 June 2015



Q2 2015 : -0.5% excess return  
 3 Year : -0.7% p.a. excess return  
 Since inception : -0.1% p.a. excess return

### Summary

Portfolio manager resigned, so resources under pressure; latest 3 year performance remains weak relative (-0.7% pa), but strong absolute (+10% pa). Portfolio has been restructured and is now positioned for the future.

### Portfolio

The portfolio is comprised of a diverse group of 15 funds investing in property assets largely in the UK (97%). UK performance has outperformed the benchmark in each long/short period, but the Cont. European exposure remains a drag on performance. The portfolio is valued at £133m.

The manager has re-positioned away from London offices by continuously selling WELPUT<sup>1</sup> and has made commitments for investing in industrial property and a small lot size multi-sector partnership fund (Metro PUT via a new partnership managed by Hermes). The partnership fund is only available to Schroders' clients.

Continental Europe now amounts to 3% of the portfolio. It produced a positive return in € due to asset disposals for the second consecutive quarter after adjusting for distribution, but the positive return was offset by EUR/GBP depreciation. (Recap in '06-07, 10% of the portfolio was committed to Europe.) The poor three year relative performance has been dominated by this exposure, which is not in the benchmark. Schroders is expecting the recovery in Europe will continue and plans to hold the exposures till maturity (2018).

The portfolio's risk profile has been rebalanced through greater investment in low geared, core balanced property funds and those funds targeting an income focussed approach. As a result, the manager believes the portfolio is well positioned for the current investment environment, in which the income yield on property is very competitive with government bonds.

Given a constructive outlook, the manager targets to hold minimal amounts of cash after the above commitments have been drawn. Schroders' real estate return forecast is 15% for 2015, but 6-8% per annum for 2014-2019.

### Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the **client base** is fairly stable and the **investment process** has not changed. The **investment team** is changing meaningfully: post end of quarter, the portfolio manager departed.

<sup>1</sup> West End of London Property Unit Trust



### APPENDIX 3 – GLOSSARY

**Benchmark** - The yardstick used to measure the success and structure of a portfolio. All managers are measured against benchmarks. Passive managers are tasked with producing returns that are the same as the benchmark. Active managers are tasked with producing returns that are higher than the benchmark.

**Benchmark return** - Identifies the total return of the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

**Dividend Yield** - The dividend a company pays divided by its current price.

**Duration** - A measure of the sensitivity to interest rates of bonds. It identifies the approximate percentage change in a bond's price for a 100 basis point change in yield

**Excess Return** - Is the out / underperformance of the portfolio relative to the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

**Investment Objective** – All managers (and the Fund) are set investment objectives, which are related to a specific benchmark. The investment objective for a passive manager is to match the returns of the benchmark. The investment objective for an active manager is to exceed the returns of the benchmark by a pre-determined percentage per annum over a pre-determined period.

**Market value (£)** - Identifies the total market value of the portfolio / Fund

**Portfolio return** - Identifies the total time weighted rate of return of the assets of the portfolio for the identified period. Returns for periods up to 12 months are the return over that period. Returns for periods longer than 12 months are annualised returns – they show the return per annum (%pa).

**Turnover** - Is the level of purchases and sales for the period. High turnover is generally regarded as bad because trading costs are incurred.





**FALKIRK COUNCIL**

**Subject: PRIVATE EQUITY AND ALTERNATIVES UPDATE**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 24 SEPTEMBER 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 This report updates the Pensions Committee and Board on the progress and key events arising from each Manager's investment programme for the three months to 30 June 2015.
- 1.2 The Fund's private equity and alternatives programme is managed as follows:
- |                            |                                 |
|----------------------------|---------------------------------|
| SL Capital (Standard Life) | - European Private Equity       |
| Wilshire Associates        | - Global Private Equity         |
| Grosvenor Capital          | - Global Infrastructure         |
| M&G                        | - Credit Markets                |
| Hearthstone                | - Social and Affordable Housing |
| Lothian Co-Investments     | - UK Focused Infrastructure     |
- 1.3 The Fund's strategic allocation to private equity and alternatives (excluding the allocation to the Baillie Gifford Diversified Growth Fund) is set at 10% of total fund assets. This is split 5% to private equity and 5% to infrastructure.
- 1.4 The attached schedules give details of the current valuations and commitment levels in both the original currencies and summarised in Sterling.

**2. SL CAPITAL PARTNERS**

- 2.1 SL Capital is a subsidiary of Standard Life Investments, who in turn own 60% of the business. The remaining 40% is owned by 8 partners.
- 2.2 The Fund's overall commitment to SL Capital is €102m spread across four European Investment Funds – ESP 2004, ESP 2006, ESP 2008 and ESF 1 – all being fund of fund structures. The partnerships have been established for 14 years from the final close of each Fund.
- 2.3 During the quarter €3.207m was returned from ESP 2004, 2006 and 2008 Funds with the largest distribution from ESP 2006 (€1.6m). Funds drawdown amounted to £1.243m (including €0.837m for ESP 2008). There were no transactions for ESF 1. SL have now drawn down 77% of the total commitment of €102m.

### **3. WILSHIRE ASSOCIATES**

3.1 Over the period The Fund has made various commitments to Wilshire Associates as follows:

European Funds	-	<u>€10.9m</u>
Dollar Funds		<u>\$72.0m</u>

3.2 90% of the Euro funds and 75% of the dollar funds have been drawndown.

3.3 During the quarter Wilshire distributed €0.081m and \$2.7m (mainly from Fund VII US and Fund VIII US). \$0.97m was called (mainly from Fund VIII US and Fund IX).

### **4. GROSVENOR CAPITAL**

4.1 The Fund's global infrastructure investments are made via a commitment of \$80m to the Customised Infrastructure Strategies (CIS) Fund managed by the Grosvenor Capital Customised Fund Investment Group (CFIG).

4.2 The CIS Fund seeks to generate attractive risk-adjusted returns by investing in a diversified range of infrastructure funds, co-investments and secondaries.

4.3 During the quarter \$7,987 m was returned and \$0.238m called. Distributions were made from transactional activity in Energy Capital Partners II (EquiPower Co-Invest).

4.4 As previously outlined, Grosvenor Capital is fund raising for a second global infrastructure fund. Further reference is made to this in the Strategy Review report.

### **5. M&G UK COMPANIES FINANCING FUNDS**

5.1 The M&G UK Companies Financing Funds provide the Fund with exposure to UK credit markets. The Funds play a valuable role in providing debt financing to UK companies facing refinancing obstacles. The aim of the Funds is to create attractive levels of income for investors – an absolute return of LIBOR plus 3%-6% - with a low level of risk.

5.2 Falkirk's commitment to the M&G Funds is £11.8m to Fund I and £10m to Fund II. Fund I has been fully invested and Fund II is in the process of being drawn down.

5.3 For Fund 1, the portfolio consists of 8 loans with an average repayment period of 4.3 years and average credit ratings of BB+. Loans have been made to companies such as Barrett, Taylor Wimpey, Wincanton and Provident Financial. Since inception the return was 4.88%

5.4 For Fund II, the portfolio consists of 9 loans but with an average repayment period of 5.7 years. This includes loans to Caffè Nero, Holidaybreak Limited and Workplace Group plc and added in this quarter Nando's UK. Distribution yield for the past year to June was 3.47%

5.5 All loans continue to be paid in accordance with their covenants.

## **6. SOCIAL AND AFFORDABLE HOUSING**

- 6.1 The Committee has agreed to make a £30m commitment to Hearthstone Investments to fund Social and Affordable Housing via their Housing Fund for Scotland. The Fund objective is to deliver returns of RPI + 2%. In order to deliver the new units in Scotland, Hearthstone is working in partnership with Castle Rock Edinvar, the Edinburgh based Housing Association.
- 6.2 A programme of 195 units in sites at Bellsdyke (62 units), Overton (34 units), Durieshill (60 units) and Alloa (39 units) has been identified by Places for People and confirmed with local authorities and Scottish Government, who are providing an element of central grant to supplement local grant allocations.
- 6.3 Hearthstone identified £2m investment in a new build location in Dalkeith, acquiring the section 75 affordable housing units associated with a Cruden Homes development in the town. Places for People have agreed to operate the units once built and also taken on the development risk, leaving the fund acquiring these units for approximately £106,000 per unit. This compares with an approximate market value in the area for open-market housing of £120,000 per unit. A S75 modification has been agreed in principle with planners such that when the fund wishes to exit the investment at the end of a 10 year period it can sell the homes into the open-market should this be financially beneficial.

## **7. LOTHIAN PENSION FUND CO-INVESTMENTS**

- 7.1 The 5 June 2014 Pension Committee approved the extension of the Fund's collaboration with Lothian Pension Fund to include the sourcing, analysing and proposal of potential infrastructure deals primarily located in the UK/Scotland.
- 7.2 During the quarter the first deals from this agreement were finalised. £1.8m was called in relation to a co-investment with Ancala Partners LLP in an expanding portfolio of small scale hydroelectric plants in the Scottish Highlands.
- 7.3 A second co-investment was finalised in Q2, with £3m called by FIM Wind Energy LP to finance construction of 22 wind turbines near the Scottish Pentlands.
- 7.4 Lothian has indicated that a strong pipeline of deals has been identified, with the potential for further deals to be completed in the coming months.

## **8. CONCLUSION**

- 8.1 The portfolio returned 0.75% over Q2 and outperformed the FTSE 7-Day LIBID Index by +66bps on a relative basis. The portfolio continues to outperform its cash benchmark by comfortable margins across all longer reported performance horizons.

**9. RECOMMENDATIONS**

- 9.1 The Committee and Board are asked to note the progress of the Fund's Alternatives investments as at 30 June 2015 and invited to comment as appropriate.**

pp **Director of Corporate & Housing Services**

**Date: 15 September 2015**

**Contact Officer: Bryan Smail/Justyna Korszen-Bennett**

**LIST OF BACKGROUND PAPERS**

NIL

## Appendix A

### Falkirk Council Pension Fund Alternative Markets Update - 30/06/15

#### Alternative Assets Summary - Original Currency

Manager	Fund	Commitment 000's	Unfunded 000's	(a) Cost 000's	(b) Return of Cost 000's	(c) Distrbtn Gains 000's	(d) Market Value 000's	(b + c + d) Total Value 000's	Total Value to Paid in Cap.	Inception Rate of Return	Percentage to be drawn down
<b>Private Equity</b>											
SL Capital Partners	European Strategic Partners 2004	€ 30,000	€ 3,169	€ 26,831	€ 13,447	€ 9,421	€ 12,257	€ 35,125	1.31	5.9%	
SL Capital Partners	European Strategic Partners 2006	30,000	3,361	26,639	10,217	5,183	19,469	34,869	1.31	3.7%	
SL Capital Partners	European Strategic Partners 2008	27,000	7,870	19,130	3,098	934	19,743	23,775	1.24	0.9%	
SL Capital Partners	European Smaller Funds I	15,000	9,129	5,871	0	0	5,357	5,357	0.91	-36.9%	
<b>SL Capital Partners Total</b>		<b>€102,000</b>	<b>€23,529</b>	<b>€78,471</b>	<b>€26,762</b>	<b>€15,538</b>	<b>€56,826</b>	<b>€99,126</b>			23.1%
Wilshire Associates	Fund VI - Europe	€ 3,600	€ 223	€ 3,377	€ 2,106	€ 1,336	€ 1,425	€ 4,867	1.44	7.0%	
Wilshire Associates	Fund VII - Europe	3,600	175	3,425	1,277	710	2,398	4,385	1.28	-0.6%	
Wilshire Associates	Fund VIII - Europe	3,700	616	3,084	799	657	2,840	4,296	1.39	30.1%	
<b>Wilshire Associates Europe Total</b>		<b>€10,900</b>	<b>€1,014</b>	<b>€9,886</b>	<b>€4,182</b>	<b>€2,703</b>	<b>€6,663</b>	<b>€13,548</b>			9.3%
Wilshire Associates	Fund VI - US	\$14,000	\$751	\$13,249	\$5,592	\$5,526	\$7,788	\$18,906	1.43	6.3%	
Wilshire Associates	Fund VII - US	11,500	553	10,947	3,805	4,169	8,340	16,314	1.49	7.2%	
Wilshire Associates	Fund VIII - US	12,700	898	11,802	4,096	2,979	10,081	17,156	1.45	11.4%	
Wilshire Associates	Fund VII - Asia	1,800	144	1,656	938	666	799	2,403	1.45	8.9%	
Wilshire Associates	Fund VIII - Asia	2,000	1,116	884	328	148	771	1,247	1.41	-10.6%	
Wilshire Associates	Opportunities Fund II-B	15,000	12,922	2,078	0	0	2,020	2,020	0.97	11.5%	
Wilshire Associates	Fund IX	15,000	12,842	2,158	0	0	2,270	2,270			
<b>Wilshire Associates US and Asia Total</b>		<b>\$72,000</b>	<b>\$29,226</b>	<b>\$42,774</b>	<b>\$14,759</b>	<b>\$13,488</b>	<b>\$32,069</b>	<b>\$60,316</b>			40.6%
<b>Infrastructure</b>											
Grosvenor Capital	Customised Infrastructure Strategies	\$80,000	\$11,024	\$68,976	\$13,887	\$11,208	\$67,303	\$92,398	1.34	9.0%	
<b>Grosvenor Capital Total</b>		<b>\$80,000</b>	<b>\$11,024</b>	<b>\$68,976</b>	<b>\$13,887</b>	<b>\$11,208</b>	<b>\$67,303</b>	<b>\$92,398</b>			13.8%
<b>Credit Markets</b>											
Prudential/M&G	UK Companies Financing Fund	£11,835	£0	£11,835	£4,943	£0	£8,721	£13,664	1.15	4.5%	
Prudential/M&G	UK Companies Financing Fund II	10,000	6,034	3,966	249	89	3,838	4,176	1.05	3.5%	
<b>Credit Market Total</b>		<b>£21,835</b>	<b>£6,034</b>	<b>£15,801</b>	<b>£5,192</b>	<b>£89</b>	<b>£12,559</b>	<b>£17,840</b>			27.6%
<b>Social / Affordable Housing</b>											
Hearthstone plc	Housing Fund for Scotland	£30,000	£8,450	£21,550	£0	£0	£21,550	£21,550			
<b>Social/Affordable Housing Total</b>		<b>£30,000</b>	<b>£8,450</b>	<b>£21,550</b>	<b>£0</b>	<b>£0</b>	<b>£21,550</b>	<b>£21,550</b>			28.2%
<b>UK Infrastructure</b>											
Ancala	Ancala Renewables LP	£2,750	£917	£1,833	0	0	£1,833	£1,833			
FIM Harburnhead	FIM Harburnhead LP	£3,038	£0	£3,038	0	0	£3,038	£3,038			
		<b>£5,788</b>	<b>£917</b>	<b>£4,871</b>	<b>£0</b>	<b>£0</b>	<b>£4,871</b>	<b>£4,871</b>			15.8%

## Appendix B

### Falkirk Council Pension Fund Alternative Markets Update - 30/06/15

Exchange Rates	
\$	1.5502
€	1.3656

### Alternative Assets Summary - Sterling

Manager	Commitment £ 000's	Unfunded £ 000's	(a) Cost £ 000's	(b) Return of Cost £ 000's	(c) Distrbtn Gains £ 000's	(d) Market Value £ 000's	(b + c + d) Total Value £ 000's	Total Value to Paid in Cap.
SL Capital Partners	74,692	17,230	57,463	19,597	11,378	41,612	72,588	1.26
Wilshire Associates	54,427	19,596	34,832	12,583	10,680	25,566	48,829	1.40
Grosvenor Capital	51,606	7,111	44,495	8,958	7,230	43,416	59,604	1.34
M & G	21,835	6,034	15,801	5,192	89	12,559	17,840	1.13
Hearthstone plc	30,000	8,450	21,550	0	0	21,550	21,550	1.00
Ancala	2,750	917	1,833	0	0	1,833	1,833	
FIM Harburnhead	3,038	0	3,038	0	0	3,038	3,038	
	<b>£238,348</b>	<b>£59,338</b>	<b>£179,012</b>	<b>£46,330</b>	<b>£29,377</b>	<b>£149,574</b>	<b>£225,282</b>	

Allocation to Private Equity  
(based on unfunded commitment plus market value) 6.1%

Allocation to Private Equity  
(based on market value only) 4.0%

Allocation to Infrastructure  
(based on unfunded commitment plus market value) 3.3%

Allocation to Infrastructure  
(based on market value only) 2.8%