**DRAFT**

**FALKIRK COUNCIL**

**MINUTE of JOINT MEETING of the PENSIONS COMMITTEE/PANEL held in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 11 DECEMBER 2014 at 9.30 A.M.**

| | |
|---|---|
| **PRESENT:** | Councillors:<br>Jim Blackwood<br>Steven Carleschi<br>Tom Coleman<br>Depute Provost Patrick (Convener)<br>Dr Craig R Martin<br><br>Andrew Douglas, Unison<br>Sandy Harrower, UCATT<br>Mary Keggan, Unison<br>Gordon Laidlaw, Scottish Autism<br>Susan MacKay, Clackmannanshire Council<br>Alistair Redpath, Pensioner Representative<br>Jennifer Welsh, SEPA |
| **ATTENDING:** | Alastair McGirr; Pensions Manager<br>Bryan Smail, Chief Finance Officer<br>Antonia Sobieraj, Committee Services Officer |
| **ALSO IN ATTENDANCE:** | Bruce Miller, Investment Manager, Lothian Pension Fund<br>George Murphy, Stirling Council<br>Catherine McFadyen and Lorna Lyon, Hymans Robertson<br>Jim Rundell and Louise Dodds, Audit Scotland<br>Claire Watson, Graeme Rutter and Anthony Doherty, Schroders |

## PE29. APOLOGIES

Apologies were intimated on behalf of Councillor Campbell, Stirling Council; Councillor Drummond, Clackmannanshire Council; Ian McLean, Pensioner Representative; Ed Morrison, Scottish Children's Reporter Administration's (SCRA); and Jim Boyle, Stirling Council.

## PE30. DECLARATIONS OF INTEREST

No declarations were made.

**PE31. MINUTES**

**Decision**

**(a) The minute of the meeting of the Pensions Panel on 11 September 2014 was approved; and**

**(b) The minute of the meeting of the Pensions Committee held on 25 September 2014 was approved.**

**PE32. PENSION FUND ANNUAL AUDIT REPORT - 2013/14**

The Committee considered a report by the Chief Finance Officer presenting Audit Scotland's Annual Report on the 2013/2014 Falkirk Council Pension Fund Audit.

**Decision**

**The Committee noted Audit Scotland's Pension Fund Annual Report on the 2013/14 Pension Fund Audit.**

**PE33. GENERAL GOVERNANCE MATTERS**

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

The areas covered within the report included the following:-

- Social Housing;
- Local Infrastructure;
- Prudential Additional Voluntary Contributions (AVC's);
- Staff Transfer - Sign Factory; and
- The Local Authority Pension Fund Forum (LAPFF) of 58 local authority Pension Funds.

**Decision**

**The Committee noted the report.**

**PE34. PENSION FUND - VALUATION AND STRATEGIC REVIEW**

The Committee considered a report by the Chief Finance Officer providing an update on the progress of the 2014 Fund Valuation together with consideration of the pending review of the Fund's investment strategy.

The report indicated:-

- The requirement for a Pension Fund valuation by an independent actuary on a three yearly basis in line with the rules of the Local Government Pension Scheme;
- The valuation's purpose to establish the financial position of the Fund in relation to assets and liabilities and, for this valuation, to set an appropriate rate of employers' contribution for the three years' commencing 1 April 2015;
- The valuation of the Fund being conducted as at 31 March 2014 by the Fund's Actuary, Hymans Robertson; and
- The funding considerations and objectives.

The Committee also heard from Catherine McFadyen and Lorna Lyon, Hyman's Robertson and circulated the Actuarial Valuation Initial Results for 2014.

The Convener thanked Ms McFadyen and Ms Lyon for the comprehensive information.

**Decision**

**The Committee noted the report and associated presentations.**

## PE35. PENSION FUND - GOVERNANCE ARRANGEMENTS

The Committee considered a report by the Chief Finance Officer providing an update on the recent developments in relation to the governance arrangements in respect of the ongoing reform of the Local Government Pension Scheme (LGPS) through the Public Service Pensions Act 2013 with effect from 1 April 2015.

The report confirmed:-

- That Falkirk Council was designated an Administering Authority within Local Government Pension Scheme legislation with responsibility for maintaining and managing the Pension Fund;
- The provisions of the Public Service Pensions Act 2013 including the requirements for a Scheme Manager – the legally constituted decision making body and a Pension Board - a supporting entity;
- That at a national level the requirement for the overseeing of the Scheme to be undertaken by an Advisory Board comprising Employer and Trades Union representatives;
- The recently issued consultative draft Regulations and the Falkirk Council response on behalf of the Fund detailed in Appendix A to the report;
- The statutory requirements and the practical considerations relating to the operation of the Pensions Board;
- The guidance within the Governance Heads of Agreement and Model Constitution authorised by the Scottish Local Government Pensions Advisory Group (SLOGPAG);
- The publishing of the final Governance Regulations in late January 2015; and
- The overseeing national governance arrangements through the national Advisory Board.

The report also indicated (a) the current governance arrangements by Falkirk Council through the Pensions Committee and Panel; and (b) recommended (i) that the Falkirk

Pension Fund's business continue to be delegated to the Pensions Committee; and (ii) that the Pensions Panel discontinue with effect from 1 April 2015 with alternative governance arrangements to be put in place.

Circulated at the meeting were options for the future composition of the Committee and the Board issued (i) for information to Panel members; and (ii) for consideration by the Committee.

**Decision**

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

**The Committee thereafter agreed:-**

**(1) to recommend to Council that:-**

**(a) the Pensions Panel be discontinued from 1 April 2015;**

**(b) the Pensions Committee should continue to operate as at present (i.e. with 6 elected members from Falkirk Council and 3 co-opted members representing Employer, Trade Unions and Pensioners;**

**(c) in the event that the legislation remains as presently drafted, there should be a Pensions Board of 8 members consisting of 4 Employer and 4 Trade Union representatives or in the event that the legislation permits non Trade Union member representation, there should be a Pensions Board of 10 members with 5 Employer representatives, 4 Trade Union representatives and 1 non Trade Union member representative; and**

**(d) the allocation of Board (dependant on the legislation at (c) above) seats to Employers and Trades Unions as detailed below:-**

| | Committee | Board |
|---|---|---|
| 1. | 9 Members<br><br>6 Falkirk Council Elected members +<br>3 Non-Falkirk Council members<br>- 1 Employer representative +<br>- 1 Trade Union representative +<br>- 1 Pensioner representative<br><br>For example:<br>- 1 x Stirling Council (1)<br>- 1 x Unison<br>- 1 x Pensioner representative<br><br><u>Comment</u> | 8 Members<br><br>4 Employer representatives +<br>4 Member representatives<br><br>1 x Clackmannanshire Council<br>1 x SEPA<br>1 x SCRA<br>1 x Scheduled or Admitted Body<br><br>1 x Unison (2)<br>1 x GMB<br>1 x Unite<br>1 x UCATT<br><br><u>Comment</u><br>(2) It would be open to the Trade |

| | | |
|---|---|---|
| | **(1) Where the seat on the Committee is taken by Stirling Council, Clackmannanshire Council would be represented on the Board and vice versa.** | **Unions to agree an alternative composition among them.** |
| **2.** | **As above** | **10 Members**<br><br>**5 Employer representatives +**<br>**5 Member representatives**<br><br>**2 x Local Authority (3)**<br>**1 x SEPA**<br>**1 x SCRA**<br>**1 x Scheduled or Admitted Body**<br><br>**1 x Unison**<br>**1 x GMB**<br>**1 x UCATT**<br>**1 x Unite**<br>**1 x Non Union Member Representative**<br><br>**<u>Comment</u>**<br>**(3) One of the local authority representatives would be appointed by Falkirk Council.** |

**and**

**(2) that the final meeting of the Pensions Panel would be a joint meeting with the Committee and Panel on 12 March 2015.**

## PE36. ORDER OF BUSINESS

In terms of Standing Order 14.2(i), Depute Provost Patrick advised of 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.

Councillor Dr C R Martin left the meeting prior to consideration of the following item of business.

## PE37. FUND MANAGER REVIEW

The Committee received a presentation by Claire Watson, Graeme Rutter and Anthony Docherty, Schroders.

The presentation covered the UK Equity and Property mandates and included information as undernoted:-

- The "Value" philosophy of the UK Equity Team;
- The rationale for recent sales and purchases;
- An overview of the underlying property funds, including the Continental European Fund, and
- The threats and opportunities in the property market.

The Convener thanked Ms Watson, Mr Rutter and Mr Docherty for their comprehensive presentation.

**Decision**

**The Committee noted the presentation.**

## PE38. FUND MANAGER PERFORMANCE REVIEW

The Committee 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 Bonds;
- Baillie Gifford Diversified Growth;
- Legal and General;
- Newton Investment Management;
- Schroder Investment Management UK Equities; and
- Schroder Investment Management Property.

**Decision**

**The Committee noted the Fund Managers' performance and the action taken by them during the quarter to 30 September 2014, in accordance with their investment policies.**

## PE39. PRIVATE EQUITY AND ALTERNATIVES UPDATE

The Committee 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 of SL Capital (Standard Life), Wilshire Associates, Grosvenor Capital and M&G for the quarter ending 30 September 2014.

The Committee agreed that the information contained in the Appendix to the report contained exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973 and resolved that, to the extent that there was confidential information in relation to new Grosvenor Infrastructure Fund.

**Decision**

**The Committee:-**

**(1) noted the progress of the Pension Fund's private equity, infrastructure and credit markets programme for the quarter ending 30 September 2014; and**

**(2) agreed not to invest in the new Grosvenor Fund at this point in time ahead of the Investment Strategy Review.**

**AGENDA ITEM 4**

**FALKIRK COUNCIL**

| | |
|---|---|
| **Subject:** | **PENSION FUND - ANNUAL AUDIT PLAN** |
| **Meeting:** | **JOINT MEETING OF PENSIONS PANEL AND COMMITTEE** |
| **Date:** | **12 MARCH 2015** |
| **Author:** | **CHIEF FINANCE OFFICER** |

## 1. INTRODUCTION

1.1 This purpose of this report is to bring the Annual Audit Plan of Audit Scotland to the attention of the Panel and Committee.

## 2. ANNUAL AUDIT PLAN 2014/15

2.1 Audit Scotland has submitted its formal plan for the audit of the 2014/15 pension fund annual report and accounts. A copy of the plan is attached as Appendix 1 to this report.

2.2 The key milestones of the audit process are set out on Page 6 of the plan. These include the requirement to have unaudited final statements completed by 30 June 2015 and the audited annual report and accounts completed by 30 September 2015. Matters identified as being of potential risk to the Fund are set out on Pages 9 and 10 of the plan.

2.3 The Local Authority Accounts (Scotland) Regulations 2014 require that the following items must now be included in the annual report and accounts:.

- a management commentary;
- an annual governance statement (i.e. including a review of the system of internal financial control);
- a statement of responsibilities; and
- a remuneration statement.

2.4 The management commentary has to be signed by the Pensions Committee Convener and by the Council's Chief Executive.

2.5 Audit Scotland has produced a guidance note on the new disclosures and this is attached at Appendix 2.

2.6 In terms of process, the unaudited accounts now require to be approved by 31 August. It is therefore intended to bring these accounts to the meeting of the Pensions Committee on 26 June 2015. A further change is that the Annual Audit Report – which concludes the audit process - will be combined with the ISA260 ("Communication of audit matters to those charged with governance") to enable it to be formally issued by 30 September.

2.7 The fee for the 2014/15 audit is £23,010 and represents an increase of 3.4% from the 2013/14 audit. This reflects additional audit work considered necessary in the light of the systems and governance developments taking place.

## 3. RECOMMENDATION

**3.1 The Panel and Committee are asked to note the issuing of the Annual Audit Plan by Audit Scotland, consistent with the audit of the pension fund annual report and accounts 2014/15.**

**Chief Finance Officer**

**Date: 01 March 2015**

**Contact Officer: Alastair McGirr**

**<u>LIST OF BACKGROUND PAPERS</u>**

NIL

AUDIT SCOTLAND

# Falkirk Council Pension Fund

# Annual Audit Plan 2014/15

**Prepared for Members of Falkirk Council as administering body of Falkirk Council Pension Fund and the Controller of Audit**

**February 2015**

# Contents



# Key contacts

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# Summary

## Introduction

1. Our audit is focused on the identification and assessment of the risks of material misstatement in Falkirk Council Pension Fund's financial statements.

2. This report summarises the key challenges and risks facing Falkirk Council Pension Fund and sets out the audit work that we propose to undertake in 2014/15. Our plan reflects:
   - the risks and priorities facing Falkirk Council Pension Fund
   - current national risks that are relevant to local circumstances
   - the impact of changing international auditing and accounting standards
   - our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland
   - issues brought forward from previous audit reports.

## Summary of planned audit activity

3. Our planned work in 2014/15 includes:
   - an audit of the financial statements and provision of an opinion on whether:
     – they give a true and fair view of the state of affairs of Falkirk Council Pension Fund as at 31 March 2015 and its income and expenditure for the year then ended
     – the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2014 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)
   - a review and assessment of Falkirk Council Pension Fund's governance and performance arrangements in a number of key areas including: arrangements supporting the governance statement, and information gathering for the Annual Audit Report.
   - provision of an annual audit report addressed to the members of Falkirk Council Pension Fund and the Controller of Audit for review.
   - regular attendance at Pensions Committee.

# Responsibilities

4. The audit of the financial statements does not relieve management or the Pensions Committee as the body charged with governance, of their responsibilities.

## Responsibility of the appointed auditor

5. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

6. Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs and to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

## Responsibility of the Chief Finance Officer

7. It is the responsibility of the Chief Finance Officer, as the appointed "proper officer", to prepare the financial statements in accordance with relevant legislation and the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 (the Code). This means:

- maintaining proper accounting records
- preparing financial statements which give a true and fair view of the state of affairs of Falkirk Council Pension Fund as at 31 March 2015 and its expenditure and income for the year then ended.

## Format of the accounts

8. The financial statements should be prepared in accordance with the Code which constitutes proper accounting practice.

# Audit Approach

## Our approach

9. Our audit approach is based on an understanding of the characteristics, responsibilities, principal activities, risks and governance arrangements of Falkirk Council Pension Fund. We also consider the key audit risks and challenges in the local government sector generally. This approach includes:

- understanding the business of Falkirk Council Pension Fund and the risk exposure which could impact on the financial statements
- assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how Falkirk Council Pension Fund will include these in the financial statements
- assessing and addressing the risk of material misstatement in the financial statements
- determining the nature, timing and extent of the audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements give a true and fair view.

10. We have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus audit testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Management action being relied on for 2015 includes:

- comprehensive closedown procedures for the financial statements accompanied by a timetable issued to all relevant staff
- the appointment of a lead accountant with responsibilities for preparing the financial statements, the provision of supporting working papers, liaising with external audit and responding to audit queries
- delivery of unaudited financial statements to agreed timescales with a comprehensive working papers package.

11. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible. However, as reported in our 2013/14

Annual Audit Report, limited reliance can be placed on the work of Internal Audit for our current audit. Internal Audit's Plan does not include the provision for any work on the Pension Fund in 2014/15 although management advised that internal audit testing of 2014/15 data is scheduled for early 2015/16.

## Materiality

12. International Standard on Auditing 320 provides guidance on the concept of materiality. We consider materiality and its relationship to audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

13. Based on our knowledge and understanding of Falkirk Council Pension Fund we have set our planning materiality at 10% of contributions as per the 2013/14 audited financial statements. For 2014/15 planning materiality is £7.643 million.

14. We set a lower level, known as performance materiality, when defining our audit procedures. This level depends on professional judgement and is informed by a number of factors including:

- extent of estimation and judgement within the financial statements
- nature and extent of prior year misstatements
- extent of audit testing coverage.

15. For 2014/15 performance materiality has been set at £3.822 million. Also, we will report, to those charged with governance, all misstatements greater than £100,000.

16. In addition, an inaccuracy which would not normally be regarded as material in terms of monetary value may be important for other reasons (for example the failure to achieve a statutory requirement, or an item contrary to law). In the event of such an item arising, its materiality has to be viewed in a narrower context; such matters would normally fall to be covered in an explanatory paragraph in the independent auditor's report.

## Reporting arrangements

17. The Local Authority Accounts (Scotland) Regulations 2014 require that the unaudited annual accounts are submitted to the appointed external auditor no later than 30 June each year. The authority (or a committee whose remit includes audit or governance) is required to consider the unaudited annual accounts at a meeting by 31 August.

18. The Fund must publish the unaudited accounts on their website until the date on which the audited annual accounts are published.

19. The 2014 regulations require the local authority (or a committee whose remit includes audit or governance) to meet by 30 September to consider whether to approve the audited annual accounts for signature.

20. Immediately after approval, the annual accounts require to be signed and dated by specified members and officers and then provided to the auditor.  The Controller of Audit requires audit completion and issue of an independent auditor's report (opinion) by 30 September each year.

21. The authority is required to publish on its website its signed audited annual accounts, and the audit certificate, by 31 October.  The annual audit report is required to be published on the website by 31 December.

22. An agreed timetable is included at Exhibit 1 below which takes account of submission requirements and planned Pension Committee dates.

### Exhibit 1:  Financial statements audit timetable

| Key stage | Date |
|---|---|
| Testing and review of internal control systems and transactions | By April 2015 |
| Meetings with officers to clarify expectations of working papers and financial system reports | By April 2015 |
| Planned committee approval of unaudited financial statements | 26 June 2015 |
| Submission of unaudited council financial statements with working papers package to external audit | By 30 June 2015 |
| Progress meetings with lead officers on emerging issues | As required during the audit |
| Latest date for final clearance meeting with Pensions Manager and Accountant | 31 July 2015 |
| Agreement of unsigned financial statements for Pension Committee agenda, and issue of combined ISA 260 report to those charged with governance and Annual Audit Report. | By 10 Sept 2015 |
| Pensions Committee | 24 Sep 2015 |
| Independent auditors report signed | By 30 Sep  2015 |
| Annual report to Members and the Controller of Audit | By 30 Sep 2015 |

23. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the responsible relevant officers to confirm factual accuracy. Responses to draft reports are expected within two weeks of submission. A copy of all final agreed reports will be sent to the Chief Executive, Chief Finance Officer, Pensions Manager, Internal Audit and Audit Scotland's Performance Audit and Best Value Group.

24. We will provide an independent auditor's report to Falkirk Council Pension Fund and the Accounts Commission that the audit of the financial statements has been completed in accordance with applicable statutory requirements. As part of streamlining our audit approach, this year the Annual Audit Report will be combined with the ISA 260 report. As a result, the Annual Audit Report will be issued by 30 September which is one month earlier than in previous years.

25. All annual audit reports produced are published on Audit Scotland's website: (www.audit-scotland.gov.uk).

26. Planned outputs for 2014/15 are summarised at Appendix I.

## Quality control

27. International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit Scotland and approved by the Accounts Commission. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews and has been subject to a programme of external reviews by the Institute of Chartered Accountants of Scotland (ICAS).

28. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We do, however, welcome feedback at any time and this may be directed to the engagement lead, Fiona Mitchell Knight.

## Independence and objectivity

29. Auditors appointed by the Accounts Commission must comply with the Code of Audit Practice. When auditing the financial statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB) and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards

including an annual “fit and proper” declaration for all members of staff.  The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland’s Ethics Partner.

30. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff.  We are not aware of any such relationships pertaining to the audit of Falkirk Council Pension Fund.

# Audit issues and risks

## Financial statement audit issues and risks

31. Based on our discussions with staff, attendance at committee meetings and a review of supporting information, we have identified the following main financial statements risk areas for Falkirk Council Pension Fund (the Fund).

32. **Accountancy Staff**: Currently, the Fund does not have a dedicated and experienced Pension Fund Accountant in place. There is a risk of the financial statements being submitted to external audit late. Also, there is also an increased risk of errors within the accounts due to a lack of specialist accounting knowledge and support.

33. **Annual Governance Statement:** The Local Authority Accounts (Scotland) Regulations 2014 require that an Annual Governance Statement (AGS) be published as part of the annual accounts. It should be prepared in accordance with proper practices as set out in *Delivering good governance in local government: framework* published by CIPFA and SOLACE. This is in addition to the Governance Compliance Statement required under pension administration regulations.

34. It is recommended that one statement is prepared which satisfies the requirements of both an AGS and a GCS.

35. Also, the 2014 Regulations require local authorities (including Pension Funds) to conduct a review, at least once in each financial year, of the effectiveness of their systems of internal control and report this in their Annual Governance Statements. This review must also be considered at a meeting of the Pensions Committee. The 2014/15 internal audit plan does not include any specific work on the Pension Fund. This could affect the level of assurances given on internal controls and there is also a risk that disclosures in the AGS (or combined AGS and GCS) could be incomplete.

36. **Investment Management Expenses**: Accurate presentation and disclosure of investment management costs has been problematic for Pension Funds. There is a risk that these will not be presented correctly in the financial statements and that members may not be able to gauge whether best value is being achieved. Management have advised that they will endeavour to follow the most recent guidance on the disclosure of management expenses.

37. **Management override of controls**:  International Standard on Auditing (ISA) 240 recognises that management are in a unique position and have the ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. ISA 240 requires that this risk be recognised in audit plans. We will design and perform audit procedures to address these risks within Falkirk Council Pension Fund.

## Wider dimension audit issues and risks

38. **Public Services Pension Act 2013**: Changes to the public service pensions are required in line with the Public Service Pensions Act 2013. The main changes are the introduction of career average pensions (at a national level) and the introduction of a Scheme Manager and the establishment of a Pensions Board to support the Manager (at a local level). There is a risk that the Fund may not comply with the Act at its effective date of 1 April 2015. Falkirk Council Pension Fund is taking steps to ensure its preparedness and compliance and we will continue to monitor its progress.

39. **IT Systems Change**: In our 2013/14 Annual Audit Report it was identified that there is a risk of corruption in the migration of data to the new pensions administration system (Altair). As part of our interim audit testing we will perform additional testing to gain our own assurances that management's process for the implementation of the new system is sound.

40. **Risk Management**: A risk register was introduced in 2013. When changes in criteria are identified they are notified to committee members however, the core risk register is not kept up to date. Risk management should reflect current risks. The potential issue is that the likelihood and impact of risks crystallising are not properly monitored and controlled. The Pensions Manager has indicated that risk management arrangements will be revisited with the establishment of the Pensions Board.

41. **Bank Account**: In our Annual Audit Report we noted that, in our opinion, Falkirk Council Pension Fund is not fully compliant with the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 in that it does not fully operate a separate bank account. Some transactions are processed through Falkirk Council's main bank account with transfers made to/from the Fund.  It is management's opinion that this set up is required because any non-fund charges to the element could result in the loss of tax exempt status.

42. **Budgetary Control**: At the date of this report no budgetary information on controllable administration costs has been reported to committee. There is a risk that performance against budget is not monitored effectively. In response to our 2013/14 Annual Audit Report management gave assurances that steps would be taken to report the administration budget to the Pensions Committee in 2014/15.

## Summary assurance plan

43. In terms of financial statements risks actions to manage these risks are either planned or already underway within the organisation. Details of the sources of assurance that we have received for each of these risks and any audit work we plan to undertake is also set out in Appendix II. In the period prior to the submission of the unaudited financial statements, we will liaise with senior officers on any new or emerging issues.

# Fees and resources

## Audit fee

44. Over the past four years, Audit Scotland has reduced audit fees by 23.5% in real terms, exceeding our 20% target.  In 2014/15 it has been necessary to increase our audit fee by 3.6% (or £809) compared to 2013/14.  This is due to the fact that there is no planned internal audit work, other than NFI in 2014/15, and there are also significant changes affecting the Fund's governance arrangements.  In addition, a new pensions administration system is being implemented during 2014/15 involving the migration of data from the old system. This will require some additional audit input.

45. In determining the audit fee we have taken account of the risk exposure of Falkirk Council Pension Fund, the management assurances in place, and the level of reliance we plan to take from the work of internal audit.  We have assumed receipt of a complete set of unaudited financial statements and comprehensive working papers package by 30 June 2015.

46. The agreed audit fee for the 2014/15 audit of Falkirk Council Pension Fund is £23,010.  Our fee covers:

- The costs of planning, delivering and reporting the annual audit including auditor's attendance at committees.
- a contribution towards functions that support the local audit process (e.g. technical support and coordination of the National Fraud Initiative), support costs and auditors' travel and subsistence expenses.

47. Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied.  An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

## Audit team

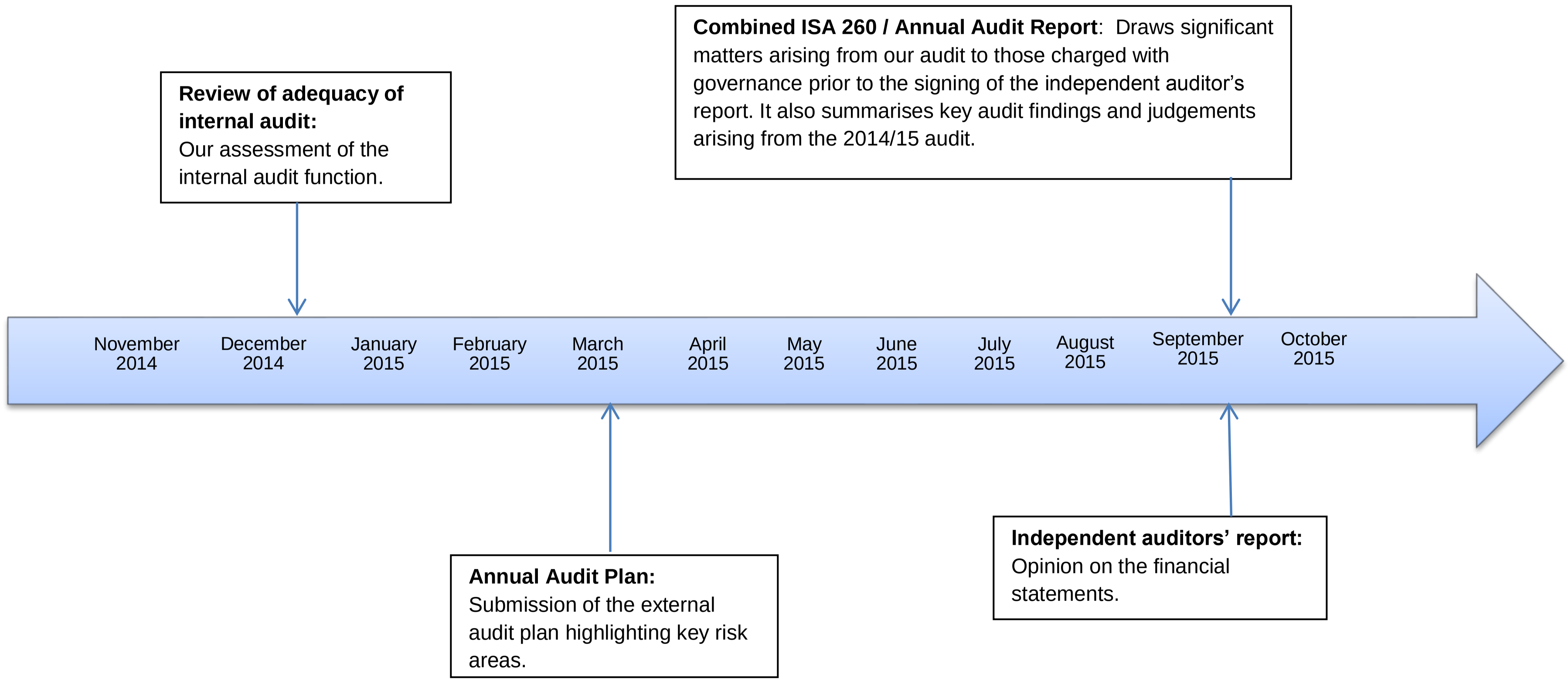
48. Fiona Mitchell-Knight, Assistant Director, Audit Services is your appointed auditor.  The local audit team will be led by Louise Dodds who will be responsible for day to day management of the audit and who will be your primary contact.  Details of the experience and skills of our team are provided in Exhibit 2 overleaf.   The core team will call on other specialist and support staff as necessary.

### Exhibit 2: Audit team

| Name | Experience |
| --- | --- |
| Fiona Mitchell-Knight, BA (Hons) FCA, Assistant Director | Fiona has been an Assistant Director of Audit Scotland since 2007, following 6 years as the Senior Audit Manager for a number of local authority bodies including Glasgow City Council. Fiona trained as an auditor in the private sector in England, and has over 20 years' experience of public sector audit with Audit Scotland, covering local government, health and the further education sectors. |
| Jim Rundell, MA (Hons) CPFA, Senior Audit Manager | Jim has 30 years public sector audit experience mostly in the local government and health areas. He has worked on both the City of Edinburgh Council audit and the NHS Greater Glasgow and Clyde audit. Jim has been a Senior Audit Manager for 17 years. He is also the Audit Services Group's 'risk champion' and recently he updated Audit Scotland's Risk Strategy and Policy Framework. |
| Louise Dodds, BA(Hons), Auditor | Louise joined Audit Scotland in 2011 as part of the professional trainee graduate scheme having studied accountancy at Glasgow Caledonian University. She is at the final stage of qualification with the Institute of Chartered Accountants of Scotland (ICAS). Experience with Audit Scotland has primarily covered local government and health sectors. |
| Toby Freer, BA(Hons), Auditor | Toby has worked on varied Central Government audits since joining Audit Scotland in October 2012. He is currently on the professional trainee graduate scheme studying for the ICAS professional accountancy qualification. |

# Appendix I: Planned audit outputs

The diagram below shows the key outputs planned for Falkirk Council Pension Fund in 2014/15.



# Appendix II: Significant audit risks

We undertake a risk-based audit whereby we focus on those areas where we have identified a risk of material misstatement in the accounts. This section shows how our audit approach focuses on the risks we have identified through our planning procedures. ISA 315 *Identifying and assessing the risks of material misstatement through understanding the entity and its environment* defines a significant risk as "an identified and assessed risk of material misstatement that, in the auditor's judgement, requires special audit consideration."

In this section we identify a range of risks facing Falkirk Council Pension Fund, the related source of assurance received and the audit work we propose to undertake to secure additional assurance. The management of risk is the responsibility of Falkirk Council Pension Fund and its officers, with the auditor's role being to review the arrangements put in place by management. Planned audit work, therefore, will not necessarily address all residual risks.

| Audit Risk | Source of assurance | Assurance procedure |
| --- | --- | --- |
| ***Audit risk of material misstatement in financial statements*** | | |
| **Accountancy staff**<br>At the date of this report there is no Pension Fund Accountant. There is a risk of the financial statements being submitted to external audit late and there is also an increased risk of errors within the accounts due to a lack of specialist accounting knowledge and support. | • Updates to be provided to the external audit team on plans to fill the accountant post (possibly from the redeployment of staff from the finance section).<br>• The financial statements and supporting working papers will be provided to external audit by 30 June 2015. | • A working papers checklist will be provided to management detailing the minimum upfront working papers required.<br>• Testing of financial statements compliance with the Code of Practice. |

| Audit Risk | Source of assurance | Assurance procedure |
|---|---|---|
| **Annual Governance statement**<br>From 2014/15 Pensions Funds are required to include an Annual Governance Statement (AGS). This is in addition to the Governance Compliance Statement already required under pension administration regulations. The 2014 Accounts Regulations also require the Pension Fund to undertake an annual review of the system of internal control and report this in the AGS or combined AGS and GCS. Internal Audit's plan for 2014/15 does not include any specific work on the Pension Fund. This could affect the level of assurances given on the review of internal controls and there is also the risk that disclosures may be incomplete. | • The Fund will comply with the requirement to prepare an Annual Governance Statement.<br>• regular reporting of financial information including accounts and investment performance to the Pensions Committee.<br>• Previous years' work carried out by external audit including remedial actions taken in response to recommendations raised.<br>• Internal audit testing of pension of 2014/15 data is scheduled for early 2015/16.<br>• Participation in the National Fraud Initiative.<br>• The Pension Section is subject to the council's wider framework of control including Financial Regulations, Codes of Conduct, Schemes of Delegation, etc. | • Review arrangements put in place to provide assurances on the completeness and accuracy of the AGS.<br>• Check that information disclosed in AGS is consistent with our knowledge of the Fund's control environment. |

| Audit Risk | Source of assurance | Assurance procedure |
|---|---|---|
| **Investment Management Expenses**<br>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 that members may not be able to gauge whether best value is being achieved. | • The Fund will follow, as far as practical, Cipfa's newly published guidance which sets out a framework for the consistent disclosure of expenses.<br>• Consult with other Pension Funds and practitioners, as appropriate, on disclosures. | • Review presentation and disclosure of management expenses to check compliance with extant guidance.<br>• Consult with our technical staff on the adequacy of disclosures. |
| **Management override of controls**<br>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. | • Quarterly performance reports from Fund Managers.<br>• Reports from the Pension Fund Custodian.<br>• Scrutiny of accounts and performance by the Pension Committee. | • Detailed testing of journal entries.<br>• Review of accounting estimates for bias.<br>• Evaluating significant transactions that are outside the normal course of business.<br>• Focused testing of regularity and cut-off assertions during the financial statements audit. |

# Falkirk Council Pension Fund

## External Audit Update

AUDIT SCOTLAND

Prepared for the Falkirk Council Pensions Committee - March 2015

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

# Contents

## Introduction

1. The Local Authority Accounts Regulations (Scotland) Regulations 2014 introduced a number of key changes which impact on the financial statements of local authorities (including Pension funds), including the introduction of a:
   - a management commentary (see details at paragraphs 4 to 8).
   - an annual governance statement (see details at paragraphs 8 to 15).
2. The regulations also require that the annual accounts to include
   - A statement of responsibilities prepared in accordance with the Code of Practice in Local Government Accounting in the United Kingdom (the *Code*) 2014/15 as adapted by paragraph 5 of finance circular 7/2014
   - A remuneration report or statement that no remuneration report is required because no persons have received remuneration that requires to be disclosed.
3. Additionally, the regulations set out the process for approving the unaudited and audited annual accounts.

## Management commentary

4. Pension Fund regulations already require a report on management and performance to be included in the annual accounts. The 2014 regulations introduce a requirement from 2014/15 for the annual accounts to include a management commentary. This is to take into account the relevant provisions of the Government financial reporting manual (FReM) in respect of management commentaries.
5. Separate guidance from the Scottish Government is currently being drafted which will align to the reporting requirements in the FReM. The FReM requires the management commentary to comprise:
   - a **strategic report** that includes
     - a fair review of the fund's business and a description of the principal risks and uncertainties it faces. The FReM states that, while the report should be self-standing and comprehensive, it is permitted to provide a summary with adequate cross-references to other documents where they provide the full information required
     - an analysis using financial and other key performance indicators
     - the main trends and factors likely to affect the future development, performance and position of the fund's business
     - additional explanations of amounts included in the fund's financial statements.
     - information on social, community and human rights issues, including information about any policies of the fund in relation to those matters and the effectiveness of those policies
     - a description of the body's strategy and business model

- a breakdown showing at the end of the financial year the number of persons of each gender who were directors, senior managers and employees of the body.

- a **directors' report** disclosing the matters required by sections 416 of the Companies Act 2006 and Schedule 7 of The Large and Medium-sized companies and Groups (Accounts and Reports) Regulations 2008 (as amended) with additional matters required by FReM paragraph such as sickness absence data and personal data related incidents.

6. The management commentary in the audited annual accounts requires to be signed by the proper officer, the Convener of the Pensions Committee and the Chief Executive of the Council. There is no requirement for the unaudited version to be signed.

### Auditors' responsibilities

7. Auditors are required to read the management commentary and express an opinion in the auditor's report as to whether it is consistent with the financial statements. An inconsistency is anything in the management commentary that contradicts information contained in the audited financial statements. Inconsistencies include
   - differences between amounts or narrative appearing in the financial statements and the management commentary
   - differences between the bases of preparation of related items where the figures are not directly comparable and the different bases are not disclosed
   - contradictions between figures in the financial statements and the narrative explanation of those figures in the management commentary.

## Annual Governance Statement /Governance Compliance Statement

8. Regulation 5 of the 2014 regulations introduces a new requirement from 2014/15 for local authorities (including Pension Funds) to undertake an annual review of their system of internal control and report this in an annual governance statement. Regulation 8(2) requires the annual governance statement to be published as part of the annual accounts

9. The regulations require the annual governance statement to be prepared in accordance with proper practices in relation to internal control, which are those set out in *Delivering good governance in local government: framework* published by CIPFA and SOLACE.

10. Pension administration regulations require an administering authority to prepare and publish a Governance compliance statement for the pension fund. The statement is required to provide detail regarding the delegation of the pension fund function, and set out the extent to which the governance arrangements for the pension fund comply with guidance from the Scottish Ministers.

11. Auditors are required to review the governance compliance statement and annual governance statement (or combined governance statement where that option is chosen) and report by exception in the auditor's report if they do not comply with relevant requirements. Auditors are also required to identify any information that is apparently materially incorrect based on, or

materially inconsistent with, the knowledge acquired by auditors in the course of performing the audit.

## Compliance with requirements

### Annual governance statement

12. Local authorities (including pension Funds) under the 2014 regulations are responsible for ensuring that the financial management of the pension fund is adequate and effective and that there is a sound system of internal control. They are required to conduct a review at least once in each financial year of the effectiveness of its system of internal control. The findings of the review require to be considered at a meeting of the committee whose remit includes audit or governance (i.e. Pensions Committee). This should also include the findings of any assessment of the efficiency and effectiveness of its internal auditing service.

13. Following consideration of the review findings, the committee is required to approve an annual governance statement (AGS). The AGS being part of the annual accounts should be approved before the end of June (best practice).

14. The AGS should be prepared in line with *Delivering good governance in local government* and an addendum. In summary, the following information should be included in the statement

    - An acknowledgement of responsibility for ensuring there is a sound system of governance (incorporating the system of internal control).
    - An indication of the level of assurance that the systems and processes that comprise the pension fund's governance arrangements can provide.
    - A brief description of the key elements of the governance framework
    - A brief description of the process that has been applied in maintaining and reviewing the effectiveness of the governance arrangements, including some comment on the role of Pensions Committee and Panel, internal audit and other explicit reviews/ assurance mechanisms.
    - An outline of the actions taken, or proposed, to deal with significant governance issues including an agreed action plan.
    - A specific statement on whether the fund's financial management arrangements conform with the governance requirements of the CIPFA *Statement on the role of the chief financial officer in the local government pension scheme*; and, where they do not, an explanation of how they deliver the same impact.

15. There is no requirement for the unaudited version to of the AGS to be signed although it is best practice for it to be approved prior to inclusion in the annual accounts.

### Governance compliance statement

16. The administration regulations require the governance compliance statement to set out the following details relating to the delegation of the pension fund function

    - the terms, structure and operational procedures of the delegation

- the frequency of any committee or sub-committee meetings
- whether such a committee or sub-committee includes representatives of employing authorities or members and, if so, whether those representatives have voting rights.

17. Guidance from Scottish Ministers sets out nine principles (e.g. structure; representation; selection and role of lay members; voting, etc) against which administering authorities should measure their governance arrangements. Where compliance does not meet a principle, there is a requirement to set out any reasons for non-compliance in the statement.

### Consistency with financial statements and auditors knowledge

18. Auditors are required to read the governance compliance statement and annual governance statement (or combined governance statement) to identify any material inconsistencies with the financial statements. An inconsistency arises when information in the statement contradicts information contained in the financial statements.

19. Audit Scotland does not require appointed auditors in the public sector to provide an explicit opinion on consistency with the governance statements. Auditors should instead report a material inconsistency.

20. The administration regulations allow an authority the option of giving details of where the governance compliance statement can be obtained rather than including it in the annual report. The auditors' responsibilities to read and report on the statement continue to apply. The 2014 regulations require the annual governance statement to be included in the document and not just simply referred to. This would also apply to a combined governance statement.

## Approval and publication of local authority accounts (including pension fund annual accounts)

21. From 2014/15, the 2014 regulations provide for the approval and publication of local authority annual accounts, including the pension fund annual accounts as detailed below

### Unaudited accounts

22. Regulation 8(5) introduces new requirements for the proper officer under section 95 of the 1973 Act to ensure that the financial statements give a true and fair view of the pension fund's financial position and transactions and that the statement of responsibilities accurately reflects the proper officer's responsibilities.

23. Regulation 8(6) requires the proper officer to certify the above by signing and dating the statement of responsibilities and the net assets statement and then submit the annual accounts to the appointed external auditor no later than 30 June.

24. Regulation 8(8) introduces a new requirement to publish the unaudited annual accounts on the website of the authority until the date on which the audited annual accounts are published.

25. Regulation 8(9) introduces a requirement for the authority, or a committee whose remit includes audit or governance (i.e. Pensions Committee) to consider the unaudited annual accounts at a meeting by 31 August.

## Approval of audited accounts

26. Regulation 10 sets out the process for the consideration and signing of the audited annual accounts as follows

- The Pensions Committee (whose remit includes audit or governance) is required to meet to consider whether to approve the audited annual accounts for signature.
- In making this consideration, the regulations require elected members to have regard to any report made, or advice provided, on the annual accounts by the proper officer or auditor (e.g. ISA 260 communication).
- The Pensions Committee is required to aim to approve the audited annual accounts for signature no later 30 September.

27. Immediately following approval, the statements which form part of the annual accounts require to be signed and dated by the following individuals

- the management commentary by the proper officer, the Chief Executive and the Convener of the Pensions Committee
- the statement of responsibilities by the Chief Executive and the proper officer. The Convener of the Pensions Committee is also required to certify that the annual accounts have been approved for signature, and the proper officer is required to re-certify that the financial statements give a true and fair view
- the annual governance statement by the Chief Executive and the Convener of the Pensions Committee
- the remuneration report (if required) by the Chief Executive and the Convener of the Pensions Committee
- the net assets statement by the **proper officer to authorise** the financial statements for issue using the form of words set out in the *Code*.

28. Following signature, the proper officer is required to provide the signed annual accounts to the auditor. Regulation 10(8) requires any further reports made on the annual accounts by the auditor after they have been approved the annual audit report to also be considered by the Pensions Committee.

## Publication of audited accounts

29. Regulation 11 requires an authority to publish on its website the signed pension fund audited annual accounts, and the audit certificate, by 31 October. The annual audit report is required to be published on the website by 31 December. Copies of these documents should remain on the website for at least five years. Any statutory reports on the accounts under section 102 of the 1973 Act should also be published on the website for every year to which the report relates.

AGENDA ITEM 5

**FALKIRK COUNCIL**

| | |
|---|---|
| **Subject:** | **PENSION FUND – FUNDING STRATEGY STATEMENT** |
| **Meeting:** | **JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE** |
| **Date:** | **12 MARCH 2015** |
| **Author:** | **CHIEF FINANCE OFFICER** |

## 1. INTRODUCTION

1.1 The Local Government Pension Scheme requires all administering authorities to prepare, maintain and publish a Funding Strategy Statement ("FSS").

1.2 The FSS for the Falkirk Council Pension Fund has been updated to take account of the 2014 Valuation process and a copy of the revised document is attached as an appendix to this report.

## 2. BACKGROUND

2.1 The Fund is required to maintain a Funding Strategy Statement in accordance with Regulation 31 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

2.2 The FSS is the formal record of the approach the Fund intends to take in funding its liabilities.

2.3 Government guidance states that the FSS should:

- identify how employers' scheme liabilities are to be met going forward;
- have stability of employer contribution rates as a key objective; and
- encourage a prudent long-term view to be taken in the funding of liabilities

2.4 It is recognised that funding objectives, such as securing long term fund solvency and maintaining stable contribution rates, may be contradictory and it is a function of the FSS to balance these conflicting aims.

2.5 The existence of the FSS ensures that there is transparency around the Fund's funding aims and objectives as well as providing stakeholders with reassurance that funding matters will be dealt with equitably and in a consistent manner.

## 3. FUNDING STRATEGY STATEMENT

3.1 The changes that have been made relate to both style and content.

3.2 The entire narrative has been re-written to improve readability and a number of areas expanded to provide more detail. This includes the triggers for moving "at risk" employers to a more prudent funding basis; strategies for employers seeking to leave the Fund; and the options available to employers who may need to transfer sections of staff to a new employer.

3.3 In addition, the FSS continues to hold information that is essential to the actuary when setting employer contribution rates, including:

- the range of deficit recovery periods permitted
- the assessment of employer covenant
- the phasing in of contribution rises or reductions
- the circumstances in which employers may be allowed to pay a "stabilised "contribution rate
- the treatment of surpluses
- the interaction of funding and investment strategies

3.4 The FSS also contains a detailed section on the types of risk that could impact on the funding strategy and the steps taken to reduce that risk.

## 4. CONSULTATION PROCESS

4.1 In reviewing the FSS, the Fund must:

- consult with "such persons as they consider appropriate"; and
- have regard to the guidance of the Chartered Institute of Public Finance and Accountancy (CIPFA)

4.2 The revised FSS has been drafted in accordance with the necessary CIPFA Guidance and with the assistance of Hymans Robertson, the Fund's Actuarial Advisers.

4.3 The FSS was circulated to all Committee and Panel Members and to all Fund employers in early February. No comments have been received in response.

## 5. CONCLUSION

5.1 In accordance with Scheme rules, the Funding Strategy Statement has been reviewed with input from the Fund Actuary. Various updates have been made to the document to ensure that it is aligned with the 2014 valuation process and is reflective of the Fund's current approach to funding its liabilities.

## 6. RECOMMENDATIONS

**6.1 The Panel and Committee is asked to note the revised Funding Strategy Statement of the Falkirk Council Pension Fund.**

**6.2 The Committee is asked to approve the revised Funding Strategy Statement of the Falkirk Council Pension Fund**

**Chief Finance Officer**

**Date: 1 March 2015**

**Contact Officer: Alastair McGirr**

**LIST OF BACKGROUND PAPERS**

NIL

Falkirk Council
Chief Executive Office
(Finance Services)

# Falkirk Council Pension Fund

## Local Government Pension Scheme

## Funding Strategy Statement

# Contents

DRAFT Funding Strategy Statement — PAGE

# 1 Introduction

### 1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the Falkirk Council Pension Fund ("the Fund"), which is administered by Falkirk Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser. It is effective from 31 March 2015.

### 1.2 What is the Falkirk Council Pension Fund?

The Fund is part of the national Local Government Pension Scheme (Scotland) (referred to in this document as the "LGPS"). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the Falkirk Council Pension Fund, in effect the LGPS for the Central Scotland area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth;
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS (Scotland) Regulations. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

### 1.3 Why does the Fund need a Funding Strategy Statement?

Employees' benefits are guaranteed by the LGPS (Scotland) Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees' contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in Appendix A.

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the Local Government Pension Scheme (Scotland) Regulations 2014 ("the Regulations") and previous LGPS (Scotland) regulations where these may still apply;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Statement of Investment Principles (see Section 4).

### 1.4 How does the Fund and this FSS affect me?

This depends who you are:

- a member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;
- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, and in what circumstances you might need to pay more. Note that the FSS applies to all employers participating in the Fund;
- an Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- a Council Tax payer: your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

### 1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- 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.

### 1.6 How do I find my way around this document?

In Section 2 there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In Section 3 we outline how the Fund calculates the contributions payable by different employers in different situations.

In Section 4 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail if you are interested:

A. the regulatory background, including how and when the FSS is reviewed,

B. who is responsible for what,

C. what issues the Fund needs to monitor, and how it manages its risks,

D. some more details about the actuarial calculations required,

E. the assumptions which the Fund actuary currently makes about the future,

F. a glossary explaining the technical terms occasionally used here.

If you have any other queries please contact the Falkirk Council Pension Fund in the first instance at:

Pensions Section or pensions@falkirk.gov.uk
PO Box 14882
Falkirk Council
Municipal Buildings
Falkirk
FK1 5ZF

# 2 Basic Funding issues

(More detailed and extensive descriptions are given in Appendix D).

### 2.1 How does the actuary calculate a contribution rate?

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being built up from year to year, referred to as the "*future service rate*"; plus

b) an adjustment for the difference between the assets built up to date and the value of past service benefits, referred to as the "*past service adjustment*". If there is a deficit, the past service adjustment will be an increase in the employer's total contribution; if there is a surplus, there may be a reduction in the employer's total contribution. Any past service adjustment will aim to return the employer to full funding over an appropriate period (the "deficit recovery period").

### 2.2 How is a deficit (or surplus) calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets, to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

A larger deficit will give rise to higher employer contributions. If a deficit is spread over a longer period then the annual employer contribution is lower than if it is spread over a shorter period.

### 2.3 How are contribution rates calculated for different employers?

The Fund's actuary is required by the Regulations to report the *Common Contribution Rate*, for all employers collectively at each triennial valuation, combining items (a) and (b) above. This is based on actuarial assumptions about the likelihood, size and timing of benefit payments to be made from the Fund in the future, as outlined in Appendix E.

The Fund's actuary is also required to adjust the *Common Contribution Rate* for circumstances specific to each individual employer. The sorts of specific circumstances which are considered are discussed in Section 3. It is this adjusted contribution rate which the employer is actually required to pay, and the rates for all employers are shown in the Fund's Rates and Adjustments Certificate.

In effect, the *Common Contribution Rate* is a notional quantity, as it is unlikely that any employer will pay that exact rate. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific circumstances.

Details of the outcome of the Actuarial Valuation as at 31 March 2014 can be found in the formal valuation report dated [TBC], including an analysis at Fund Level of the *Common Contribution Rate*. Further details of individual employer contribution rates can also be found in the formal report.

### 2.4 What else might affect the employer's contribution?

Employer covenant (see glossary) and likely term of membership are also considered when setting contributions: more details are given in Section 3.

For some employers it may be agreed to pool contributions, see 3.4.

Any costs due to non ill-health early retirements must be paid by the employer, see 3.6.

The contribution rate payable by each employer will be effected by whether they are open or closed to new entrants, see D.2.

If an employer is approaching the end of its participation in the Fund then its contributions may be amended appropriately, so that the assets meet (as closely as possible) the value of its liabilities in the Fund when its participation ends.

Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of the higher rate will be taken by the Fund Actuary at subsequent valuations.

### 2.5 What different types of employer participate in the Fund?

Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate.

In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: contractors, housing associations, charities, etc.

The LGPS (Scotland) Regulations define various types of employer as follows:

**Scheduled bodies** - councils and other specified employers such as further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS (Scotland) Regulations.

**Admission bodies** - employers able to participate in the Fund via an admission agreement. These employers are generally those with a "community of interest" with another scheme employer – **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer – **transferee admission bodies** ("TAB"). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements, as per the Fund's approach to admissions, are not met.

### 2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher pension Fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;
- Contributions which further education establishments pay to the Fund will therefore not be available to pay for providing education;

- Other employers will provide various services to the local community, perhaps through housing associations, charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;
- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result;
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period;
- There is a statutory requirement for contribution rates to be set at a level so as to ensure the solvency of the Fund.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see 3.1). In deciding which of these techniques to apply to any given employer, the Fund will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc. This helps the Fund establish a picture of the financial standing of the employer, i.e. its ability to meet its long term Fund commitments.

For instance, where an employer is considered relatively low risk then the Fund will permit greater smoothing (such as stabilisation or a longer deficit recovery period relative to other employers) which may temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, an employer whose risk assessment indicates a less strong covenant will generally be required to pay higher contributions (for instance, with a more prudent funding basis or a shorter deficit recovery period relative to other employers). This is because of the higher probability that at some point it will fail or be unable to meet its pension contributions, with its deficit in the Fund then falling to other Fund employers.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see Appendix A.

# 3 Calculating contributions for individual Employers

## 3.1 General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of methods which the Administering Authority may permit, in order to improve the stability of employer contributions. These include, where circumstances permit:-

- capping of employer contribution rate changes from one year to the next, within a pre-determined range ("stabilisation");
- the use of extended deficit recovery periods;
- the phasing in of contribution rises or reductions;
- the pooling of contributions amongst employers with similar characteristics; and
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

These methods and the associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

## 3.2 The effect of paying contributions below the theoretical market implied level

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than the theoretical market implied contribution rate at the valuation date. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the choice of funding method;
- lower contributions in the short term will be assumed to incur a greater loss of investment returns on the deficit. Thus, deferring a certain amount of contribution will lead to higher contributions in the long-term; and
- it will take longer to reach full funding, all other things being equal.

Overleaf (3.3) is a summary of how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

Section 3.4 onwards deals with various other funding issues which apply to all employers.

### 3.3 The different approaches used for different employers

| **Type of employer** | **Scheduled Bodies** | | **Community Admission Bodies** | | **Transferee Admission Bodies** |
|---|---|---|---|---|---|
| **Sub-type** | **Local Authorities and similar employers (see note (a))** | **Police, Fire and other eligible employers (see note (b))** | **Open to new entrants** | **Closed to new entrants** | **(all)** |
| **Basis used** | Ongoing, assumes long-term Fund participation (see Appendix E) | | Ongoing, but may move to "gilts basis" - see Note (c) | | Ongoing, assumes fixed contract term in the Fund (see Appendix E) |
| **Pooling** | For contribution rate setting only (individual asset shares are tracked) | No pooling | Pooled contribution rates for employers with fewer than 30 members at the valuation date (See 3.4) | | No pooling |
| **Future service rate approach** | Projected Unit Credit (see Appendix D – D.2 | | | Attained Age (see Appendix D – D.2 | Projected Unit Credit (see Appendix D – D.2 |
| **Stabilised rate?** | Yes - see Note (d) | | No | | |
| **Maximum deficit recovery period Note (e)** | 20 years | | Various – see note (e) | | Outstanding contract term or future working lifetime – whichever is shortest |
| **Deficit recovery payments Note (f)** | Monetary amount (unless otherwise agreed) | | | | |
| **Treatment of surplus** | Covered by stabilisation arrangement | | Preferred approach: contributions kept at future service rate. However, reductions may be permitted by the Admin. Authority | | Reduce contributions by spreading the surplus over the remaining contract term. |
| **Phasing of contribution changes** | Covered by stabilisation arrangement | | 3 years - Note (g) | | Not permitted |
| **Review of rates Note (f)** | Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations. | | | | |
| **New employer** | n/a | | Note (i) | | Notes (i) & (j) |
| **Cessation debt payable** | Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the event of cessation occurring (e.g. machinery of Government changes), the cessation debt principles applied would be as per Note (k). | | Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (k). | | Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising. |

**Note (a)** 'The Local Government Group' of employers;

- Clackmannanshire Council
- Falkirk Council
- Stirling Council
- Central Scotland Joint Valuation Board

**Note (b)** Other employers with stabilised rates;

- Scottish Fire and Rescue Service
- Scottish Police Authority
- Strathcarron Hospice
- Forth Valley College
- Scottish Environment Protection Agency (TBC)
- Scottish Children's Reporter Administration (TBC)
- Visit Scotland (TBC)

**Note (c)** (Basis for CABs) In the circumstances where:

- the employer is an Admission Body but not a Transferee Admission Body; and
- the employer has no guarantor; and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may vary the discount rate used to set employer contribution rate. In particular contributions may be set for an employer to achieve full funding on a more prudent basis (e.g. using a discount rate set equal to gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease.

**Note (d)** (Stabilisation)

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" (and may therefore be paying less than their theoretical contribution rate) should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority (see below) and;
- there are no material events which cause the employer to become ineligible, e.g. significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring).

On the basis of extensive modelling carried out for the 2014 valuation exercise (see Section 4), the stabilised details are as follows:

- For the period from 1 April 2015 to 31 March 2018, a maximum increase of 0.5% of pay p.a. and a maximum decrease of 0.5% of pay p.a. applies.

The stabilisation criteria and limits will be reviewed again at the 31 March 2017 valuation. This will take into account the employers' membership profiles, the issues surrounding employer security and other relevant factors.

The Administering Authority reserves the right to permit deviations from the stated stabilisation criteria, in recognition of the strength of employer covenant.

**Note (e)** (Deficit Recovery Periods)

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2015 for the 2014 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example where there were no new entrants.

Where stabilisation applies, the resulting employer contribution rate would be amended to comply with the stabilisation mechanism.

Following discussion with the Actuary, it is considered that the Administering Authority should target the recovery of any deficit over a period not exceeding 20 years. However, a recovery period of 20 years is not appropriate for all employers. The following table sets out the policy of the Administering Authority;

| Type of Employer | Maximum Length of Deficit Recovery Period |
|---|---|
| Scheduled Bodies | A period not exceeding 20 years |
| Community Admission Bodies admitted before 16/5/1975 | A period not exceeding 20 years (with any cessation deficit being shared across the participating Councils). |
| Community Admission Bodies admitted after 15/5/1975 with a guarantor or providing a community wide service across Central Scotland. | A period not exceeding 20 years (with any cessation deficit being met by the guarantor or, where one is not available, shared across the participating Councils) |
| Community Admission Bodies admitted after 15/5/1975 with neither a guarantor nor providing a community wide service across Central Scotland. | A period equal to the weighted average of the period during which the body's employee members are expected to be active members of the Fund (not exceeding 10 years). |
| Closed Bodies | The period during which the body's remaining members are |

| Type of Employer | Maximum Length of Deficit Recovery Period |
|---|---|
| | expected to be active members of the Fund. Subject to ratification by the Actuary, the recovery period may be extended depending on the ability and willingness of the employer to make good the deficit over a longer time period. |
| Transferee Admission Bodies | The period remaining to the end of the employer's contract (or the weighted average of the period during which the body's employee members are expected to be active members of the Fund if shorter) |

**Note (f)** (Deficit Recovery Payments)

The deficit recovery payments for each employer (or, for stabilised employers, the difference between the total stabilised rate and the valuation future service rate) will be expressed as fixed monetary amounts.

**Note (g)** (Phasing of contribution changes)

All phasing is subject to the Administering Authority being satisfied as to the strength of the employer's covenant.

An employer who is still in deficit will not be permitted to take a contribution reduction.

Employers will be permitted to pay less than the future service rate (i.e. if in surplus), subject to the assessment of the employer's covenant and only with agreement from the Administering Authority and the Fund Actuary.

**Note (h)** (Regular Reviews)

Such reviews may be triggered by significant events, including but not limited to: significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted), and/or an increased level of security or guarantee.

**Note (i)** (New Admission Bodies)

With effect from 1 February 2013, the Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date.  Under these Regulations, all new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond.  The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund; and
- the current deficit.

For all new Transferee Admission Bodies, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis.

The Administering Authority will only consider requests from Community Admission Bodies (or other similar bodies) to join the Fund if they are sponsored by a Scheduled Body with tax raising powers, guaranteeing their liabilities and also providing a form of security as above.

The above approaches reduce the risk to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

**Note (j)** (New Transferee Admission Bodies)

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council) to another organisation (a “contractor”). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees’ Fund benefits. The quid pro quo is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see Note (k).

Employers which “outsource” have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) Pooling

Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which is may be under the stabilisation approach.

ii) Letting employer retains pre-contract risks

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor’s contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) Fixed contribution rate agreed

Under this option the contractor pays a fixed contribution rate and doesn’t pay any cessation deficit.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from;

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above;

- redundancy and early retirement decisions.

**Note (k)** (Admission Bodies Ceasing)

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund;
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

Cessation from the Fund does not remove the employer's obligation to meet its liabilities in full.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

For Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

a) On the cessation of a pre-1975 Community Admission Body, any deficit will be recovered from Clackmannanshire, Falkirk and Stirling Councils;

b) Where there is a guarantor for future deficits and contributions, or where a robust letter of comfort has been provided from a revenue raising source (i.e. the Scottish Government), the cessation valuation will normally be calculated using the ongoing basis as described in Appendix E;

c) Alternatively, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee;

d) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

Under (b) and (d), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund would look to any bond, indemnity or guarantee in place for the employer.

In the event that the Fund is not able to recover the required cessation payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the

Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

### 3.4 Pooled contributions

From time to time the Administering Authority may set up pools for employers with similar characteristics. This will always be in line with its broader funding strategy.

With the advice of the Actuary the Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service.

Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not usually permitted to participate in a pool. Transferee Admission Bodies are usually ineligible for pooling.

Smaller admitted bodies may be pooled with the letting employer, provided all parties (particularly the letting employer) agree.

Employers who are permitted to enter (or remain in) a pool at the 2014 valuation will not normally be advised of their individual contribution rate unless agreed by the Administering Authority.

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

### 3.5 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended deficit recovery period, or permission to join a pool with another body (e.g. the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan;
- whether the admission agreement is likely to be open or closed to new entrants.

Please note the legal and actuarial costs of implementing additional flexibility would have to be paid by the employer.

### 3.6 Non ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). (**NB** the relevant age may be different for different periods of service, following the benefit changes from April 2009 and April 2015). Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

With the agreement of the Administering Authority the payment can be spread over 5 years.

### 3.7 Ill health early retirement costs

The Fund monitors each employer's ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the Actuary will be notified and this may lead to additional employer additional contributions on the same basis as apply for non-ill-health cases.

### 3.8 Ill health insurance

If an employer provides satisfactory evidence to the Administering Authority of a current insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged, and
- there is no need for monitoring of allowances.

The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

### 3.9 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis (see 3.3, Note (i)) and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:

a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;

b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the remaining assets would be apportioned pro-rata by the Fund's actuary to the other Fund employer;

c) In exceptional circumstances the Fund may permit an employer with no remaining active members to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases, as the employer would have no contributing members.

### 3.10 Bulk transfers

Bulk transfer situations will be dealt with as follows. Each case will be treated on its own merits, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities;
- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.

# 4 Funding strategy and links to investment strategy

## 4.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (SIP), which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out after each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

## 4.2 What is the link between funding strategy and investment strategy?

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa.

Therefore, the funding and investment strategies are inextricably linked.

## 4.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The asset outperformance assumption contained in the discount rate (see E3) is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government (see A1).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

## 4.4 How does this differ for a large stable employer?

The Actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

- Prudence - the Fund should have a reasonable expectation of being fully funded in the long term;
- Affordability – how much can employers afford;
- Stewardship – the assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position;
- Stability – employers should not see significant moves in their contribution rates from one year to the next, and this will help to provide a more stable budgeting environment.

The key problem is that the key objectives often conflict. For example, minimising the long term cost of the scheme (i.e. keeping employer rates affordable) is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down fairly frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

Therefore a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling: this is a set of calculation techniques applied by the Fund's actuary, to model the range of potential future solvency levels and contribution rates.

The Actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach (see 3.3 Note (b)). The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes as described in 3.3 Note (b), struck an appropriate balance between the above objectives (in particular, the level of projected contributions would lead to a high likelihood of achieving full funding over the next 20 years). The stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Fund.

### 4.5 Does the Fund monitor its overall funding position?

The Administering Authority monitors the relative funding position, i.e. changes in the relationship between asset values and the liabilities value, annually. It reports this to the regular Pensions Committee meetings, and also to employers through extensive governance arrangements.

# Appendix A – Regulatory framework

## A1 Why does the Fund need an FSS?

The Department for Communities and Local Government (DCLG) has stated that the purpose of the FSS is:

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

These objectives are desirable individually, but may be mutually conflicting.

The requirement to maintain and publish a FSS is contained in LGPS (Scotland) Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2012) and to its Statement of Investment Principles.

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

## A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS (Scotland) Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to "consultation with such persons as the authority considers appropriate", and should include "a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers".

In practice, for the Fund, the consultation process for this FSS was as follows:

a) A draft version of the FSS was issued to all participating employers for comment;

b) Comments were requested from employers in tandem with discussions relating to each organisations funding position;

c) Questions regarding the FSS could be raised by employers at any time during this engagement period;

d) Following the end of the consultation period the FSS was updated, where required and then published.

## A3 How is the FSS published?

The FSS is made available through the following routes:

- Publicised on the website at www.falkirkpensionfund.org;
- A copy sent to each participating employer in the Fund
- A copy included as part of Committee papers and available to employee and pensioner representatives;
- A copy made reference to in the annual report and accounts of the Fund;
- Copies sent to investment managers and independent advisers;
- Copies made available on request.

### A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2017.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Pensions Committee and would be included in the relevant Committee Meeting minutes.

### A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Statement of Investment Principles, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at www.falkirkpensionfund.org

# Appendix B – Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to each play their part.

## B1 The Administering Authority should:-

- operate the Fund as per the LGPS (Scotland) Regulations;
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
- collect employer and employee contributions, and investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles (SIP) and LGPS (Scotland) Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the Fund's actuary;
- prepare and maintain a FSS and a SIP, after consultation;
- notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the fund's performance and funding and amend the FSS/SIP as necessary and appropriate.

## B2 The Individual Employer should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

## B3 The Fund Actuary should:-

- prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS (Scotland) Regulations, and targeting each employer's solvency appropriately;
- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;

- advise on the termination of Admission Bodies' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

**B4 Other parties:-**

- investment advisers (either internal or external) should ensure the Fund's SIP remains appropriate, and consistent with this FSS;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the SIP;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund; and
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures.

# Appendix C – Key risks and controls

## C1 Types of risk

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

- financial;
- demographic;
- regulatory; and
- governance.

## C2 Financial risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term. | Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.<br><br>Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.<br><br>Analyse progress at three yearly valuations for all employers.<br><br>Inter-valuation roll-forward of liabilities between valuations at whole Fund level. |
| Inappropriate long-term investment strategy. | Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes.<br><br>Chosen option considered to provide the best balance. |
| Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities. | Stabilisation modelling at whole Fund level allows for the probability of this within a longer term context.<br><br>Inter-valuation monitoring, as above.<br><br>Some investment in bonds helps to mitigate this risk. |
| Active investment manager under-performance relative to benchmark. | Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark. |
| Pay and price inflation significantly more than anticipated. | The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.<br><br>Inter-valuation monitoring, as above, gives early warning.<br><br>Some investment in bonds also helps to mitigate this |

| Risk | Summary of Control Mechanisms |
|---|---|
| | risk.<br><br>Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees. |
| Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies | An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions. |
| Orphaned employers give rise to added costs for the Fund | The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.<br><br>If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 3.9). |

## C3 Demographic risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Pensioners living longer, thus increasing cost to Fund. | Set mortality assumptions with some allowance for future increases in life expectancy.<br><br>The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation. |
| Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees. | Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies. |
| Deteriorating patterns of early retirements | Employers are charged the extra cost of non ill-health retirements following each individual decision.<br><br>Employer ill health retirement experience is monitored, and insurance is an option. |
| Reductions in payroll causing insufficient deficit recovery payments | In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:<br><br>Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (d) to 3.3).<br><br>For other employers, review of contributions is |

| Risk | Summary of Control Mechanisms |
|---|---|
| | permitted in general between valuations (see Note (h) to 3.3) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts. |

## C4 Regulatory risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform. | The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.<br><br>The results of the most recent reforms have been built into the 2014 valuation. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions. |

## C5 Governance risks

| Risk | Summary of Control Mechanisms |
|---|---|
| Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants. | The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.<br><br>The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions (under Regulation 34) between triennial valuations<br><br>Deficit contributions may be expressed as monetary amounts. |
| Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way | The Administering Authority maintains close contact with its specialist advisers.<br><br>Advice is delivered via formal meetings involving Elected Members, and recorded appropriately.<br><br>Actuarial advice is subject to professional requirements such as peer review. |
| Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body. | The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.<br><br>Community Admission Bodies' memberships are monitored and, if active membership decreases, steps |

| Risk | Summary of Control Mechanisms |
|---|---|
| | will be taken. |
| An employer ceasing to exist with insufficient funding or adequacy of a bond. | The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.<br><br>The risk is mitigated by:<br><br>Seeking a funding guarantee from another scheme employer, or external body, where-ever possible, or a letter of comfort from a tax-raising body (see Notes (i) and (k) to 3.3).<br><br>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.<br><br>Vetting prospective employers before admission.<br><br>Where permitted under the regulations requiring a bond to protect the Fund from various risks.<br><br>Requiring new Community Admission Bodies to have a guarantor.<br><br>Reviewing bond or guarantor arrangements at regular intervals (see Note (h) to 3.3).<br><br>Reviewing contributions well ahead of cessation if thought appropriate (see Note (c) to 3.3). |

# Appendix D – The calculation of Employer contributions

In Section 2 there was a broad description of the way in which contribution rates are calculated. This Appendix considers these calculations in much more detail.

The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

## D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the "future service rate"; plus

b) an adjustment for the funding position of accrued benefits relative to the Fund's solvency target, "*past service adjustment*". If there is a surplus there may be a reduction in the employer's contribution rate. If there is a deficit there will be an increase in the employer's contribution rate, with the surplus or deficit spread over an appropriate period. The aim is to return the employer to full funding over that period. See Section 3 for deficit recovery periods.

The Fund's actuary is required by the regulations to report the *Common Contribution Rate*[1], for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay; it is in effect an average rate across all employers in the Fund.

The Fund's actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to an individual employer[2]. It is the adjusted contribution rate which employers are actually required to pay. The sorts of "peculiar" factors which are considered are discussed below.

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

## D2 How is the Future Service Rate calculated?

The future service element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members' **future** service in the Fund. This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

The future service rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The calculation is on the "ongoing" valuation basis (see Appendix E), but where it is considered appropriate to do so the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a more prudent basis (see Section 3).

The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies that may have the power not to automatically admit all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

[1] See LGPS (Administration) Regulations 32(5).
[2] See LGPS (Administration) Regulations 32(7).

### a) Employers which admit new entrants

These rates will be derived using the "Projected Unit Method" of valuation with a one year period, i.e. only considering the cost of the next year's benefit accrual and contribution income. If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise over time.

### b) Employers which do not admit new entrants

For CABs, to give more long term stability to such employers' contributions, the "Attained Age" funding method is normally adopted. This measures benefit accrual and contribution income over the whole future anticipated working lifetimes of current active employee members.

For TABs, our standard approach is to use the "Projected Unit Method" with a control period equal to the remaining contract period of the Employer. This measures benefit accrual and contribution income over the expected contract period of current active employee members.

All approaches include expenses of administration to the extent that they are borne by the Fund, and include allowances for benefits payable on death in service and ill health retirement.

## D3 How is the Solvency / Funding Level calculated?

The Fund's actuary is required to report on the "solvency" of the whole Fund in a valuation which should be carried out at least once every three years. As part of this valuation, the actuary will calculate the solvency position of each employer.

'Solvency" is defined to be the ratio of the market value of the employer's asset share to the value placed on accrued benefits on the Fund actuary's chosen assumptions. This quantity is known as a funding level.

For the value of the employer's asset share, see D5 below.

For the value of benefits, the Fund actuary agrees the assumptions to be used with the Administering Authority – see Appendix E. These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer's current and former employees, based on pensionable service to the valuation date only (i.e. ignoring further benefits to be built up in the future).

The Fund operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see Section 3).

## D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

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

- the additional costs of any non ill-health retirements relative to any extra payments made;

over the period between each triennial valuation.

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

### D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus".

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

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

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification but not to audit standard. The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

# Appendix E – Actuarial assumptions

## E1 What are the actuarial assumptions?

These are expectations of future experience used to place a value on future benefit payments ("the liabilities"). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

Changes in assumptions will affect the measured value of future service accrual and past service liabilities, and hence the measured value of the past service deficit. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower liability values and lower employer costs. A more prudent basis will give higher liability values and higher employer costs.

## E2 What basis is used by the Fund?

The Fund's standard funding basis is described as the "ongoing basis", which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term, a more prudent basis may apply: see Note (c) to 3.3.

## E3 What assumptions are made in the ongoing basis?

### a) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund's investments. This "discount rate" assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds ("gilts"). There is, however, no guarantee that Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2014 and setting contribution rates effective from 1 April 2015, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.6% per annum greater than gilt yields at the time of the valuation (this is the same as that used at the 2011 valuation). In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

### b) Salary growth

Pay for public sector employees has continued to be restricted. Based on long term historical analysis of the membership in LGPS funds, the salary increase assumption at the 2014 valuation has been set to 0.5% above the retail prices index (RPI) per annum. This is a change from the previous valuation, which assumed a two year restriction at 1% per annum followed by longer term growth at RPI plus 1.5% per annum.

### c) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. This change was allowed for in the valuation calculations as at 31 March 2011. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the "formula effect" of the difference between RPI and CPI. At this valuation, we propose a reduction of 0.8% per annum. This is consistent with what we assumed at the 2011 valuation.

### d) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the Club Vita's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with CMI 2012 model assuming the current rate of improvements has reached a peak. This is a higher allowance for future improvements than was made in 2011.

The combined effect of the above changes from the 2011 valuation approach is to add around 1-2 years of life expectancy on average. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members' benefits.

### e) General

The same financial assumptions are adopted for all employers, in deriving the past service deficit and the future service rate: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

# Appendix F – Glossary

| | |
|---|---|
| **Actuarial assumptions/basis** | The combined set of assumptions made by the actuary, regarding the future, to calculate the value of **liabilities**. The main assumptions will relate to the **discount rate**, salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value. |
| **Administering Authority** | The council with statutory responsibility for running the Fund, in effect the Fund's "trustees". |
| **Admission Bodies** | Employers which voluntarily participate in the Fund, so that their employees and ex-employees are **members**. There will be an Admission Agreement setting out the employer's obligations. For more details (see 2.5). |
| **Common contribution rate** | The Fund-wide **future service rate** plus **past service adjustment**. It should be noted that this will differ from the actual contributions payable by individual **employers**. |
| **Covenant** | The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term. |
| **Deficit** | The shortfall between the assets value and the **liabilities** value. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions). |
| **Deficit repair/recovery period** | The target length of time over which the current **deficit** is intended to be paid off. A shorter period will give rise to a higher annual **past service adjustment** (deficit repair contribution), and vice versa. |
| **Discount rate** | The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day. This is necessary to provide a **liabilities** value which is consistent with the present day value of the assets, to calculate the **deficit**. A lower discount rate gives a higher liabilities value, and vice versa. It is similarly used in the calculation of the **future service rate** and the **common contribution rate**. |
| **Employer** | An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **liabilities** values for each employer are individually tracked, together with its **future service rate** at each **valuation**. |
| **Funding level** | The ratio of assets value to **liabilities** value: for further details (see 2.2). |
| **Future service rate** | The actuarially calculated cost of each year's build-up of pension by the current active **members**, excluding members' contributions but including Fund administrative expenses. This is calculated using a chosen set of **actuarial assumptions**. |

| | |
|---|---|
| **Gilt** | A UK Government bond, i.e. a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency. |
| **Guarantee / guarantor** | A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's. |
| **Letting employer** | An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority, but can sometimes be another type of employer. |
| **Liabilities** | The actuarially calculated present value of all pension entitlements of all **members** of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the **deficit**. It is calculated on a chosen set of **actuarial assumptions**. |
| **LGPS** | The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 101 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers. |
| **Maturity** | A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy. |
| **Members** | The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees). |
| **Past service adjustment** | The part of the employer's annual contribution which relates to past service **deficit** repair. |
| **Pooling** | Employers may be grouped together for the purpose of calculating contribution rates, so that their combined membership and asset shares are used to calculate a single contribution rate applicable to all employers in the pool. A pool may still require each individual employer to ultimately pay for its own share of **deficit**, or (if formally agreed) it may allow **deficits** to be passed from one employer to another. |

For further details of the Fund's current pooling policy (see 3.4).

| | |
|---|---|
| **Profile** | The profile of an employer's membership or liability reflects various measurements of that employer's **members**, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also. |
| **Rates and Adjustments Certificate** | A formal document required by the LGPS (Scotland) Regulations, which must be updated at least every three years at the conclusion of the formal **valuation**. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed. |
| **Scheduled Bodies** | Types of employer explicitly defined in the LGPS (Scotland) Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, police and fire authorities etc., other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers). |
| **Solvency** | In a funding context, this usually refers to a 100% **funding level**, i.e. where the assets value equals the **liabilities** value. |
| **Stabilisation** | Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS (Scotland) Regulations, but in practice is particularly employed for large stable employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these. |
| **Theoretical contribution rate** | The employer's contribution rate, including both **future service rate** and **past service adjustment**, which would be calculated on the standard **actuarial basis**, before any allowance for **stabilisation** or other agreed adjustment. |
| **Valuation** | An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is normally carried out in full every three years (last done as at 31 March 2014), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date also. |

**AGENDA ITEM 6**

# FALKIRK COUNCIL

**Subject:** **PENSION FUND – ACTUARIAL VALUATION AS AT 31/3/2014**
**Meeting:** **JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE**
**Date:** **12 MARCH 2015**
**Author:** **CHIEF FINANCE OFFICER**

## 1. INTRODUCTION

1.1 The Fund actuary, Hymans Robertson, has carried out a valuation of the Pension Fund as at 31 March 2014 in accordance with Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

1.2 The purpose of the valuation is to establish the financial position of the Fund and set an appropriate rate of employers' contribution for the next three years (i.e. from April, 2015 until March, 2018).

1.3 The results of the valuation, as it impacted on the Fund as a whole, were presented to the Joint Meeting of Panel and Committee on 11 December 2014.

1.4 The signed valuation report is attached as an Appendix to this report and contains both details of the whole fund position as well as the contribution rates to be paid by each of the Fund's participating employers.

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## 2. VALUATION RESULTS

2.1 The key results of the valuation at 31 March 2014 are set out below, together with the results from the last valuation on 31 March 2011.

| | 2011 Valuation (£m) | 2014 Valuation (£m) |
|---|---|---|
| Liabilities | £1,392 | £1,860 |
| Assets | £1,199 | £1,577 |
| *Deficit* | *£193* | *£283* |
| | | |
| Funding Level | 86.1% | 84.8% |

2.2 The results show that the deficit (i.e. the difference between liabilities and assets) has risen from from £193m to £283m and that there has been a slight fall in the funding level from 86% to 85%.

2.3 The table overleaf shows the contribution rates that are necessary to meet the cost of ongoing benefit accrual (i.e. future service rate) and deficit payments over a 20 year recovery period (i.e. past service deficit).

| | 2011 Valuation (% of pay) | 2014 Valuation (% of pay) |
|---|---|---|
| Cost of Future Service | 16.2% | 17.9% |
| Past Service Deficit | 4.3% | 5.5% |
| *Total Employer Contribution Rate* | *20.5%* | *23.4%* |
| | | |
| Employee Contribution | 6.5% | 5.8% |

2.4 The increase in the deficit and rise in the theoretical employer contribution rate is mainly attributable to the fall in yields on Government Bonds which has placed a higher value on the Fund's liabilities.

2.5 Other material factors to emerge from the valuation are:

- Employee contributions are expected to fall due to LGPS 2015
- Average age of members has stayed unchanged largely due to auto enrolment of new members
- Three yearly Fund return was 27.7% against the targeted actuarial return of 18.8%
- Club Vita analysis has allowed more Fund specific longevity assumptions to be applied

## 3. EMPLOYER CONTRIBUTION RATES

3.1 In calculating a contribution rate for each fund employer, the actuary will take the terms of the Funding Strategy Statement into account, and in particular, factors such as;

- the intervaluation experience of the employer
- the demographic profile of an employer's membership
- the strength of the employer covenant
- the type of organisation (local authority, admitted body, contractor)
- whether an employer is part of pooled group
- whether an employer is open or closed to new members
- whether an employer is approaching a cessation scenario

3.2 The pooled groupings within the Fund are set out in detail in the Funding Strategy Statement and are as follows:

- the local authority pool, comprising Clackmannanshire, Falkirk and Stirling Councils, and the Joint Valuation Board ; and
- the small admission bodies pool

3.3 The use of a pool is of particular benefit to the smaller admitted bodies as it enables them to enjoy a more stable contribution rate than would be otherwise be the case.

## 4. STABILISATION

4.1 In view of the financial pressures faced by Fund employers in meeting their theoretical contribution rate, the actuary was again asked to explore the impact of capping contribution increases. The result of the actuarial modelling indicates that it remains justifiable to limit employer contribution rate changes to +/- 0.5% of pay per annum for the three years from 1 April 2015, subject to this strategy – known as stabilisation – being available only to employers with a strong covenant. This is also subject to employers paying a minimum of their future service rate and a material contribution towards the past service deficit.

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4.2 In relation to the three Councils – who account for around 80% of the Fund - their theoretical employer contribution rate is roughly 25% of pay. However, as a result of stabilisation, the actuary was comfortable with and has authorised the undernoted rates:

| | | |
|---|---|---|
| 2015/16 | - | 21% |
| 2016/17 | - | 21% |
| 2017/18 | - | 21.5% |

4.3 Employers whose contribution rates have been "stabilised", and who are paying less than their theoretical rate may find their funding level deteriorating over the next valuation period especially if economic conditions do not improve. These employers have been made aware of the risks of stabilising and will be advised that they should consider making additional payments to the Fund if possible.

4.4 The contribution rates of employers who are not participating in the stabilisation strategy have been calculated, in the case of smaller admitted bodies, on a pooled basis, and for remaining employers, according to their individual circumstances.

## 5. COMMUNICATION AND ENGAGEMENT

5.1 Details of individual contribution rates were circulated to employers in mid-January.

5.2 The Pensions Manager and the Fund Actuary have held individual meetings with around 25 (out of 36) fund employers. The meetings disclosed that several of the employers – mainly small admitted bodies - wish to investigate exiting from the Fund. Overall, the meetings have elicited a positive response and have helped ensure that employers understand the true nature of their liabilities and the consequences of closure.

## 6. CONCLUSION

6.1 The 2014 actuarial valuation has disclosed that the funding level is 85% - largely unchanged from level shown at the 2011 valuation. The size of the deficit has increased to £283m, due in the main to the fall in gilt yields.

6.2 An up to date assessment of the funding level will be provided at the next Committee meeting.

## 7. RECOMMENDATION

**7.1 The Panel and Committee are asked to note the contents of the 2014 Pension Fund Valuation Report prepared by the Fund Actuary, Hymans Robertson.**

**Chief Finance Officer**

**Date: 1 March 2015**

**Contact Officer: Alastair McGirr**

**<u>LIST OF BACKGROUND PAPERS</u>**

NIL

Hymans Robertson LLP has carried out an actuarial valuation of the Falkirk Council Pension Fund ("the Fund") as at 31 March 2014, details of which are set out in the report dated DATE ("the Report"), addressed to Falkirk Council ("the Client"). The Report was prepared for the sole use and benefit of our Client and not for any other party; and Hymans Robertson LLP makes no representation or warranties to any third party as to the accuracy or completeness of the Report.

The Report was not prepared for any third party and it will not address the particular interests or concerns of any such third party. The Report is intended to advise our Client on the past service funding position of the Fund at 31 March 2014 and employer contribution rates from 1 April 2015, and should not be considered a substitute for specific advice in relation to other individual circumstances.

As this Report has not been prepared for a third party, no reliance by any party will be placed on the Report. It follows that there is no duty or liability by Hymans Robertson LLP (or its members, partners, officers, employees and agents) to any party other than the named Client. Hymans Robertson LLP therefore disclaims all liability and responsibility arising from any reliance on or use of the Report by any person having access to the Report or by anyone who may be informed of the contents of the Report.



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# Falkirk Council Pension Fund
# 2014 Actuarial Valuation
# Valuation Report

HYMANS ROBERTSON

March 2015

# Contents

# 1 Executive summary

We have carried out an actuarial valuation of the Falkirk Council Pension Fund ('the Fund') as at 31 March 2014. The results are presented in this report and are briefly summarised below.

## Funding position

The table below summarises the financial position of the Fund at 31 March 2014 in respect of benefits earned by members up to this date.

| Past Service Position | 31 March 2011 (£m) | 31 March 2014 (£m) |
|---|---|---|
| Past Service Liabilities | 1,392 | 1,860 |
| Market Value of Assets | 1,199 | 1,577 |
| Surplus / (Deficit) | (194) | (283) |
| | | |
| **Funding Level** | **86.1%** | **84.8%** |

The results show that the Fund had not met its objective of holding sufficient assets to meet the estimated current cost of the past service benefits as at 31 March 2014. The funding level has decreased from 86%, at the 2011 valuation to 85% at this valuation. This has resulted in the deficit rising from £194m at 31 March 2011 to £283m at 31 March 2014.

The increase in deficit reflects the adverse conditions which the Fund has had to contend with since the previous valuation. In particular, the decrease in the real gilt yield has increased the value placed on the Fund's liabilities. This has been partially offset by better than expected returns on the Fund's assets.

## Contribution rates

The table below summarises the average employer contribution rate that would be required, based on this triennial valuation.

| Contribution Rates | 31 March 2011 (% of pay) | 31 March 2014 (% of pay) |
|---|---|---|
| Employer future service rate (incl. expenses) | 16.2% | 17.9% |
| Past Service Adjustment (20 year spread) | 4.3% | 5.5% |
| Total employer contribution rate (incl. expenses) | 20.5% | 23.4% |
| Employee contribution rate | 6.5% | 5.8% |
| Expenses | 0.2% | 0.2% |

The increase in the total employer contribution rate is primarily due to the decrease in the real gilt yields which has increased both the employer future service rate and the past service adjustment.

The common contribution rate is a theoretical figure. In practice, each employer that participates in the Fund has its own underlying funding position and circumstances, giving rise to its own contribution rate requirement. The minimum contributions to be paid by each employer from 1 April 2015 to 31 March 2018 are shown in the Rates and Adjustment Certificate in **Appendix G**.

# 2 Introduction

## Purpose

We have carried out an actuarial valuation of the **Falkirk Council Pension Fund** as at 31 March 2014.

- This valuation report complies with all of the relevant regulations and professional standards, as set out in **section 7**.
- The figures in this report are based on our understanding of the benefit structure of the LGPS as at 31 March 2014, and changes being implemented from 1 April 2015, details of which are provided in **Appendix B**.
- The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. This data is summarised in **Appendix D**.
- As part of the valuation, assumptions must be made which are discussed in **section 3** as well as in **Appendix E.** Details of our valuation approach is covered in **Appendix C.**
- The valuation results are then covered in **section 4**.
- We look at some of the risks the Fund faces in **section 5** and consider any post valuation events in **Appendix F**.
- The valuation is just one aspect of the operation of the Fund, and related issues are covered in **section 6.**
- In **Appendix G** we then set out the individual employer contribution requirements from 1 April 2015.
- In **Appendix H** we show the expected cost of future ill health retirements (per annum).

## Component reports

This document is an “aggregate” report, i.e. it is the culmination of various “component” reports and discussions, in particular:

- The data report (dated 8 December 2014 and mentioned in **section 7**);
- The Initial Results Report (dated 8 December 2014) which outlined the preliminary assumption proposals and whole fund results;
- The formal agreement by the Administering Authority of the actuarial assumptions used in this document, at a meeting dated 11 December 2014;
- The stabilisation modelling carried out for certain employers, as detailed in our report and presentation to the Administering Authority dated 3 November 2014;
- The Funding Strategy Statement, confirming the different contribution rate setting approaches for different types of employer or in different circumstances.

Note that not all of these documents may be in the public domain.

# 3 Assumptions

## Actuarial assumptions

Assumptions must be made about the factors affecting the Fund's finances in the future. Broadly speaking, our assumptions fall into two categories – financial and demographic.

Demographic assumptions typically try to forecast **when** benefits will come into payment and what form these will take. For example, when members will retire (e.g. at their normal retirement age or earlier), how long they will then survive and whether a dependant's pension will be paid.

Financial assumptions typically try to anticipate the **size** of these benefits. For example, how large members' final salaries will be at retirement and how their pensions will increase over time. In addition, the financial assumptions also help us to estimate how much all these benefits will cost the Fund in today's money.

## Financial assumptions

A summary of the main financial assumptions adopted for the valuation of members' benefits are shown below.

| | 31 March 2011 | | 31 March 2014 | |
|---|---|---|---|---|
| **Financial assumptions** | **Nominal** | **Real** | **Nominal** | **Real** |
| Discount Rate | 5.9% | 3.1% | 5.1% | 2.4% |
| Salary Increases* | 5.1%** | 2.3% | 4.0% | 1.3% |
| Price Inflation / Pension Increases | 2.8% | - | 2.7% | - |

** Plus an allowance for promotional pay increases.*

*** 1% p.a. until 31 March 2013, reverting to 5.1% p.a. thereafter.*

### Discount rate

The funding valuation is effectively a planning exercise, to assess the funds needed to meet the benefits as they fall due. In order to place a current value on the future benefit payments from the Fund, an assumption about future investment returns is required in order to "discount" future benefit payments back to the valuation date at a suitable rate.

For a funding valuation such as this, the discount rate is set by taking into account the Fund's current and expected future investment strategy and, in particular, how this strategy is expected to outperform the returns from Government bonds over the long term. The additional margin for returns in excess of that available on Government bonds is called the Asset Outperformance Assumption (AOA).

The selection of an appropriate AOA is a matter of judgement and the degree of risk inherent in the Fund's investment strategy should always be considered as fully as possible.

Although there has been a slight downward shift in the expected returns on risky assets since the 2011 valuation, we believe the expected returns in excess of the returns on government bonds to be broadly unchanged since 2011. Therefore, we are satisfied that an AOA of 1.6% p.a. is a prudent assumption for the purposes of this valuation. This results in a discount rate of 5.1% p.a.

### Price inflation / pension increases

As was the case at the 2011 valuation, we expect the average long term difference between RPI and CPI to be 0.8% p.a.

At the previous valuation, the assumption for RPI was derived from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. At this valuation, we have adopted a similar approach.

## Salary increases

The long term assumption for salary increases is RPI plus 0.5% p.a. This translates to CPI plus 1.3% p.a. This is a change in approach from 2011 where we assumed 1% p.a. for 2 years and RPI plus 1.5% p.a. thereafter.

We have set a lower long term rate of salary growth to reflect both short term pay constraints and the belief that general economic growth and hence pay growth may be at a lower level than historically experienced for a prolonged period of time.

Note that this assumption is made in respect of the general level of salary increases (e.g. as a result of inflation and other macroeconomic factors). We also make a separate allowance for expected pay rises granted in the future as a result of promotion. This assumption takes the form of a set of tables which model the expected promotional pay awards based on each member's age and class. Please see **Appendix E**.

## Longevity

The main demographic assumption to which the valuation results are most sensitive is that relating to the longevity of the Fund's members. For this valuation, we have adopted assumptions which give the following sample average future life expectancies for members:

| | Actives & Deferreds | | Current Pensioners | |
|---|---|---|---|---|
| **Assumed life expectancy at age 65** | **Male** | **Female** | **Male** | **Female** |
| 2011 valuation - baseline | 19.3 | 22.2 | 19.3 | 22.2 |
| 2011 valuation - improvements | 22.0 | 25.0 | 20.7 | 23.8 |
| 2014 valuation - baseline | 19.8 | 22.4 | 19.8 | 21.8 |
| 2014 valuation - improvements | 24.3 | 26.3 | 22.1 | 23.8 |

Further details of the mortality assumptions adopted for this valuation can be found in **Appendix E**. Note that the figures for actives and deferreds assume that they are aged 45 at the valuation date.

## Assets

We have taken the assets of the Fund into account at their market value as indicated in the audited accounts for the period ended 31 March 2014.

In our opinion, the basis for placing a value on members' benefits is consistent with that for valuing the assets - both are related to market conditions at the valuation date.

## Demographic assumptions

We are in the unique position of having a very large local authority data set from which to derive our other demographic assumptions. We have analysed the trends and patterns that are present in the membership of local authority funds and tailor our demographic assumptions to reflect LGPS experience.

Details of these assumptions are set out in **Appendix E**. Further commentary on these was included in the Initial Results Report.

## Further comments on the assumptions

As required for Local Government Pension Scheme valuations, our proposed approach to this valuation must include a degree of prudence. This has been achieved by explicitly allowing for a margin of prudence in the AOA.

For the avoidance of doubt, we believe that all other proposed assumptions represent the “best estimate” of future experience. This effectively means that there is a 50% chance that future experience will be better or worse than the chosen assumption.

Taken as a whole, we believe that our proposed assumptions are more prudent than the best estimate. The assessed liability value on a “neutral” best estimate (not prudent) basis would perhaps be 15% to 20% lower than the figures shown here.

# 4 Results

The Administering Authority has prepared a Funding Strategy Statement which sets out its funding objectives for the Fund. In broad terms, the main 'past service' objective is to hold sufficient assets in the Fund to meet the assessed cost of members' past service benefits and the main 'future service' objective is to maintain a relatively stable employer contribution rate. These objectives are potentially conflicting.

### Past service

In assessing the extent to which the past service funding objective was met at the valuation date, we have used the actuarial assumptions described in the previous section of this report and funding method described in **Appendix C**. The table below compares the value of the assets and liabilities at 31 March 2014. The 31 March 2011 results are also shown for reference.

The results are presented in the form of a "funding level"; this is the ratio of the market value of assets to the assessed cost of members' past service benefits ("liabilities").

A funding level of 100% would correspond to the funding objective being met at the valuation date.

| Valuation Date | 31 March 2011 | 31 March 2014 |
|---|---|---|
| **Past Service Position** | ***(£m)*** | **(£m)** |
| Past Service Liabilities | | |
| Employees | 703 | 930 |
| Deferred Pensioners | 160 | 216 |
| Pensioners | 529 | 714 |
| Total Liabilities | 1,392 | 1,860 |
| Market Value of Assets | 1,199 | 1,577 |
| **Surplus / (Deficit)** | **(194)** | **(283)** |
| | | |
| **Funding Level** | **86.1%** | **84.8%** |

The main funding objective was not met: there was a shortfall of assets to the assessed cost of members' benefits of £283m.

### Summary of changes to the funding position

The chart below illustrates the factors that caused the funding position to deteriorate between 31 March 2011 and 31 March 2014:


Further comments on some of the items in this chart:

- There is an interest cost of £37m. This is broadly three years of compound interest at 5.9% p.a. applied to the previous valuation deficit of £194m.
- Employer contributions paid to the fund since 2011 have been greater than the cost of benefits accrued over this period, leading to a gain of £33m.
- Investment returns being higher than expected since 2011 led to a gain of £113m. This is roughly the difference between the actual three-year return (roughly 28%) and expected three-year return (roughly 19%) applied to the whole fund assets from the previous valuation of £1,199m, with a further allowance made for cashflows during the period.
- Actual experience over the period relates to the specific elements of member experience we are able to analyse and measure. In particular, the combined effect of early leaver, ill health retirement, salary growth, pension increases, pensioner longevity, cash commutation and early retirement experience since 2011 led to a loss of £9m. Please see the Initial Results document for more detail on the observed membership experience at the 2014 valuation.
- The impact of the change in demographic assumptions has been a loss of around £29m. Underlying this figure, changes to the ill health early retirements assumption have had a positive impact but this has been more than offset by assuming fewer withdrawals than at 2011.
- The change in longevity assumptions (baseline and improvements) has given rise to a gain of £50m. This is mainly due to the change in assumed baseline longevity (i.e. the adoption of Club Vita tables), the effect of which has been partially offset by the change in assumed future longevity improvements.
- The change in financial conditions between the previous valuation has led to a loss of £168m. This is due to a decrease in the real discount rate between 2011 and 2014.
- Other experience items, such as changes in the membership data, have served to increase the deficit at this valuation by around £42m.

Note that the benefit changes that come into effect as at 1 April 2015 do not change the funding position as all past service benefits to 31 March 2014 are protected.

### Future service

We have calculated the average long-term contribution rate that the Fund employers would need to pay to meet the estimated cost of members' benefits that will be earned after 31 March 2014 (the 'future service contribution rate'). Again, we have used the assumptions set out in the previous section of this report and the method set out in **Appendix C**. The resulting contribution rate is that which should (if the actuarial assumptions about the future are borne out in practice) ensure that the Administering Authority's main future service funding objective is met. The table below details this future service contribution rate for 31 March 2014 and shows the 31 March 2011 rate for comparison.

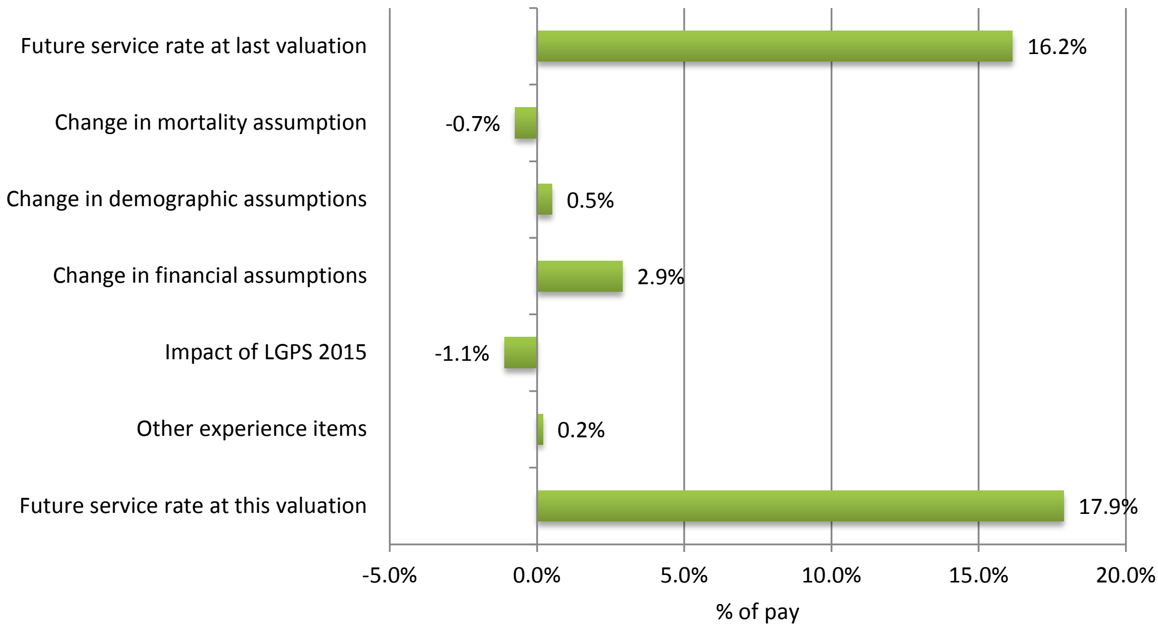
| Valuation Date | 31 March 2011 | 31 March 2014 |
|---|---|---|
| **Future service rate** | **% of pay** | **% of pay** |
| | | |
| Employer future service rate (excl. expenses) | 16.0% | 17.7% |
| Expenses | 0.2% | 0.2% |
| **Total employer future service rate (incl. expenses)** | **16.2%** | **17.9%** |
| Employee contribution rate | 6.5% | 5.8% |

Note that the employee contribution rate includes any additional contributions being paid by employees as at 31 March 2014 into the Fund. This future service contribution rate makes no allowance for the past service deficit in the Fund described above.

The average future service rate for Fund employers is 17.9% of pay. This rate is calculated as at 31 March 2014 and therefore forms part of the total contribution rate payable by employers from 1 April 2015. Note this rate makes an allowance for changes to the benefit structure that takes effect from 1 April 2015. In practice, a future service rate for each employer has been calculated which is based on their particular circumstances and membership profile. The rate above is an average future service rate for the Fund as a whole.

### Summary of changes to the future service rate

The chart below illustrates the factors that caused the future service rate to increase between 31 March 2011 and 31 March 2014:



As can be seen from this chart, the factors that have had the biggest impact on the future service rate between 2011 and 2014 are broadly similar to those discussed for the past service position.

In addition to this, the impact of the LGPS 2015 scheme has resulted in a reduction in contribution rate of 1.1% of payroll.

### Total common contribution rate payable

The total (or “common”) contribution rate payable is the average future service rate for Fund employers plus an additional amount to recover the deficit and bring the funding level back to 100% over a period of 20 years, as set out in the Funding Strategy Statement. This additional amount is referred to as the past service adjustment.

The common contribution rate based on the funding position as at 31 March 2014 is detailed below along with the results for 31 March 2011:

| Valuation Date | 31 March 2011 | 31 March 2014 |
|---|---|---|
| **Total contribution rate** | **% of pay** | **% of pay** |
| Future service rate (incl. expenses) | 16.2% | 17.9% |
| Past Service Adjustment (20 year spread) | 4.3% | 5.5% |
| **Total employer contribution rate** | **20.5%** | **23.4%** |

This does not represent the rate which any one employer is actually required to pay, nor is it the average of the actual employer rates. The actual employer contributions payable from 1 April 2015 are given in **Appendix G**, and these have been devised in line with the Funding Strategy Statement: see **section 6.**


# 5 Risk Assessment

The valuation results depend critically on the actuarial assumptions that are made about the future of the Fund. If all of the assumptions made at this valuation were exactly borne out in practice then the results presented in this document would represent the true cost of the Fund as it currently stands at 31 March 2014.

However, no one can predict the future with certainty and it is unlikely that future experience will exactly match all of our assumptions. The future therefore presents a variety of risks to the Fund and these should be considered as part of the valuation process. In particular:

- The main risks to the financial health of the Fund should be **identified**.
- Where possible, the financial significance of these risks should be **quantified**.
- Consideration should be given as to how these risks can then be **controlled** or **mitigated**.
- These risks should then be **monitored** to assess whether any mitigation is actually working.

This section investigates the potential implications of the actuarial assumptions not being borne out in practice.

Set out below is a brief assessment of the main risks and their effect on the valuation results, beginning with a look at the effect of changing the main assumptions and then focusing on the two most significant risks – namely investment risk and longevity risk.

## Sensitivity of valuation results to changes in assumptions

The table below gives an indication of the sensitivity of the valuation results to small changes in some of the main assumptions used.

| Assumption | Change | Deficit (£m) | Future service rate (% of pay) |
|---|---|---|---|
| Discount rate | Increases by 0.5% | Falls by £182m | Falls by 3.0% |
| Salary increases | Increases by 0.5% | Rises by £58m | - |
| Price inflation / pension increases | Increases by 0.5% | Rises by £124m | Rises by 3.0% |
| Life expectancy | Increases by 1 year | Rises by £56m | Rises by 0.7% |

This is not an exhaustive list of the assumptions used in the valuation. For example, changes to the assumed level of withdrawals and ill health retirements will also have an effect on the valuation results. However, the table contains those assumptions that typically are of most interest and have the greatest impact.

Note that the table shows the effect of changes to each assumption in isolation. In reality, it is perfectly possible for the experience of the Fund to deviate from more than one of our assumptions simultaneously and so the precise effect on the funding position is more complex.

## Investment risk

### Sensitivity of valuation results to market conditions and investment performance

As the assets of the Fund are taken at their market value, volatility in investment performance can have an immediate and tangible effect on the funding level and deficit. This is particularly relevant because the Fund is invested predominantly in riskier assets such as equities and equity-type investments (e.g. property). A rise or fall in the level of equity markets has a direct impact on the financial position of the Fund, which may seem obvious.

Less obvious is the effect of anticipated investment performance on the Fund's liabilities (and future service cost). Here it is the returns available on government bonds that are of crucial importance, as the discount rate that we use to place a value on the Fund's liabilities is based on gilt yields at the valuation date plus a margin of 1.6% p.a.

The table below shows how the funding level (top), deficit (middle, in £m) and total contribution rate (bottom, as % of pay) would vary if investment conditions at 31 March 2014 had been different. The level of the FTSE 100 Price index is taken as a suitable proxy for asset performance whilst the index-linked gilt yield is taken as a yardstick for the valuation of liabilities.

| Index Linked Gilt Yield | FTSE 100 Price Index: 6098 | FTSE 100 Price Index: 6598 | FTSE 100 Price Index: 7098 |
|---|---|---|---|
| -0.20% | 83%<br>(295)<br>22.5% | 88%<br>(208)<br>20.7% | 93%<br>(121)<br>19.0% |
| 0.0% | 80%<br>(370)<br>25.1% | 85%<br>(283)<br>23.4% | 89%<br>(196)<br>21.7% |
| -0.2% | 77%<br>(449)<br>27.8% | 81%<br>(362)<br>26.1% | 86%<br>(275)<br>24.5% |

The shaded box contains the results for this valuation. Note that this does not take account of the performance of all asset classes held by the Fund (e.g. overseas equities, property, bonds, cash etc.) but it does serve to highlight, in broad terms, the sensitivity of the valuation results to investment conditions at the valuation date.

Note that the scenarios illustrated above are by no means exhaustive. They should not be taken as the limit of how extreme future investment experience could be. The discount rate assumption adopted at this valuation is expected to be appropriate over the long term. Short term volatility of equity markets does not invalidate this assumption.

## Longevity risk

The valuation results are also very sensitive to unexpected changes in future longevity. All else being equal, if longevity improves in the future at a faster pace than allowed for in the valuation assumptions, the funding level will decline and the required employer contribution rates will increase.

Recent medical advances, changes in lifestyle and a greater awareness of health-related matters have resulted in life expectancy amongst pension fund members improving in recent years at a faster pace than was originally foreseen. It is unknown whether and to what extent such improvements will continue in the future.

For the purposes of this valuation, we have selected assumptions that we believe make an appropriate allowance for future improvements in longevity, based on the actual experience of the Fund since the previous valuation.

The table below shows how the valuation results at 31 March 2014 are affected by adopting different longevity assumptions.

| | Impact | | |
|---|---|---|---|
| **Longevity assumption** | **Funding level** | **Deficit (£m)** | **Future service rate** |
| 2014 valuation (valuation improvements) | 85% | (283) | 17.9% |
| 2014 valuation (further improvements) | 81% | (360) | 18.8% |
| 1 year extra | 79% | (418) | 19.6% |

Full details of the longevity improvements adopted at this valuation are set out in **Appendix E**.

The "further improvements" are a more cautious set of improvements that, in the short term, assume the 'cohort effect' of strong improvements in life expectancy currently being observed amongst a generation born around the early and mid-1930s will continue to strengthen for a few more years before tailing off. This is known as "non-peaked".

The "1 year extra" figures relative to a further year of life expectancies beyond those assumed in "further improvements".

Again, the range of assumptions shown here is by no means exhaustive and should not be considered as the limits of how extreme future longevity experience could be.

## Other risks to consider

The table below summarises the effect that changes in some of the other valuation assumptions and risk factors would have on the funding position. Note that these are probably unlikely to have a large financial impact on the Fund and therefore the analysis is qualitative rather than quantitative.

| | Impact | |
|---|---|---|
| **Factor** | **Funding level** | **Future service rate** |
| Greater level of ill health retirement | Decreases | Marginal |
| Reduced level of withdrawals | Decreases | Marginal |
| Rise in average age of employee members | Marginal effect | Increases |
| Lower take up of 50:50 option | No impact | Increases |

One further risk to consider is the possibility of future changes to Regulations that could materially affect the benefits that members become entitled to. It is difficult to predict the nature of any such changes but it is not inconceivable that they could affect not just the cost of benefits earned after the change but could also have a retrospective effect on the past service position (as the move from RPI to CPI-based pension increases already has).

## Managing the risks

Whilst there are certain things, such as the performance of investment markets or the life expectancy of members, that are not directly within the control of the pension fund, that does not mean that nothing can be done to understand them further and to mitigate their effect. Although these risks are difficult (or impossible) to eliminate, steps can be taken to manage them.

Ways in which some of these risks can be managed could be:

- Set aside a specific reserve to act as a cushion against adverse future experience (possibly by selecting a set of actuarial assumptions that are deliberately more prudent).
- Take steps internally to monitor the decisions taken by members and employers (e.g. relating to early / ill health retirements or salary increases) in a bid to curtail any adverse impact on the Fund.

- Pooling certain employers together at the valuation and then setting a single (pooled) contribution rate that they will all pay. This can help to stabilise contribution rates (at the expense of cross-subsidy between the employers in the pool during the period between valuations).
- Carrying out a review of the future security of the Fund's employers (i.e. assessing the strength of employer covenants).
- Carry out a bespoke analysis of the longevity of Fund members and monitor how this changes over time, so that the longevity assumptions at the valuation provide as close a fit as possible to the particular experience of the Fund. This is what Club Vita does.
- Undertake an asset-liability modelling exercise that investigates the effect on the Fund of possible investment scenarios that may arise in the future. An assessment can then be made as to whether long term, secure employers in the Fund can stabilise their future contribution rates (thus introducing more certainty into their future budgets) without jeopardising the long-term health of the Fund. This is exactly what our comPASS tool does (see below).
- Purchasing ill health liability insurance to mitigate the risk of an ill health retirement impacting on solvency and funding level of an individual employer where appropriate.
- Monitoring different employer characteristics in order to build up a picture of the risks posed. Examples include membership movements, cash flow positions and employer events such as cessations.

We would be delighted to set out in more detail the risks that affect the Fund and discuss with you possible strategies for managing them.

### Stabilisation of contribution rates (comPASS)

There can be occasions when the market-related employer contribution rate is not affordable or achievable in practice in the short term. This can occur in times of tight fiscal control or where budgets have been set in advance of new employer contribution rates being available.

In view of this possibility, the Administering Authority has carried out extensive modelling to explore the long term effect on the Fund of capping future contribution increases (and decreases).

The comPASS modelling that we carry out makes an explicit allowance for the possible future investment risks that the Fund may encounter over the period of stabilisation. By doing so, the aim is to justify whether or not the long-term health of the Fund will be adversely impacted by the application of a cap on changes to contribution rates.

# 6 Related issues

The Fund's valuation operates within a broader framework, and this document should therefore be considered alongside the following:

- the Funding Strategy Statement, which in particular highlights how different types of employer in different circumstances have their contributions calculated;
- the Statement of Investment Principles (e.g. the discount rate must be consistent with the Fund's asset strategy);
- the general governance of the Fund, such as meetings of the Pensions Committee, decisions delegated to officers, the Fund's business plan, etc.;
- the Fund's risk register;
- the register of Fund employers.

## Further recommendations

### Valuation frequency

Under the provisions of the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2017. In light of the uncertainty of future financial conditions, we recommend that the financial position of the Fund (and for individual employers in some cases) is monitored by means of interim funding reviews in the period up to this next formal valuation. This will give early warning of changes to funding positions and possible contribution rate changes.

### Investment strategy and risk management

We recommend that the Administering Authority continues to regularly review its investment strategy and ongoing risk management programme.

### New employers joining the Fund

Any new employers or admission bodies joining the Fund should be referred to the Fund actuary for individual calculation as to the required level of contribution.

### Additional payments

Employers may make voluntary additional contributions to recover any shortfall over a shorter period, subject to agreement with the Administering Authority and after receiving the relevant actuarial advice.

Further sums should be paid to the Fund by employers to meet the capital costs of any unreduced early retirements, reduced early retirements before age 60 and/or augmentation (i.e. additional membership or additional pension) using the methods and factors issued by me from time to time or as otherwise agreed.

In addition, payments may be required to be made to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those allowed for within our assumptions. Further details of the ill-health budget allowed for can be found in **Appendix H**.

### Cessations and bulk transfers

Any Admission Body who ceases to participate in the Fund should be referred to us in accordance with Regulation 62 of the Administration Regulations.

Any bulk movement of scheme members:

- involving 10 or more scheme members being transferred from or to another LGPS fund, or
- involving 2 or more scheme members being transferred from or to a non-LGPS pension arrangement.

should be referred to us to consider the impact on the Fund.

# 7 Reliances and limitations

### Scope

This document has been requested by and is provided to Falkirk Council in its capacity as Administering Authority to the Falkirk Council Pension Fund. It has been prepared by Hymans Robertson LLP to fulfil the statutory obligations in accordance with regulation 36 of the Administration Regulations. None of the figures should be used for accounting purposes (e.g. under FRS17, FRS102 or IAS19) or for any other purpose (e.g. a termination valuation under Regulation 34(1)).

This document should not be released or otherwise disclosed to any third party without our prior written consent, in which case it should be released in its entirety. Hymans Robertson LLP accepts no liability to any other party unless we have expressly accepted such liability.

The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. We have previously issued a separate report confirming that the data provided is fit for the purposes of this valuation and have commented on the quality of the data provided. The data used in our calculations is as per our report of 8 December 2014.

### Actuarial Standards

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with where material:

- TAS R – Reporting;
- TAS D – Data;
- TAS M – Modelling; and
- Pensions TAS.

| | |
|---|---|
| Catherine McFadyen | Steven Scott |
| Fellow of the Institute and Faculty of Actuaries | Fellow of the Institute and Faculty of Actuaries |
| DATE | DATE |

[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work, including the information and advice contained in this report.

# Appendix A: About the pension fund

For more details please refer to the Fund's Funding Strategy Statement.

The purpose of the Fund is to provide retirement and death benefits to its members. It is part of the Local Government Pension Scheme (LGPS) and is a multi-employer defined benefit pension scheme.

### Defined benefit pension scheme

In a defined benefit scheme such as this, the nature of retirement benefits that members are entitled to is known in advance. For example, it is known that members will receive a pension on retirement that is linked to their salary and pensionable service according to a pre-determined formula.

However, the precise cost to the Fund of providing these benefits is **not** known in advance. The estimated cost of these benefits represents a liability to the Fund and assets must be set aside to meet this. The relationship between the value of the liabilities and the value of the assets must be regularly assessed and monitored to ensure that the Fund can fulfil its core objective of providing its members with the retirement benefits that they have been promised.

### Liabilities

The Fund's liabilities are the benefits that will be paid in the future to its members (and their dependants).

The precise timing and amount of these benefit payments will depend on future experience, such as when members will retire, how long they will live for in retirement and what economic conditions will be like both before and after retirement. Because these factors are not known in advance, assumptions must be made about future experience. The valuation of these liabilities must be regularly updated to reflect the degree to which actual experience has been in line with these assumptions.

### Assets

The Fund's assets arise from the contributions paid by its members and their employers and the investment returns that they generate. The way these assets are invested is of fundamental importance to the Fund. The selection, monitoring and evolution of the Fund's investment strategy are key responsibilities of the Administering Authority.

As the estimated cost of the Fund's liabilities is regularly re-assessed, this effectively means that the amount of assets required to meet them is a moving target. As a result, at any given time the Fund may be technically in surplus or in deficit.

A contribution strategy must be put in place which ensures that each of the Fund's employers pays money into the Fund at a rate which will target the cost of its share of the liabilities in respect of benefits already earned by members and those that will be earned in the future.

### The long-term nature of the Fund

The pension fund is a long-term commitment. Even if it were to stop admitting new members today, it would still be paying out benefits to existing members and dependants for many decades to come. It is therefore essential that the various funding and investment decisions that are taken now recognise this and come together to form a coherent long-term strategy.

In order to assist with these decisions, the Regulations require the Administering Authority to obtain a formal valuation of the Fund every three years. Along with the Funding Strategy Statement, this valuation will help determine the funding objectives that will apply from 1 April 2015.

# Appendix B: Summary of the Fund's benefits

Provided below is a brief summary of the non-discretionary benefits that we have taken into account for active members at this valuation. This should not be taken as a comprehensive statement of the exact benefits to be paid. For further details please see the Regulations.

| Provision | Benefit Structure To 31 March 2009 | Benefit Structure From 1 April 2009 to 31 March 2015 | Benefit Structure From 1 April 2015 |
|---|---|---|---|
| Normal retirement age (NRA) | Age 65. | Age 65. | Equal to the individual member's State Pension Age (minimum 65). |
| Earliest retirement age (ERA) on which immediate unreduced benefits can be paid on voluntary retirement | As per NRA (age 65).<br>(a) having previously had an NRA of age 60 (or after age 60 on attaining 25 years of scheme membership), due to being a member of the scheme immediately prior to 1 April 1998; or<br>(b) having the potential to satisfy the rule of 85 prior to age 65 (if the sum of age (whole years) and membership (whole years) is 85 or more). The minimum age from which the Rule of 85 applies is age 60.<br>The benefits relating to various segments of scheme membership are protected as follows, which means their benefits are calculated based on the above definitions of earliest retirement age in relation to these protected periods of scheme membership.<br>(a) A member born on 31 March 1960 or earlier – membership up to 31 March 2020 protected;<br>(b) All other members in the scheme immediately prior to 1 December 2006 – membership up to 31 March 2008 protected. | | As per NRA (minimum age 65).<br>Protections apply to active members in the scheme for pensions earned up to 1 April 2015, due to:<br>a) Accrued benefits relating to pre April 2015 service at age 65.<br>b) Continued 'Rule of 85' protection for qualifying members.<br>c) Members within 10 years of existing NRA at 1 April 2012 – no change to when they can retire and no decrease in pension they receive at existing NRA. |
| Member contributions | Officers - 6% of pensionable pay<br>Manual Workers – 5% of pensionable pay if has protected lower rates rights or 6% for post 31 March 1998 entrants or former entrants with no protected rights. | Tiered rates (5.5%-12.0%) depending upon level of full-time equivalent pay. A mechanism for sharing any increased scheme costs between employers and scheme members is to be included in the LGPS regulations. | Banded rates varying between 5.5% and 12.0% on five different tranches of actual pay. A mechanism for sharing any increased scheme costs between employers and scheme members will be included in the LGPS regulations in due course.<br>Contribution rates are based on actual pay rather than full-time equivalent pay. |
| Pensionable pay | All salary, wages, fees and other payments in respect of the employment, excluding non-contractual overtime and some other specified amounts.<br>Some scheme members may be covered by special agreements. | | Pay including contractual overtime and additional hours but excluding non-contractual elements. |

| Provision | Benefit Structure To 31 March 2009 | Benefit Structure From 1 April 2009 to 31 March 2015 | Benefit Structure From 1 April 2015 |
|---|---|---|---|
| Final pay | The pensionable pay in the year up to the date of leaving the scheme. Alternative methods used in some cases, e.g. where there has been a break in service or a drop in pensionable pay.<br><br>Will be required for the statutory underpin and in respect of the final salary link that may apply in respect of certain members of the CARE scheme who have pre-April 2015 accrual. | | N/A |
| Period of scheme membership | Total years and days of service during which a member contributes to the Fund. Additional periods may be granted (e.g. transfers from other pension arrangements, augmentation, or from April 2009 the award of additional pension). For part time members, the membership is proportionate with regard to their contractual hours and a full time equivalent. | | N/A |
| Normal retirement benefits at NRA | Annual Retirement Pension - 1/80th of final pay for each year of scheme membership.<br><br>Lump Sum Retirement Grant - 3/80th of final pay for each year of scheme membership. Additional lump sum can be provided by commutation of pension (within overriding limits) on a basis of £12 additional lump sum for each £1 of pension surrendered. | Scheme membership to 31 March 2009:<br><br>Annual Retirement Pension - 1/80th of final pay for each year of scheme membership.<br><br>Lump Sum Retirement Grant - 3/80th of final pay for each year of scheme membership.<br><br>Scheme membership from 1 April 2009:<br><br>Annual Retirement Pension - 1/60th of final pay for each year of scheme membership.<br><br>Lump Sum Retirement Grant – none except by commutation of pension. | Scheme membership from 1 April 2015:<br><br>Annual Retirement Pension - 1/49th of pensionable pay (or assumed pensionable pay) for each year of scheme membership revalued to NRA in line with CPI.<br><br>Lump Sum Retirement Grant - none except by commutation of pension. |

<table>
<tr><th>Provision</th><th>Benefit Structure To 31 March 2009</th><th>Benefit Structure From 1 April 2009 to 31 March 2015</th><th>Benefit Structure From 1 April 2015</th></tr>
<tr><td>Option to increase retirement lump sum benefit</td><td>At the time that benefits come into payment, members have the option to exchange (‘commute’) some of the retirement pension into additional lump sum. The terms for the conversion of pension in to lump sum is £12 of lump sum for every £1 of annual pension surrendered.</td><td>Scheme membership to 31 March 2009:<br><br>At the time that benefits come into payment, members have the option to exchange (‘commute’) some of the retirement pension into additional lump sum. The terms for the conversion of pension in to lump sum is £12 of lump sum for every £1 of annual pension surrendered.<br><br>Scheme membership from 1 April 2009:<br><br>No automatic lump sum. Any lump sum is to be provided by commutation of pension. The terms for the conversion of pension in to lump sum is £12 of lump sum for every £1 of annual pension surrendered.</td><td>No automatic lump sum. Any lump sum is to be provided by commutation of pension (within overriding HMRC limits). The rule for the conversion of pension to lump sum is £12 of lump sum for every £1 of annual pension surrendered.</td></tr>
<tr><td>Voluntary early retirement benefits (non ill-health)</td><td colspan="2">On retirement after age 60, subject to reduction on account of early payment in some circumstances (in accordance with ERA protections).</td><td>On retirement from age 60, subject to reduction on account of early payment in some circumstances (in accordance with ERA protections).</td></tr>
<tr><td rowspan="2">Employer’s consent early retirement benefits (non ill-health)</td><td>On retirement after age 50 with employer’s consent a pension and lump sum based on actual scheme membership completed may be paid.</td><td>On retirement after age 55 (or age 50 for active members with certain protections on grounds of redundancy of efficiency) with employer’s consent a pension and lump sum based on actual scheme membership completed may be paid.</td><td rowspan="2">Benefits paid on redundancy or efficiency grounds (for members aged 55 or over) are paid with no actuarial reduction.<br><br>Otherwise, benefits are subject to reduction on account of early payment as mentioned in the previous row, unless this is waived by the employer.</td></tr>
<tr><td colspan="2">Benefits paid on redundancy or efficiency grounds are paid with no actuarial reduction.<br><br>Otherwise, benefits are subject to reduction on account of early payment, unless this is waived by the employer.</td></tr>
</table>

| Provision | Benefit Structure To 31 March 2009 | Benefit Structure From 1 April 2009 to 31 March 2015 | Benefit Structure From 1 April 2015 |
|---|---|---|---|
| Ill-health benefits | In the event of premature retirement due to permanent ill-health or incapacity, an immediate pension and lump sum are paid based on actual scheme membership plus an enhancement period of scheme membership.<br><br>The enhancement period is dependent on scheme membership at date of leaving and is seldom more than 6 years 243 days.<br><br>No reduction is applied due to early payment. | In the event of premature retirement due to permanent ill-health or incapacity and a reduced likelihood of obtaining gainful employment (local government or otherwise) before age 65, an immediate pension and lump sum are due based on actual scheme membership plus an enhanced period of scheme membership.<br><br>The enhancement period is:<br><br>25% of the period to age 65, if there is reasonable prospect of undertaking gainful employment before age 65; or<br><br>100% of the period to age 65, if there is no likelihood of undertaking gainful employment prior to age 65. | As a result of permanent ill-health or incapacity and a reduced likelihood of obtaining gainful employment (local government or otherwise) before age 65.<br><br>Immediate payment of unreduced benefits.<br><br>Enhanced to scheme membership, dependent on severity of ill health.<br><br>100% of prospective pension to age 65 where no likelihood of undertaking any gainful employment prior to age 65.<br><br>25% of prospective pension to age 65 where reasonable prospect of undertaking gainful employment before reaching age 65. |
| Flexible retirement | After 5th April 2006, a member who has attained the age of 50, with his employer's consent, reduces the hours he works, or the grade in which he is employed, may elect in writing to the appropriate Administering Authority that such benefits may, with his employer's consent, be paid to him notwithstanding that he has not retired from that employment.<br><br>Benefits are paid immediately and subject to actuarial reduction unless the reduction is waived by the employer. | A member who has attained the age of 55 and who, with his employer's consent, reduces the hours he works, or the grade in which he is employed, may make a request in writing to the appropriate Administering Authority to receive **all or part** of his benefits,<br><br>Benefits are paid immediately and subject to actuarial reduction unless the reduction is waived by the employer. | |

| Provision | Benefit Structure To 31 March 2009 | Benefit Structure From 1 April 2009 to 31 March 2015 | Benefit Structure From 1 April 2015 |
|---|---|---|---|
| Pension increases | All pensions in payment, deferred pensions and dependant's pensions other than benefits arising from the payment of additional voluntary contributions are increased annually. Pensions are increased partially under the Pensions (Increases) Act 1971 and partially in accordance with statutory requirements (depending on the proportions relating to pre 88 GMP, post 88 GMP and excess over GMP). | | |
| Death after retirement | A spouse's or civil partner's pension of one half of the member's pension (generally post 1 April 1972 service for widowers' pension and post 6 April 1988 for civil partners) is payable; plus<br>If the member dies within five years of retiring and before age 75 the balance of five years' pension payments will be paid in the form of a lump sum; plus<br>Children's pensions may also be payable. | A spouse's, civil partner's or nominated cohabiting partner's pension payable at a rate of 1/160th of the member's total membership multiplied by final pay is payable; plus<br>If the member dies within ten years of retiring and before age 75 the balance of ten years' pension payments will be paid in the form of a lump sum; plus<br>Children's pensions may also be payable. | |
| Death in service | A lump sum of two times final pay; plus<br>A spouse's or civil partner's pension of one half of the ill-health retirement pension that would have been paid to the scheme member if he had retired on the day of death (generally post 1 April 1972 service for widowers' pension and post 6 April 1988 for civil partners); plus | A lump sum of three times final pay; plus<br>A spouse's, civil partner's or cohabiting partner's pension payable at a rate of 1/160th of the member's total (augmented to age 65) membership, multiplied by final pay; plus<br>Children's pensions may also be payable. | |
| Leaving service options | If the member has completed two years or more scheme membership, deferred benefits with calculation and payment conditions similar to general retirement provisions ; or<br>A transfer payment to either a new employer's scheme or a suitable insurance policy, equivalent in value to the deferred pension; or<br>If the member has completed less than two years scheme membership, a return of the member's contributions with interest, less a State Scheme premium deduction and less tax at the rate of 20%. | | |

| Provision | Benefit Structure To 31 March 2009 | Benefit Structure From 1 April 2009 to 31 March 2015 | Benefit Structure From 1 April 2015 |
|---|---|---|---|
| State pension scheme | The Fund is contracted-out of the State Second Pension and the benefits payable to each member are guaranteed to be not less than those required to enable the Fund to be contracted-out. | | |
| Assumed pensionable pay | N/A | | This applies in cases of reduced contractual pay (CP) resulting from sickness, child related and reserve forces absence. In these circumstances benefits are based on an assumption of what pay would have been had the reduction not occurred. |
| 50/50 option | N/A | | Optional arrangement allowing 50% of main benefits to be accrued on a 50% contribution rate. |

Note: Certain categories of members of the Fund are entitled to benefits that differ from those summarised above.

## Discretionary benefits

The LGPS Regulations give employers a number of discretionary powers. The effect on benefits or contributions as a result of the use of these provisions as currently contained within the Local Government Pension Scheme Regulations has been allowed for in this valuation to the extent that this is reflected in the membership data provided. No allowance has been made for the future use of discretionary powers that will be contained within the scheme from 1 April 2015.

# Appendix C: About the valuation

For more details please refer the Fund's Funding Strategy Statement.

It is important to realise that the actual cost of the pension fund (i.e. how much money it will ultimately have to pay out to its members in the form of benefits) is currently unknown. This cost will not be known with certainty until the last benefit is paid to the last pensioner. The core purpose of this valuation is to estimate what this cost will be, so that the Fund can then develop a strategy to meet it.

Such a valuation can only ever be an estimate – as the future cannot be predicted with certainty. However, as actuaries, we can use our understanding of the Fund and the factors that affect it to determine an anticipated cost which is as sensible and realistic as possible. A decision can then be made as to how much is set aside now to meet this anticipated cost. The pace of this funding can vary according to the level of prudence that is built into the valuation method and assumptions.

For this valuation, as for the previous valuation, our calculations identify separately the expected cost of members' benefits in respect of scheme membership completed before the valuation date ("past service") and that which is expected to be completed after the valuation date ("future service").

## Past service

The principal measurement here is the comparison at the valuation date of the assets (taken at market value) and the value placed on the Fund's liabilities (calculated using a market-based approach). By maintaining a link to the market in both cases, this helps ensure that the assets and liabilities are valued in a consistent manner. Our calculation of the Fund's liabilities also explicitly allows for expected future pay and pension increases.

The funding level is the ratio of assets to liabilities at the valuation date. A funding level of less/more than 100% implies that there is a deficit/surplus in the Fund at the valuation date.

The funding target is to eliminate any deficit (or surplus) over a specified period and therefore get back to a funding level of 100%. To do so, additional contributions may be required to be paid into the Fund, either via lump sums or by increasing the employer's contribution rate. These additional contributions are known as the past service adjustment.

## Future service

In addition to benefits that have already been earned by members prior to the valuation date, employee members will continue to earn new benefits in the future. The cost of these new benefits must be met by both employers and employees. The employers' share of this cost is known as the future service contribution rate.

For the valuation results for the Fund as a whole, we have calculated the future service rate as the cost of benefits being earned by members over the year following the valuation, taking account of expected future salary increases until retirement. If new entrants are admitted to the Fund to the extent that the overall membership profile remains broadly unchanged (and if the actuarial assumptions are unchanged) then the future service rate should be reasonably stable.

This funding method we have used is known as the Projected Unit Method. As well as the whole fund, it is appropriate for individual employers that continue to admit new entrants to the Fund.

However, some participating employers may have a policy of not admitting new entrants. In this case, the membership profile will inevitably begin to age. Under these circumstances, the Projected Unit Method is arguably no longer appropriate and will not promote sufficient stability in the future service rate. For these employers, we will adopt a funding method known as the Attained Age Method, which effectively looks at the cost of benefits that members will earn over the entirety of their remaining working lifetime (rather than just the year following the valuation).

Combining this future service rate with any past service adjustment required to repay a deficit (or reduce a surplus) gives us the total contribution rate. The total rate for the Fund as a whole is known as the common contribution rate. This is really just a notional figure. In practice, each individual employer will have a contribution rate which reflects their own particular circumstances.

### The sensitivity of valuation results

The aim of this valuation is not only to determine these important figures but also to demonstrate their sensitivity to a number of key influences. This will promote an understanding of how the expected cost of the Fund may change in response to uncertain future events (e.g. changes in life expectancy or investment returns). Please refer to **section 5** for details of the sensitivity analysis.

# Appendix D: Data

This section contains a summary of the membership, investment and accounting data provided by the Administering Authority for the purposes of this valuation (the corresponding membership and investment data from the previous valuation is also shown for reference). For further details of the data, and the checks and amendments performed in the course of this valuation, please refer to our separate report.

## Membership data – whole fund

### Employee members

| | 31 March 2011 | | 31 March 2014 | |
|---|---|---|---|---|
| | Number | Pensionable Pay* (£000) | Number | Pensionable Pay* (£000) |
| **Total employee membership** | 12,887 | 244,944 | 14,783 | 285,193 |

*actual pay (not full-time equivalent).

### Deferred pensioners

| | 31 March 2011 | | 31 March 2014 | |
|---|---|---|---|---|
| | Number | Deferred pension (£000) | Number | Deferred pension (£000) |
| **Total deferred membership** | 4,979 | 10,309 | 5,683 | 12,739 |

The figures above also include any “frozen refunds” and “undecided leavers” members at the valuation date.

### Current pensioners, spouses and children

| | 31 March 2011 | | 31 March 2014 | |
|---|---|---|---|---|
| | Number | Pension (£000) | Number | Pension (£000) |
| Members | 6,447 | 31,493 | 7,482 | 40,753 |
| Dependants | 1,091 | 2,731 | 1,199 | 3,266 |
| Children | 62 | 97 | 64 | 139 |
| **Total pensioner members** | **7,600** | **34,321** | **8,745** | **44,158** |

Note that the membership numbers in the table above refer to the number of records provided to us and so will include an element of double-counting in respect of any members who are in receipt (or potentially in receipt of) more than one benefit.

| Membership Profile | Average Age (years) | | FWL (years) | |
|---|---|---|---|---|
| | 2011 | 2014 | 2011 | 2014 |
| Employees | 50.2 | 50.2 | 9.4 | 12.4 |
| Deferred Pensioners | 49.0 | 49.7 | - | - |
| Pensioners | 65.0 | 65.4 | - | - |

The average ages are weighted by liability.

The expected future working lifetime (FWL) indicates the anticipated length of time that the average employee member will remain as a contributor to the Fund. Note that it allows for the possibility of members leaving, retiring early or dying before retirement.

## Membership data – individual employers

| Employer code | Employer Name | Employees Number | Employees Actual Pay (£000) | Deferreds Number | Deferreds Pension (£000) | Pensioners Number | Pensioners Pension (£000) |
|---|---|---|---|---|---|---|---|
| 1 | Central Regional Council | 0 | 0 | 318 | 456 | 7 | 9 |
| 2 | Clackmannan District Council | 0 | 0 | 34 | 50 | 0 | 0 |
| 3 | Falkirk District Council | 0 | 0 | 127 | 181 | 1 | * |
| 4 | Stirling District Council | 0 | 0 | 89 | 172 | 2 | * |
| 5 | Dollar Academy Trust | 88 | 1,549 | 27 | 40 | 38 | 113 |
| 6 | Falkirk College | 0 | 0 | 36 | 55 | 36 | 155 |
| 7 | Stirling University | 0 | 0 | 0 | 0 | 17 | 110 |
| 8 | Clackmannan College | 0 | 0 | 10 | 13 | 15 | 44 |
| 9 | Snowdon School for Girls (Old) | 0 | 0 | 0 | 0 | 0 | 0 |
| 10 | St Ninians School | 0 | 0 | 1 | * | 4 | * |
| 11 | Ballikinrain School | 54 | 1,386 | 25 | 57 | 35 | 242 |
| 13 | Strathcarron Hospice | 125 | 2,702 | 42 | 92 | 76 | 392 |
| 14 | Stirling Enterprise Park Limited | 16 | 354 | 12 | 30 | 7 | 39 |
| 15 | Scottish Autism | 551 | 8,518 | 325 | 491 | 112 | 343 |
| 16 | CESU | 0 | 0 | 1 | * | 1 | * |
| 17 | Boness Heritage Trust | 0 | 0 | 0 | 0 | 1 | * |
| 18 | Snowdon School Ltd | 16 | 368 | 5 | 11 | 2 | * |
| 19 | Ceteris | 34 | 587 | 26 | 30 | 14 | 74 |
| 22 | Association of Scottish Colleges | 1 | * | 13 | 31 | 4 | * |
| 23 | Stirling University Innovation Park Ltd | 0 | 0 | 3 | * | 5 | 7 |
| 24 | Cowane's Hospital | 5 | 61 | 3 | * | 7 | 14 |
| 25 | Community Training and Development Unit | 0 | 0 | 2 | * | 0 | 0 |
| 26 | Falkirk Women's Technology Centre | 0 | 0 | 3 | * | 1 | * |
| 27 | Bo'ness Development Trust | 0 | 0 | 0 | 0 | 1 | * |
| 28 | Smith Art Gallery | 7 | 131 | 5 | 9 | 2 | * |
| 29 | VisitScotland | 15 | 355 | 29 | 62 | 0 | 0 |
| 31 | Alsorts | 1 | * | 2 | * | 1 | * |
| 32 | Langlees Community Dev. Project | 0 | 0 | 1 | * | 0 | 0 |
| 33 | Careers Central Ltd. | 0 | 0 | 8 | 19 | 13 | 99 |
| 34 | Scottish Children's Reporter Admin. | 449 | 11,658 | 152 | 425 | 218 | 1,832 |
| 36 | Central Carers Association | 7 | 151 | 4 | * | 4 | * |
| 37 | Central Scotland Regional Equality Council Ltd | 4 | * | 7 | 10 | 1 | * |
| 38 | Scottish Environment Protection Agency | 1,266 | 39,134 | 559 | 1,765 | 285 | 3,445 |
| 39 | Scottish Water and Sewerage Customers Council | 0 | 0 | 1 | * | 123 | 521 |
| 52 | Clackmannanshire Council | 2,078 | 36,757 | 527 | 1,416 | 1,220 | 5,569 |
| 53 | Falkirk Council | 5,986 | 101,829 | 1,687 | 3,323 | 3,308 | 14,851 |
| 54 | Stirling Council | 2,753 | 52,755 | 1,125 | 2,734 | 2,107 | 10,516 |
| 55 | Central Scotland Police | 0 | 0 | 118 | 293 | 202 | 809 |
| 56 | Central Scotland Fire and Rescue Service | 44 | 1,157 | 25 | 72 | 43 | 255 |
| 57 | Central Scotland Joint Valuation Board | 43 | 1,166 | 13 | 52 | 43 | 515 |
| 58 | St Mary's Episcopal P.S. | 0 | 0 | 1 | * | 0 | 0 |
| 59 | Open Secret | 2 | * | 4 | * | 2 | * |
| 60 | Tourist Board Training | 0 | 0 | 2 | * | 21 | 128 |
| 61 | Water Industry Commissioner for Scotland | 16 | 747 | 23 | 79 | 4 | * |
| 62 | Clackmannanshire Leisure Trust | 0 | 0 | 6 | 6 | 8 | 34 |
| 63 | Plus | 2 | * | 4 | * | 1 | * |
| 64 | Seamab School | 21 | 513 | 11 | 18 | 5 | 32 |
| 65 | McLaren Community Leisure Centre | 1 | * | 6 | 9 | 0 | 0 |
| 66 | Forth Valley College | 256 | 5,432 | 81 | 250 | 58 | 322 |
| 67 | Stirling District Tourism Ltd | 5 | 112 | 1 | * | 4 | * |
| 68 | Active Stirling Ltd | 92 | 1,741 | 51 | 119 | 7 | 42 |
| 69 | Forth and Oban Limited (Stirling Schools Contract) | 26 | 461 | 13 | 10 | 2 | * |
| 70 | Thinkwhere | 22 | 611 | 15 | 49 | 2 | * |
| 71 | Raploch URC | 0 | 0 | 7 | 22 | 2 | * |
| 72 | Scottish Police Services Authority | 0 | 0 | 25 | 66 | 4 | * |
| 73 | Waterwatch Scotland | 0 | 0 | 5 | 22 | 1 | * |
| 74 | Valad Management (UK) Ltd | 2 | * | 1 | * | 0 | 0 |
| 75 | Amey (Clackmannanshire Schools) | 11 | 111 | 3 | * | 2 | * |
| 76 | Forth and Oban Limited (Falkirk Schools Contract) | 3 | * | 0 | 0 | 0 | 0 |
| 77 | Falkirk Community Trust Limited | 514 | 7,891 | 34 | 41 | 26 | 123 |
| 82 | Scottish Police Authority | 31 | 1,138 | 0 | 0 | 0 | 0 |
| 85 | Scottish Police Authority | 237 | 5,468 | 25 | 85 | 4 | * |
| 90 | Ex CRC (Water and Drainage staff) | 0 | 0 | 0 | 0 | 635 | 3,195 |
| 93 | Ex Stirling County (NHS Recharge) | 0 | 0 | 0 | 0 | 1 | * |

* Please note that for compliance with data protection legislation the figures in the table above have been blanked out where the number of members for an employer is less than 5 for any status of membership.

## Assets at 31 March 2014

A summary of the Fund's assets (excluding members' money-purchase Additional Voluntary Contributions) as at 31 March 2014 and 31 March 2011 is as follows:

| Asset class | Market Value at 31 March 2011 (£000) | Allocation % | Market Value at 31 March 2014 (£000) | Allocation % |
|---|---|---|---|---|
| UK equities | 388,062 | 33% | 457,984 | 29% |
| UK fixed interest gilts | 53,383 | 5% | 82,263 | 5% |
| UK corporate bonds | 77,090 | 7% | 28,054 | 2% |
| UK index-linked gilts | 22,548 | 2% | 24,781 | 2% |
| Overseas equities | 504,154 | 43% | 579,352 | 37% |
| Overseas bonds | 0 | 0% | 223,304 | 14% |
| Property | 87,781 | 7% | 112,035 | 7% |
| Cash and net current assets | 48,167 | 4% | 68,908 | 4% |
| **Total** | **1,181,185** | 100% | **1,576,681** | 100% |

## Accounting data – revenue account for the three years to 31 March 2014

| Consolidated accounts (£000) | Year to | | | |
|---|---|---|---|---|
| | 31 March 2012 | 31 March 2013 | 31 March 2014 | Total |
| **Income** | | | | |
| Employer - normal contributions | 51,934 | 50,063 | 54,432 | 156,429 |
| Employer - additional contributions | 0 | 0 | 0 | 0 |
| Employer - early retirement and augmentation strain contributions | 6,000 | 2,481 | 4,552 | 13,033 |
| Employee - normal contributions | 16,301 | 16,352 | 17,224 | 49,877 |
| Employee - additional contributions | 237 | 234 | 225 | 696 |
| Transfers In Received (including group and individual) | 2,455 | 4,383 | 3,316 | 10,154 |
| Other Income | 0 | 0 | 0 | 0 |
| **Total Income** | **76,927** | **73,513** | **79,749** | **230,189** |
| | | | | |
| **Expenditure** | | | | |
| Gross Retirement Pensions | 36,326 | 39,651 | 42,038 | 118,015 |
| Lump Sum Retirement Benefits | 14,627 | 10,915 | 12,919 | 38,461 |
| Death in Service Lump sum | 1,100 | 2,163 | 1,528 | 4,791 |
| Death in Deferment Lump Sum | 0 | 0 | 0 | 0 |
| Death in Retirement Lump Sum | 0 | 0 | 0 | 0 |
| Gross Refund of Contributions | 191 | 137 | 151 | 479 |
| Transfers out (including bulk and individual) | 2,825 | 3,921 | 4,504 | 11,250 |
| Fees and Expenses | 444 | 375 | 430 | 1,249 |
| **Total Expenditure** | **55,513** | **57,162** | **61,570** | **174,245** |
| | | | | |
| **Net Cashflow** | **21,414** | **16,351** | **18,179** | **55,944** |
| | | | | |
| **Assets at start of year** | **1,186,171** | **1,251,989** | **1,463,075** | **1,186,171** |
| Net cashflow | 21,414 | 16,351 | 18,179 | 55,944 |
| Change in value | 44,404 | 194,735 | 95,427 | 334,566 |
| **Assets at end of year** | **1,251,989** | **1,463,075** | **1,576,681** | **1,576,681** |
| | | | | |
| **Approximate rate of return on assets** | **3.7%** | **15.5%** | **6.5%** | **27.5%** |

Note that the figures above are based on the Fund accounts provided to us for the purposes of this valuation, which were fully audited at the time of our valuation calculations.

# Appendix E: Assumptions

## Financial assumptions

| Financial assumptions | 31 March 2011 (% p.a.) | 31 March 2014 (% p.a.) |
|---|---|---|
| **Discount rate** | 5.9% | 5.1% |
| **Retail Price inflation** | 3.6% | 3.5% |
| **Pay increases*** | 5.1% | 4.0% |
| **Pension increases:** | | |
| pension in excess of GMP | 2.8% | 2.7% |
| post-88 GMP | 2.8% | 2.7% |
| pre-88 GMP | 0.0% | 0.0% |
| **Revaluation of deferred pension** | 2.8% | 2.7% |
| **Revaluation of accrued CARE pension** | - | 2.7% |
| **Expenses** | 0.2% | 0.2% |

*An allowance is also made for promotional pay increases (see table below). Note that the assumption at 31 March 2011 is actually 1% p.a. until 31 March 2013, reverting to 5.1% p.a. thereafter.

## Mortality assumptions

| Longevity assumptions | 31 March 2014 |
|---|---|
| **Longevity - baseline** | Vita curves |
| **Longevity - improvements** | |
| CMI Model version used | CMI_2012 |
| Starting rates | CMI calibration based on data from Club Vita using the latest available data as at December 2012. |
| Long term rate of improvement | Period effects:<br>1.25% p.a. for men and women.<br>Cohort effects:<br>0% p.a. for men and for women. |
| Period of convergence | Period effects:<br><br>CMI model core values i.e. 10 years for ages 50 and below and 5 years for those aged 95 and above, with linear transition to 20 years for those aged between 60 and 80.<br><br>Cohort effects:<br><br>CMI core i.e. 40 years for those born in 1947 or later declining linearly to 5 years for those born in 1912 or earlier. |
| Proportion of convergence remaining at mid point | 50% |

We have suggested a longevity improvement assumption based on the latest industry standard and combined information from our longevity experts in Club Vita. The start point for the improvements has been based on observed death rates in the Club Vita data bank over the period.

In the short term we have assumed that the ‘cohort effect’ of strong improvements in life expectancy currently being observed amongst a generation born around the early and mid-1930s will start to tail off, resulting in life expectancy increasing less rapidly than has been seen over the last decade or two. This is known as ‘peaked’.

In the long term (post age 70) we have assumed that increases in life expectancy will stabilise at a rate of increase of 1 year per decade for men and women. This is equivalent to assuming that longer term mortality rates will fall at a rate of 1.25% p.a. for men and women.

However, we have assumed that post age 90 improvements in mortality are hard to achieve, declining between ages 90 and 120 so that no improvements are seen at ages 120 and over.

As a member of Club Vita, the longevity assumptions that have been adopted at this valuation are a bespoke set of VitaCurves that are specifically tailored to fit the membership profile of the Fund. These curves are based on the data you have provided us with for the purposes of this valuation. Full details of these are available on request.

### Other demographic valuation assumptions

| | |
|---|---|
| Retirements in ill health | Allowance has been made for ill-health retirements before Normal Pension Age (see table below). |
| Withdrawals | Allowance has been made for withdrawals from service (see table below). |
| Family details | A varying proportion of members are assumed to be married (or have an adult dependant) at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. Husbands are assumed to be 3 years older than wives. |
| Commutation | 50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2009 (equivalent 75% for service from 1 April 2009). |
| 50:50 option | 10% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option. |

The tables below show details of the assumptions actually used for specimen ages. The promotional pay scale is an annual average for all employees at each age. It is in addition to the allowance for general pay inflation described above. For membership movements, the percentages represent the probability that an individual at each age leaves service within the following twelve months.

## Death in Service:

| Age | Incidence per 1000 active members per annum | | | |
|---|---|---|---|---|
| | Male officers and Post 98 | Male Manuals | Female officers and Post 98 | Female Manuals |
| | Death | Death | Death | Death |
| 20 | 0.21 | 0.27 | 0.12 | 0.15 |
| 25 | 0.21 | 0.27 | 0.12 | 0.15 |
| 30 | 0.26 | 0.32 | 0.18 | 0.22 |
| 35 | 0.30 | 0.37 | 0.30 | 0.37 |
| 40 | 0.51 | 0.64 | 0.48 | 0.60 |
| 45 | 0.85 | 1.07 | 0.77 | 0.97 |
| 50 | 1.36 | 1.71 | 1.13 | 1.42 |
| 55 | 2.13 | 2.68 | 1.49 | 1.87 |
| 60 | 3.83 | 4.82 | 1.90 | 2.39 |
| 65 | 6.38 | 8.03 | 2.44 | 3.07 |

## Ill Health Early Retirements:

### Tier 1

| Age | Incidence for 1000 active members per annum | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Male Officers & Post 98 Males | | Male Manuals | | Female Officers & Post 98 Females | | Female Manuals | |
| | Ill Health | | Ill Health | | Ill Health | | Ill Health | |
| | FT | PT | FT | PT | FT | PT | FT | PT |
| 20 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 25 | 0.00 | 0.00 | 0.60 | 0.60 | 0.15 | 0.11 | 0.79 | 0.79 |
| 30 | 0.00 | 0.00 | 1.11 | 1.11 | 0.20 | 0.15 | 1.15 | 1.15 |
| 35 | 0.15 | 0.11 | 1.66 | 1.66 | 0.40 | 0.30 | 1.58 | 1.58 |
| 40 | 0.25 | 0.19 | 2.42 | 2.42 | 0.60 | 0.45 | 2.30 | 2.30 |
| 45 | 0.55 | 0.42 | 3.33 | 3.33 | 0.81 | 0.60 | 3.02 | 3.02 |
| 50 | 1.41 | 1.06 | 4.94 | 4.94 | 1.51 | 1.13 | 4.03 | 4.03 |
| 55 | 5.53 | 4.15 | 11.69 | 11.69 | 5.61 | 4.20 | 10.83 | 10.83 |
| 60 | 9.73 | 7.30 | 18.74 | 18.74 | 11.89 | 8.92 | 19.05 | 19.05 |
| 65 | 18.48 | 13.86 | 36.12 | 36.12 | 21.37 | 16.03 | 36.12 | 36.12 |

### Tier 2

| Age | Incidence for 1000 active members per annum | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Male Officers & Post 98 Males | | Male Manuals | | Female Officers & Post 98 Females | | Female Manuals | |
| | Ill Health | | Ill Health | | Ill Health | | Ill Health | |
| | FT | PT | FT | PT | FT | PT | FT | PT |
| 20 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 25 | 0.00 | 0.00 | 0.64 | 0.64 | 0.16 | 0.12 | 0.84 | 0.84 |
| 30 | 0.00 | 0.00 | 1.18 | 1.18 | 0.21 | 0.16 | 1.22 | 1.22 |
| 35 | 0.16 | 0.12 | 1.77 | 1.77 | 0.43 | 0.32 | 1.68 | 1.68 |
| 40 | 0.27 | 0.20 | 2.57 | 2.57 | 0.64 | 0.48 | 2.45 | 2.45 |
| 45 | 0.59 | 0.44 | 3.53 | 3.53 | 0.86 | 0.64 | 3.21 | 3.21 |
| 50 | 1.90 | 1.42 | 6.65 | 6.65 | 2.03 | 1.53 | 5.43 | 5.43 |
| 55 | 4.27 | 3.20 | 9.03 | 9.03 | 4.33 | 3.25 | 8.37 | 8.37 |
| 60 | 3.66 | 2.75 | 7.05 | 7.05 | 4.48 | 3.36 | 7.17 | 7.17 |
| 65 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

## Withdrawal:

### Less than 1 year

| Age | Incidence for 1000 active members per annum | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Male Officers Withdrawals | | Male Manuals Withdrawals | | Female Officers Withdrawals | | Female Manuals Withdrawals | | Post 98 Males Withdrawals | | Post 98 Females Withdrawals | |
| | FT | PT | FT | PT | FT | PT | FT | PT | FT | PT | FT | PT |
| 20 | 304.04 | 506.74 | 304.04 | 506.74 | 288.39 | 400.55 | 288.39 | 400.55 | 557.41 | 750.00 | 384.52 | 640.87 |
| 25 | 200.83 | 334.72 | 200.83 | 334.72 | 194.00 | 269.45 | 194.00 | 269.45 | 368.19 | 736.38 | 258.67 | 431.11 |
| 30 | 142.46 | 237.40 | 142.46 | 237.43 | 162.58 | 225.80 | 162.58 | 225.80 | 261.17 | 522.34 | 216.77 | 361.28 |
| 35 | 111.28 | 185.44 | 111.28 | 185.47 | 140.22 | 194.75 | 140.22 | 194.75 | 204.02 | 408.04 | 186.96 | 311.60 |
| 40 | 89.55 | 149.18 | 89.55 | 149.25 | 116.62 | 161.98 | 116.62 | 161.98 | 164.17 | 328.34 | 155.50 | 259.16 |
| 45 | 73.28 | 121.99 | 73.28 | 122.13 | 96.01 | 133.34 | 96.01 | 133.34 | 134.34 | 268.69 | 128.01 | 213.35 |
| 50 | 56.76 | 94.52 | 56.76 | 94.60 | 73.15 | 101.60 | 73.15 | 101.60 | 104.06 | 208.12 | 97.54 | 162.56 |
| 55 | 49.18 | 81.86 | 49.18 | 81.97 | 56.39 | 78.32 | 56.39 | 78.32 | 90.17 | 180.34 | 75.18 | 125.30 |
| 60 | 29.81 | 49.62 | 29.81 | 49.68 | 26.21 | 36.40 | 26.21 | 36.40 | 54.65 | 109.30 | 34.94 | 58.24 |

### Between 1-2 years

| Age | Incidence for 1000 active members per annum | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Male Officers Withdrawals | | Male Manuals Withdrawals | | Female Officers Withdrawals | | Female Manuals Withdrawals | | Post 98 Males Withdrawals | | Post 98 Females Withdrawals | |
| | FT | PT | FT | PT | FT | PT | FT | PT | FT | PT | FT | PT |
| 20 | 152.02 | 253.37 | 152.02 | 253.37 | 144.20 | 200.27 | 144.20 | 200.27 | 278.70 | 557.41 | 192.26 | 320.44 |
| 25 | 100.42 | 167.36 | 100.42 | 167.36 | 97.00 | 134.72 | 97.00 | 134.72 | 184.10 | 368.19 | 129.33 | 215.56 |
| 30 | 71.23 | 118.70 | 71.23 | 118.71 | 81.29 | 112.90 | 81.29 | 112.90 | 130.59 | 261.17 | 108.39 | 180.64 |
| 35 | 55.64 | 92.72 | 55.64 | 92.74 | 70.11 | 97.38 | 70.11 | 97.38 | 102.01 | 204.02 | 93.48 | 155.80 |
| 40 | 44.77 | 74.59 | 44.77 | 74.62 | 58.31 | 80.99 | 58.31 | 80.99 | 82.09 | 164.17 | 77.75 | 129.58 |
| 45 | 36.64 | 60.99 | 36.64 | 61.07 | 48.00 | 66.67 | 48.00 | 66.67 | 67.17 | 134.34 | 64.00 | 106.67 |
| 50 | 28.38 | 47.26 | 28.38 | 47.30 | 36.58 | 50.80 | 36.58 | 50.80 | 52.03 | 104.06 | 48.77 | 81.28 |
| 55 | 24.59 | 40.93 | 24.59 | 40.99 | 28.19 | 39.16 | 28.19 | 39.16 | 45.08 | 90.17 | 37.59 | 62.65 |
| 60 | 14.90 | 24.81 | 14.90 | 24.84 | 13.10 | 18.20 | 13.10 | 18.20 | 27.32 | 54.65 | 17.47 | 29.12 |

### Greater than 2 years

| Age | Incidence for 1000 active members per annum | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Male Officers Withdrawals | | Male Manuals Withdrawals | | Female Officers Withdrawals | | Female Manuals Withdrawals | | Post 98 Males Withdrawals | | Post 98 Females Withdrawals | |
| | FT | PT | FT | PT | FT | PT | FT | PT | FT | PT | FT | PT |
| 20 | 89.89 | 149.82 | 89.89 | 149.82 | 85.26 | 118.42 | 85.26 | 118.42 | 164.80 | 329.60 | 113.69 | 189.48 |
| 25 | 59.38 | 98.96 | 59.38 | 98.96 | 57.36 | 79.66 | 57.36 | 79.66 | 108.86 | 217.71 | 76.48 | 127.46 |
| 30 | 42.12 | 70.19 | 42.12 | 70.20 | 48.07 | 0.00 | 48.07 | 66.76 | 77.22 | 154.43 | 64.09 | 106.81 |
| 35 | 32.90 | 54.82 | 32.90 | 54.84 | 41.46 | 57.58 | 41.46 | 57.58 | 60.32 | 120.64 | 55.28 | 92.13 |
| 40 | 26.48 | 44.10 | 26.48 | 44.13 | 34.48 | 47.89 | 34.48 | 47.89 | 48.54 | 97.08 | 45.97 | 76.62 |
| 45 | 21.66 | 36.05 | 21.66 | 36.11 | 28.38 | 39.42 | 28.38 | 39.42 | 39.72 | 79.44 | 37.85 | 63.08 |
| 50 | 16.78 | 27.94 | 16.78 | 27.97 | 21.63 | 30.04 | 21.63 | 30.04 | 30.77 | 61.53 | 28.84 | 48.06 |
| 55 | 14.54 | 24.19 | 14.54 | 24.24 | 16.67 | 23.15 | 16.67 | 23.15 | 26.66 | 53.32 | 22.23 | 37.05 |
| 60 | 8.81 | 14.66 | 8.81 | 14.69 | 7.75 | 10.76 | 7.75 | 10.76 | 16.16 | 32.31 | 10.33 | 17.22 |

### Promotional salary scale

| Age | Promotional Salary Scales | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Male Officers & Post 98 Males | | Male Manuals | | Female Officers & Post 98 Females | | Female Manuals | |
| | FT | PT | FT | PT | FT | PT | FT | PT |
| 20 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 25 | 135 | 116 | 100 | 100 | 118 | 105 | 100 | 100 |
| 30 | 169 | 134 | 100 | 100 | 137 | 111 | 100 | 100 |
| 35 | 192 | 146 | 100 | 100 | 151 | 116 | 100 | 100 |
| 40 | 208 | 153 | 100 | 100 | 163 | 121 | 100 | 100 |
| 45 | 222 | 154 | 100 | 100 | 166 | 122 | 100 | 100 |
| 50 | 236 | 154 | 100 | 100 | 166 | 122 | 100 | 100 |
| 55 | 239 | 154 | 100 | 100 | 166 | 122 | 100 | 100 |
| 60 | 239 | 154 | 100 | 100 | 166 | 122 | 100 | 100 |
| 65 | 239 | 154 | 100 | 100 | 166 | 122 | 100 | 100 |

# Appendix F: Events since valuation date

### Post-valuation events

These valuation results are in effect a snapshot of the Fund as at 31 March 2014. Since that date, various events have had an effect on the financial position of the Fund. Whilst we have not explicitly altered the valuation results to allow for these events, a short discussion of these "post-valuation events" can still be beneficial in understanding the variability of pension funding.

### Investment conditions since 31 March 2014

In the period from the valuation date to late February 2015, investment markets moved in the following manner:

- asset returns have been between 12 – 14%; and
- long term Government bond yields have increased by more than long term expected price inflation, which is likely to have increased past service liabilities by around 14 – 17%.

It should be noted that the above is for information only: the figures in this report have all been prepared using membership data, audited asset information and market-based assumptions all as at 31 March 2014. In particular, we do not propose amending any of the contribution rates listed in the Rates & Adjustments Certificate on the basis of these market changes, and all employer contribution rates are based on valuation date market conditions. In addition, these rates are finalised within a risk-measured framework as laid out in the Fund's Funding Strategy Statement (FSS).

### Other events

Other than investment conditions changes above, I am not aware of any material changes or events occurring since the valuation date.

# Appendix G: Rates and adjustments certificate

In accordance with regulation 60(1) of the Administration Regulations we have made an assessment of the contributions that should be paid into the Fund by participating employers for the period 1 April 2015 to 31 March 2018 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in the Funding Strategy Statement dated DATE and our report on the actuarial valuation dated DATE.

The required minimum contribution rates are set out in the table below.

| | | |
|---|---|---|
| Signature: | | |
| Date: | DATE | DATE |
| Name: | Catherine McFadyen | Steven Scott |
| Qualification: | Fellow of the Institute and Faculty of Actuaries | Fellow of the Institute and Faculty of Actuaries |
| Firm: | Hymans Robertson LLP | Hymans Robertson LLP |
| | 20 Waterloo Street | 20 Waterloo Street |
| | Glasgow | Glasgow |
| | G2 6DB | G2 6DB |

# Statement to the rates and adjustments certificate

The Common Rate of Contribution payable by each employing authority under regulation 32(4)(a) of the Administration Regulations for the period 1 April 2015 to 31 March 2018 is 23.4% of pensionable pay (as defined in Appendix B).

Individual Adjustments are required under regulation 32(4)(b) of the Administration Regulations for the period 1 April 2015 to 31 March 2018 resulting in Minimum Total Contribution Rates (expressed as a combination of percentage of pensionable pay and monetary amounts) as set out below:

The contributions shown include expenses and the expected cost of lump sum death benefits but exclude early retirement strain and augmentation costs which are payable by Fund employers in addition.

| Employer code | Employer name | Contributions currently being paid in 2014/15 | Minimum Contributions for the Year Ending | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | 31 March 2016 | | 31 March 2017 | | 31 March 2018 | |
| | | | % Payroll | £000 | % Payroll | £000 | % Payroll | '£000 |
| **Council pool** | | | | | | | | |
| 52 | Clackmannanshire Council | 20.5% | 21.0% | | 21.0% | | 21.5% | |
| 53 | Falkirk Council | 20.5% | 21.0% | | 21.0% | | 21.5% | |
| 54 | Stirling Council | 20.5% | 21.0% | | 21.0% | | 21.5% | |
| 57 | Central Scotland Joint Valuation Board | 20.5% | 21.0% | | 21.5% | | 22.0% | |
| 77 | Falkirk Community Trust | 20.5% | 21.0% | | 21.0% | | 21.5% | |
| **Other stabilised bodies** | | | | | | | | |
| 56 | Central Scotland Fire and Rescue Service | 20.5% | 18.3% | 33.8 | 18.3% | 41.6 | 18.3% | 50.1 |
| Pool | Scottish Police Authority | 20.7% | 18.2% | 180.7 | 18.2% | 188.0 | 18.2% | 195.5 |
| 13 | Strathcarron Hospice | 20.1% | 20.6% | 14.6 | 20.6% | 30.4 | 20.6% | 47.4 |
| 66 | Forth Valley College | 19.4% | 17.9% | 117.5 | 17.9% | 152.8 | 17.9% | 190.7 |
| 38 | Scottish Environment Protection Agency | 18.0% | 16.1% | 1,015.9 | 16.1% | 1,276.6 | 16.1% | 1,556.6 |
| 34 | Scottish Children's Reporter Admin. | 17.6% | 17.4% | 88.3 | 17.4% | 157.4 | 17.4% | 231.9 |
| 29 | VisitScotland | 21.6% plus £94.5k | 24.7% | 88.3 | 24.7% | 89.9 | 24.7% | 91.4 |
| **Transferee Admission Bodies** | | | | | | | | |
| 74 | Valad Management (UK) Ltd | 22.2% | 22.2% | 0.0 | 22.2% | 0.0 | 22.2% | 0.0 |
| 75 | Amey (Clackmannanshire Schools) | 22.8% | 22.8% | 0.0 | 22.8% | 0.0 | 22.8% | 0.0 |
| 69 | Forth and Oban Limited (Schools Contract) | 18.8% | 18.8% | 0.0 | 18.8% | 0.0 | 18.8% | 0.0 |
| **Community Admission Bodies** | | | | | | | | |
| 5 | Dollar Academy Trust | 19.8% | 18.9% | 20.1 | 18.9% | 25.7 | 18.9% | 31.7 |
| 11 | Ballikinrain School | 21.4% | 18.3% | 67.7 | 18.3% | 92.5 | 18.3% | 119.1 |
| 14 | Stirling Enterprise Park Limited | 22.8% | 19.3% | 13.4 | 19.3% | 13.9 | 19.3% | 14.5 |
| 15 | Scottish Autism | 17.1% | 18.0% | 0.0 | 18.9% | 0.0 | 19.8% | 0.0 |
| 19 | Ceteris | 25.8% | 19.5% | 40.2 | 19.5% | 41.8 | 19.5% | 43.4 |
| 64 | Seamab School | 19.1% | 17.1% | 7.4 | 17.1% | 3.8 | 17.1% | 0.0 |
| 68 | Active Stirling Ltd | 17.7% | 13.3% | 54.7 | 13.3% | 28.5 | 13.3% | 0.0 |
| 70 | Thinkwhere | 17.3% | 12.6% | 20.7 | 12.6% | 10.8 | 12.6% | 0.0 |
| **Small Admitted Bodies pool** | | | | | | | | |
| 18 | Snowdon School Ltd | 21.9% | 21.9% | 0.0 | 21.9% | 0.0 | 21.9% | 0.0 |
| 22 | Association of Scottish Colleges | 21.9% | 10.0% | 4.9 | 10.0% | 5.1 | 10.0% | 5.3 |
| 24 | Cowane's Hospital | 21.9% | 21.9% | 0.0 | 21.9% | 0.0 | 21.9% | 0.0 |
| 28 | Smith Art Gallery | 21.9% | 21.9% | 0.0 | 21.9% | 0.0 | 21.9% | 0.0 |
| 36 | Central Carers Association | 21.9% | 21.9% | 0.0 | 21.9% | 0.0 | 21.9% | 0.0 |
| 61 | Water Industry Commissioner for Scotland | 21.9% | 19.1% | 22.6 | 19.1% | 23.5 | 19.1% | 24.5 |
| 67 | Stirling District Tourism Ltd | 21.9% | 21.9% | 0.0 | 21.9% | 0.0 | 21.9% | 0.0 |
| **'Least risk' employers** | | | | | | | | |
| 31 | Alsorts | 21.9% | 35.0% | 2.5 | 35.0% | 8.3 | 35.0% | 14.4 |
| 37 | Central Scotland Regional Equality Council Ltd | 21.9% | 28.2% | 0.0 | 33.8% | 0.5 | 33.8% | 5.3 |
| 59 | Open Secret | 22.4% | 36.2% | 1.0 | 36.2% | 9.1 | 36.2% | 17.8 |
| 63 | Plus | 21.9% | 35.9% | 1.8 | 35.9% | 9.0 | 35.9% | 16.7 |
| 65 | McLaren Community Leisure Centre | 21.9% | 35.1% | 0.0 | 35.1% | 4.5 | 35.1% | 9.4 |

**Further notes:**

- Contributions should be paid to Falkirk Council Pension Fund ('the Fund') at a frequency in accordance with the requirements of the Regulations.
- Further sums should be paid to the Fund to meet the costs of any non-ill health early retirements and/or augmentation (i.e. additional membership or additional pension) using methods and factors issued by me from time to time, or GAD guidance if I consider it to be appropriate.
- In addition, further sums may be required to be paid to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those included within my assumptions.
- The certified contribution rates represent the minimum level of contributions to be paid. Employing authorities may pay further amounts at any time, and future periodic contributions may be adjusted on a basis approved by the Fund actuary.

### Ill health liability insurance

Note that, if an employer has ill health liability insurance in place with a suitable insurer and provides satisfactory evidence to the administering authority, then their Minimum Total Contribution Rate may be reduced by the lower of their insurance premium and their ill-health budget (as set out in **Appendix H**), for the period the insurance is in place.

# Appendix H: Ill Health Retirements

Included in the valuation calculations is an assumption in relation to the expected incidence of retirements on the grounds of ill health for employee members for each year in the future.

The following table sets out:

- the expected cost per annum as a monetary amount as at the valuation date; and
- the expected cost per annum as a percentage of pensionable pay.

| Employer Code | Employer Pool | Expected Cost | |
|---|---|---|---|
| | | £000's p.a. | % of payroll p.a. |
| **Scheduled bodies** | | | |
| 52 | Clackmannanshire Council | **868.6** | 2.4% |
| 53 | Falkirk Council | **2,438.0** | 2.2% |
| 54 | Stirling Council | **1,230.5** | 2.3% |
| 57 | Central Scotland Joint Valuation Board | **25.0** | 2.1% |
| **Other stabilised bodies** | | | |
| 56 | Central Scotland Fire and Rescue Service | **32.4** | 2.8% |
| pool | Scottish Police Authority | **150.9** | 2.3% |
| 13 | Strathcarron Hospice | **57.1** | 2.1% |
| 66 | Forth Valley College | **112.3** | 2.1% |
| 38 | Scottish Environment Protection Agency | **793.9** | 2.0% |
| 34 | Scottish Children's Reporter Admin. | **259.9** | 2.2% |
| 29 | VisitScotland | **11.0** | 3.1% |
| **Transferee Admission Bodies** | | | |
| 74 | Valad Management (UK) Ltd | **2.1** | 3.7% |
| 75 | Amey (Clackmannanshire Schools) | **2.7** | 2.4% |
| 69 | Forth and Oban Limited (Schools Contract) | **21.0** | 4.0% |
| **Community Admission Bodies** | | | |
| 5 | Dollar Academy Trust | **37.3** | 2.4% |
| 11 | Ballikinrain School | **28.4** | 2.1% |
| 14 | Stirling Enterprise Park Limited | **7.0** | 2.0% |
| 15 | Scottish Autism | **140.7** | 1.7% |
| 19 | Ceteris | **12.7** | 2.2% |
| 64 | Seamab School | **11.8** | 2.3% |
| 68 | Active Stirling Ltd | **25.2** | 1.4% |
| 70 | Thinkwhere | **9.7** | 1.6% |
| **Small Admitted Bodies pool** | | | |
| 18 | Snowdon School Ltd | **9.6** | 2.6% |
| 22 | Association of Scottish Colleges | **0.4** | 1.0% |
| 24 | Cowane's Hospital | **0.9** | 1.6% |
| 28 | Smith Art Gallery | **0.7** | 0.6% |
| 36 | Central Carers Association | **3.8** | 2.5% |
| 61 | Water Industry Commissioner for Scotland | **17.1** | 2.3% |
| 67 | Stirling District Tourism Ltd | **2.7** | 2.4% |
| **'Least risk' employers** | | | |
| 31 | Alsorts | **0.4** | 2.2% |
| 37 | Central Scotland Regional Equality Council Ltd | **1.0** | 1.5% |
| 59 | Open Secret | **1.3** | 2.9% |
| 63 | Plus | **1.1** | 3.4% |
| 65 | McLaren Community Leisure Centre | **0.7** | 2.3% |

March 2015

**FALKIRK COUNCIL**

**Subject:** **PENSION FUND – REVIEW OF INVESTMENT STRATEGY**
**Meeting:** **JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE**
**Date:** **12 MARCH 2015**
**Author:** **CHIEF FINANCE OFFICER**

## 1. INTRODUCTION

1.1 This report provides the Panel and Committee with an update on the progress of the Fund's review of investment strategy.

1.2 The report highlights the level of risk associated with various investment strategies, the options for reducing that risk and how the chosen investment strategy can be put into practice.

1.3 A short paper from Hymans Robertson is attached as an appendix to the report.

## 2. BACKGROUND

2.1 At the joint meeting of Panel and Committee on 11 December 2014, it was agreed that the review of Fund investment strategy should proceed on the following basis, recognising that the approach would be to work sequentially from a) to d):

a) Determine the level of risk that the Committee was prepared to tolerate
b) Determine the mix of growth and defensive assets that the Fund should target
c) Determine the mix of assets that the Fund should hold in order to meet its objectives
d) Determine the managers who should manage these assets?

2.2 It was recognised that this process would take time to work through and would ultimately require input from Hymans Robertson as investment advisers and from the in house investment team.

2.3 Information relating to the process was given to Panel and Committee members at the Investment Workshop on 2 February 2015.

## 3. INVESTMENT STRATEGY AND RISK MANAGEMENT

3.1 The Fund's objective is to be 100% fully funded by 2035 (i.e. in 20 years).

3.2 There are, however, no guarantees that full funding will be achieved in this timeframe and accordingly, it is important that Panel and Committee understand the risks that are inherent in the funding strategy. This includes the upside risk (i.e. the risk of not being fully funded) and the downside risk (i.e. the risk of having a very poor funding level).

3.3 The key components of the current strategy are as follows:

- Deficit being repaired over a 20 year period
- Expected asset outperformance is the return on Gilts + 1.6%
- Current asset mix is 10% Bonds and 90% Other Assets

3.4 Based on Hymans actuarial modelling, the current strategy has the following chances of success/failure:

- there is a 80% chance that the Fund will be 100% (fully) funded after 20 years
- there is a 5% chance that the funding level will be 50% or worse after 20 years
- there is an 85% chance that the funding level will be at least 70% by 2017

3.5 By increasing the level of bonds relative to other assets, it is possible to reduce the levels of risk without materially affecting the chances of achieving full funding. The table below shows how the chances of success are affected as the investment strategy is altered:

| | **Investment Strategy Options** | | | |
|---|---|---|---|---|
| | 10% Bonds 90% Other | 20% Bonds 80% Other | 30% Bonds 70% Other | 40% Bonds 60% Other |
| Probability of being fully funded after 20 years | 80% | 80% | 80% | 79% |
| Funding level based on the average of the worst 5% economic outcomes | 50% | 55% | 60% | 65% |
| Probability that funding level will be at least 70% by 2017 | 85% | 88% | 90% | 91% |

3.6 The key messages from the table are that:

- Reducing growth assets to 60% does not adversely affect the 100% funding objective
- Increasing bond exposure helps reduce the risk of poor funding outcomes

3.7 Hymans modelling indicates that the Fund could adopt a lower risk strategy (i.e. increase bond exposure). This could be applied on a gradual basis with a de-risking plan put in place to control the process. The plan would consist of a series of triggers which would prompt the Fund to change its bond exposure as funding levels changed. Triggers could be reviewed at subsequent valuations to ensure they remained relevant, and indeed in the interim, if the landscape changed materially.

3.8 Whilst having a de-risking plan in place would demonstrate good risk management of the Fund, it is worth noting that gilt yields have fallen since March, 2014 and the funding level of 85% in March 2014 is now likely to be closer to 80%. Taken in conjunction with the fact that gilts are now even more expensive than they were in March last year, means that there is no immediate sound basis on which to put a "de-risking" plan into action.

3.9 Representatives from Hymans Robertson are attending the meeting and will be able to answer questions on a possible de-risking strategy.

## 4. IMPLEMENTING THE STRATEGY

4.1 Once the high level investment strategy has been determined, the next stage of the investment review is to implement any changes, such as asset type, asset allocation and managers, which may be required to enable the Fund to meet its strategic objectives.

4.2 This part of the review will look at factors such as current market influences, prospective returns from asset classes and underlying strategies within each of the asset pools. This will include:

- The balance between active and passive management
- The arguments for a non-market cap passive mandate
- The composition of the bond portfolio
- The review of existing managers and mandates
- The costs of realigning the portfolio

4.3 In order to progress the review, it is suggested that the Committee may wish to form a sub-group to work on these issues with the Chief Finance Officer, the internal team and Fund advisers. It is recognised that the scope of work involved may require initial recommendations only to be brought to the next joint meeting of Committee and Board and further recommendations brought to a subsequent joint meeting.

## 5. CONCLUSION

5.1 The current investment and contribution strategies mean that the Fund has an 80% chance of being fully funded after 20 years and only a 5% chance of having a funding level less than 50% over the same period.

5.2 Actuarial modelling suggests that there are opportunities for the Fund to reduce its exposure to assets, such as equities, without materially affecting the chances of the Fund achieving a 100% funding position. Committee may wish to adopt a lower risk strategy and put a "de-risking" plan in place, although due to current financial conditions there would be no need to put such a plan into action immediately.

5.3 The potential for the Fund to alter its assets and review asset allocations will be considered in the coming weeks. This is to ensure that investments remain aligned with Fund objectives and that mandates are operating satisfactorily. A sub group of the Committee could be an effective way of taking these matters forward.

**6. RECOMMENDATIONS**

**6.1 The Panel and Committee are asked to note the contents of this report and invited to comment as appropriate.**

**6.2 The Committee is asked:**

**i) to note the range of investment strategies set out in paragraph 3.5;**

**ii) to recognise the risks associated with these strategies;**

**iii) to determine which of the strategies should be adopted;**

**iv) to agree that a de-risking plan be put in place to allow risk to be further reduced as the funding level improves;**

**v) to agree that a sub group of the Committee be convened to make recommendations regarding the implementation of the strategy and the range of asset classes, asset allocations and managers to be deployed by the Fund; and**

**vi) to ask the Chief Finance Officer to report progress on these matters to the next meeting of the Committee.**

**Chief Finance Officer**

**Date: 4 March 2015**

**Contact Officer: Alastair McGirr**

**<u>LIST OF BACKGROUND PAPERS</u>**

NIL

# Investment Strategy

## Addressee

This paper is addressed to the Officers and Pensions Committee ("the Committee") of the Falkirk Pension Fund ("the Fund"). It follows on from the training session held on 2 February 2015. The slides that were used at the training session have been attached to this paper as an Appendix. This paper provides a summary of the training and sets out options for consideration for the future investment strategy for the Fund. It has not been prepared for use for any other purpose. The paper should not be released or otherwise disclosed to any third party except as required by law or regulatory obligation or without our prior written consent.

We accept no liability where the report is used by, or released or otherwise disclosed to, a third party unless we have expressly accepted such liability in writing. Where this is permitted, the report may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

## Setting objectives

The Fund's Statement of Investment Principles states that the Fund's objective is 'to provide pension and lump sum benefits on death, before or after retirement … In meeting this objective, the Fund will also seek to keep contributions as low and as stable as possible through effective management of its assets.' This objective is consistent with the published objectives of other LGPS funds.

This objective is partially quantified by the actuarial valuation of the Fund. The valuation establishes the target funding basis which determines the level of assets the Fund aims to hold to meet the liabilities. At the most recent valuation as at 31 March 2014, the Funds had a funding level of 85%, a shortfall of £283m was identified and an appropriate contribution strategy was put in place to partially fund the deficit. The contribution strategy alone will not be sufficient to restore the fund to full funding and there is reliance on the Fund's investment strategy to deliver returns which will assist in returning the Fund to a full funding position.

In order to help identify the optimal investment strategy, it would be helpful to further refine the Fund's objective and to transform the qualitative statements above into quantitative measures which could then be reflected in modelling work which could help to identify the appropriate level of risk to be taken now and in the future as the funding level evolves.

When full funding is achieved, the Fund will still need some growth, but significantly less than is needed today.

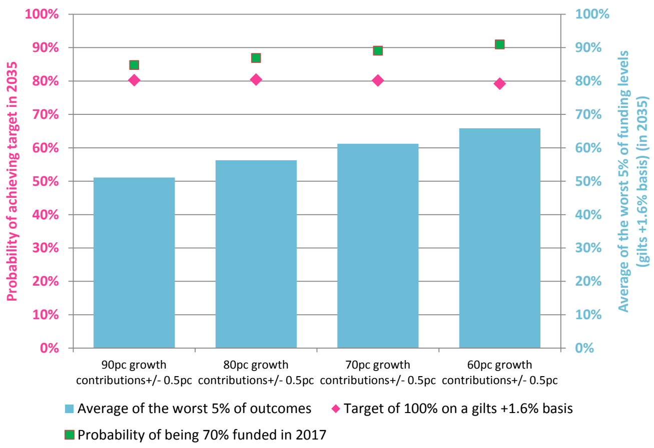
As an example these measures could be;

- The probability of being fully funded by 2035 should be greater than 75%
- The probability of the funding level being below 60% in 2035 should be very small, say 10-20%
- The probability of the funding level falling below 70% at the next valuation in 2017 should be less than 20%.

The Committee should discuss and agree the measures that are consistent with their appetite for risk. Chart 1 below shows the output from modelling that was done based on membership data at 31 March 2013 and calibrated to market data as at 30 June 2014.

From the employers' perspective we need to balance the investment strategy with the contributions strategy. In our experience employers are content to accept relative stability in contributions, which could result in less potential for reductions in contributions, in return for a reduced risk of higher contributions.

Chart 1: Probability of meeting target by 2035, risk in 2035 and 2017




Under the current strategy (90% growth assets) there was

- an 80% chance of achieving full funding by 2035
- a 5% chance that the funding level would be 50% or lower by 2035
- c. 15% chance of the funding level falling below 70% at the next valuation

Reducing the growth assets from 90% down to 60% marginally reduces the probability of reaching full funding but also improves the downside in both the long and the short term.

### Setting the investment strategy

The Fund should ideally take no more risk than it needs to achieve full funding over the agreed time horizon. Taking more risk than is required might make a small difference to the probability of reaching full funding but will also result in a potentially poorer outcome on the downside. When risk can be reduced without impacting on the probability of success then this option should be given serious consideration. The result should be a smooth progression from the high returns required today down to the lower level that will be required when full funding is achieved.

### Funding level evolution

Including growth assets like equities in the investment strategy means that the expectation is that the assets will grow faster than the liabilities over the long term. As a result the funding level is expected to improve over time. For example if the fund were targeting full funding over 15 years and currently had a funding level of 82% then in 5 years' time the funding level would be expected to have increased to c 88%. It is only if the funding level gets ahead of 'plan' that de-risking should take place, otherwise there is a risk that the contribution rate takes the strain and has to be increased.

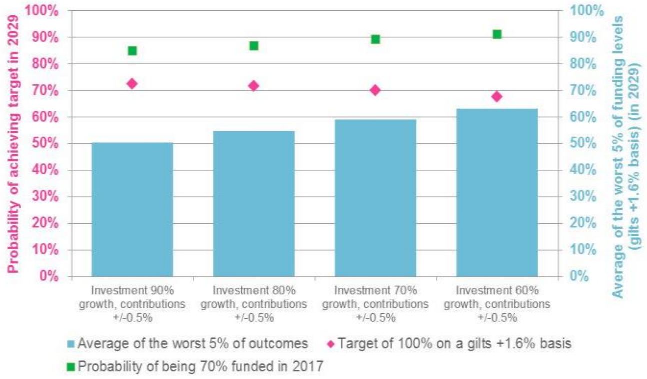
If the funding level increases faster than expected then there may be an opportunity to reduce the level of risk in the strategy. This would be done by reducing the Fund's exposure to equities. An extension of the modelling that has already been carried out for the Fund could be used to identify the appropriate funding level for reducing the level of risk while maintaining an acceptable chance of reaching full funding and reducing the volatility on the downside.

The modelling should also consider the impact on the contribution rate as there is a requirement to provide stability on the level of employer contribution rates. If the level of risk is reduced too quickly then the burden will be borne by the contribution rate. The presentation at the training session on funding issues and the interaction with investment strategy made this very clear.

### Time horizon

The decision about de-risking is dependent on the timescale; if the objective was to achieve full funding earlier, say in 2029 rather than 2035, then it is likely that the exposure to risky assets will need to remain 'higher for longer'. This can be seen clearly if Chart 2 below is compared with Chart 1 above. 2029 is about the time when the Fund is likely to go cashflow negative (when benefit outgo exceeds contribution income.)

Chart 2: probability of meeting target in 2029, risk in 2029 and 2017




### Feedback on objectives

We sought some feedback from those who attended the training session to firm up on the time horizon and the degree of certainty for achieving full funding that the Officers and Committee would be comfortable with. While the balance of opinion on timescale was that the appropriate time horizon was 2035, there was some support from the Committee for a shorter timescale, c 2026. A relatively high degree of certainty was common in the responses with the average pointing towards 80-90% probability of achieving full funding. On the potential for the funding level to deteriorate by the next valuation in 2017, the consensus was that a level of 70% or better was desirable and that a good degree of certainty (70-80%) was required around this not being breached.

### Recommendations

In order to set an investment strategy for now and a plan for adapting the strategy as the funding level changes, the Committee should agree;

1. the time horizon for reaching full funding
2. the preferred probability of being fully funded at the time horizon
3. the acceptable lower 'limit' for the funding level and the acceptable probability of falling below this level at the time horizon
4. the probability that can be tolerated of the funding level falling below an agreed funding level at the next valuation in 2017

Following that, further modelling should be carried out which will help to define

a) a funding level trigger for reducing risk

b) the evolution of that funding level trigger over time

c) the size of the risk reduction that should be implemented if the trigger is reached

d) implications for contribution strategy

The agreed trigger should be reviewed at each formal valuation and a new trigger for further de-risking should be considered after the first trigger is implemented.

A robust process for monitoring the funding level on an appropriate frequency should be implemented to ensure that the Fund can act quickly if the trigger level is reached. This may require delegation to the Officers.

Prepared by:-

Linda Selman, Partner

Simon Jones, Senior Investment Consultant

Catherine McFadyen, Fund Actuary

February 2015

For and on behalf of Hymans Robertson LLP

**AGENDA ITEM 8**

**FALKIRK COUNCIL**

**Subject:** **GENERAL GOVERNANCE MATTERS**
**Meeting:** **JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE**
**Date:** **12 MARCH 2015**
**Author:** **CHIEF FINANCE OFFICER**

## 1. INTRODUCTION

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

## 2. PENSION FUND GOVERNANCE ARRANGEMENTS

2.1 At the joint meeting of the Pensions Committee and Pensions Panel on 11 December 2014, the Pensions Committee recommended that:

- the Pensions Panel be discontinued;
- a Pension Board be established;
- the Pensions Committee remain as presently configured (i.e. 6 Falkirk Council members plus 3 co-opted members with one each drawn from Unions, Employers and Pensioners);
- the Pension Board should consist of 4 employer members and 4 trade union members;
- the Trade Union members would be drawn from Unison, GMB, Unite and UCATT;
- the employers would be drawn from Clackmannanshire Council, SEPA, SCRA and one other Scheduled or Admitted Body;
- the place for Clackmannanshire Council would be shared with Stirling Council depending on which one was already represented on the Pensions Committee.

2.2 In accordance with the scheme of delegation, the recommendations were considered at the meeting of Falkirk Council on 17 December 2014 and agreed in full.

2.3 It was a recommendation of the Committee that in the event of the final Governance regulations allowing the Board to contain non-Union representation, then the Board should consist of 5 member and 5 employer representatives in order to accommodate a non-Union member. As it happens, the final regulations state that Board members must be from a recognised Trade Union, in which case this recommendation is no longer of relevance.

2.4 The Employers and Unions named above have been invited to nominate an individual to sit on the Pension Board.

2.5 A constitution for the Falkirk Pension Board is currently being constructed based on the model constitution agreed by the Scottish Local Government Pensions Advisory Group and will enable appropriate Governance arrangements to be put in place for the Fund.

2.6 The requirement for the Board to have nominated substitutes has been dropped from the final Governance regulations.

2.7 The Chief Finance Officer has written to the employers and Unions being represented on the Pension Board to seek nominations from them. Formal documentation relating to the Board will be finalised once nominees have been confirmed.

2.8 The first meeting of the Joint Pensions Committee and Pension Board will be held on 26 June 2015. Initial training for new Board Members will be arranged in late May/early June. Ongoing training will also be provided.

## 3. RISK REGISTER

3.1 The Committee has asked officers to provide a regular update on any areas of heightened risk. The following items are considered worthy of reporting:

| **Identified Risk per Risk Register** | **Reason for Change in Risk Rating** |
|---|---|
| Failure of IT Systems | The new pension administration system ("Altair") is scheduled to "go live" from week commencing 9th March, 2015. The Council's Public Service Network protocol requires that Altair runs on a network separate to that of other Council networks. This may result in technical issues in the short term.<br><br>*Mitigation – Staff have been provided with additional PCs that connect only to the "Altair" network. Testing has been undertaken with no adverse results. External specialist resource is being procured by ICT as a further safeguard.* |
| Staff error or inability to carry out duties | Due to migration taking place within a compressed timescale, staff will require time in order to familiarise themselves with the new systems configuration.<br><br>*Mitigation – On site training has been delivered to staff by the contractor and a further tranche will be available shortly after the go live date* |
| Failure to implement material changes to Scheme rules | LGPS 2015 contains an array of new rules for both scheme employers and the Fund. There is a risk that these rules may not be applied or may be misapplied.<br><br>*Mitigation – Training has been delivered to both employers and Pension Fund staff. In addition, the national websites to which employers have been directed contain valuable information about the Scheme including comprehensive guides for Payroll and HR Administrators. The new Pensions administration system will provide the full range of calculations needed to comply with LGPS 2015.* |

| | |
|---|---|
| Funding position deteriorates | From April, 2015, individuals from the age of 55 in a defined contribution (DC) scheme will be able to access their pension pot by taking the proceeds as a lump sum, albeit with the element in excess of 25% being subject to a tax charge. There is a risk that a material number of LGPS members will transfer their rights to a DC arrangement in order to realise the cash sums on offer. This could lead to the Fund a) having to hold more cash, and b) facing a drain on its assets.<br><br>*Mitigation – individuals will be required to take advice from a professional adviser who is authorised by the Financial Conduct Authority (FCA) before transferring. Ministers will have powers to reduce the value of transfers if they consider that the cumulative scale of transfers will increase the risk of tax-payers having to intervene to support a scheme.* |

## 4. SOCIAL HOUSING

4.1 The Committee has agreed to make a £30m commitment to Hearthstone plc to fund Social and Affordable Housing. The Fund objective is to deliver returns of RPI + 2%.

4.2 An initial drawdown of £15m has been invested in a short term debt instrument pending deployment of the capital to support the Social Housing initiative. A further £1.8 million has been drawndown to support the first phase of the Affordable Housing investment. This relates to a unit in Bo'ness which the Housing Fund for Scotland intend to acquire and lease to Castle Rock Edinvar (CRE).

4.3 There has been a series of meetings between CRE, the Scottish Government and the housing leads of the three Councils to facilitate the social housing builds on a local basis. The position so far is that:

- The investment will be split on a ratio of 3/2/1 across Falkirk / Stirling / Clackmannanshire
- Provisional site locations have been identified and CRE are progressing more detailed development proposals including unit numbers and sizes for agreement
- Rent levels are to be kept under review to ensure that they are comparable to local operators and in accordance with Scottish Government funding criteria
- In accordance with the decision of Falkirk Council's Executive on 13 January 2015 further discussions are ongoing with the Scottish Government regarding Affordable Housing Grant in order to meet the identified funding gap. Once these have been concluded a further report will be submitted to Executive for consideration.

## 5. LOCAL INFRASTRUCTURE – COLLABORATION WITH LOTHIAN PENSION FUND

5.1 The Pensions Committee at its meeting of 5 June 2014 agreed to invest £30m in UK infrastructure projects in collaboration with the Lothian Pension Fund.

5.2 At present, two potential investments are under serious consideration – a Scottish renewable asset and a UK regulated utility. The expected return from the investments is around 10%.

5.3 The Resourcing Agreement, whereby staff from the Lothian Pension Fund are considered to be Falkirk Council employees when working on Falkirk Fund business, has now been signed. This agreement extends to both infrastructure other investment related work being undertaken.

## 6. NATIONAL FRAUD INITITAIVE

6.1 The National Fraud Initiative is a data matching exercise conducted every two years by the Audit Commission to detect fraud and irregularities in various areas of public finance.

6.2 The Pensions Section submitted pensioner and deferred pensioner data to the Commission in October, the main aim being to identify pensioners who have died but for whom payments are still being claimed. The exercise also helps identify deferred pensioners who may have died without the Council being notified.

6.3 The results show that one elderly pensioner, resident in a Nursing Home, had died in mid-2014 and that his pension had continued to be paid until his death was identified through the NFI exercise. A survivor's pension is payable to the deceased's 85 year old widow which will allow the pension overpayment to be recovered. No other irregularities were reported.

## 7. ABOLITION OF CONTRACTING OUT

7.1 As part of the Government initiative to introduce a Single Tier State pension, contracting out is being abolished from April, 2016.

7.2 Contracting Out allows employees and employers who participate in a contracted out pension scheme, such as the Local Government Pension Scheme, to pay a reduced rate of national insurance. In return, the Scheme has to guarantee that pensions in retirement will be not less than a guaranteed minimum – the Guaranteed Minimum Pension (GMP). Broadly speaking, the State is responsible for indexing the GMP and the Scheme responsible for indexing the rest of the pension.

7.3 The impact on Falkirk Council alone of losing the Contracting – Out Rebate has been estimated at around £4m per annum.

7.4 The GMP is calculated by HM Revenue and Customs (HMRC), based on employers' national insurance returns, and is a key component in ensuring that scheme members receive the correct inflationary increases on their benefits.

7.5 HMRC will only accept queries in relation to the GMP until 2018. They have launched a reconciliation service to assist schemes in verifying that all GMP liabilities attributed to their scheme are valid.

7.6 The scale of the reconciliation exercise is such that it is likely to be more cost effective for the work to be carried by an external provider. Initial estimates suggest that the cost of preliminary reconciliation and analysis will be in the order of between £8,000 - £10,000. This work is considered necessary to satisfy the Regulator's data quality standards; to ensure that as far as possible that pensioners are receiving the correct level of pension; and to check that no liabilities are being incorrectly attributed to the Fund.

## 8. STAFF TRANSFER – ADVICE SERVICE PARTNERSHIP

8.1 Agreement has been reached in principle for a small section of staff from Stirling Council to be transferred to the Advice Services Partnership (ASP). This is a not for profit social enterprise, which specializes in providing financial advice to the local community.

8.2. Stirling Council, in its role as a fund employer wishes to protect the pension rights of the dozen staff being transferred by allowing them continued access to the Local Government Pension Scheme. To this end, Stirling has agreed to act as guarantors of ASP's admission to the Scheme and has accepted responsibility for all pension liabilities of transferred staff. This includes any underpayment by ASP of employer contributions and any current or future funding deficit.

8.3 Where a local authority is entering into a contract with a third party which involves a staff transfer and the local authority wishes the staff to have continued access to the Scheme, then the Fund is obliged to allow the new employer to have access to the Scheme.

8.4 As Stirling Council has accepted responsibility for ASPs participation in the Scheme, there is no financial risk to other fund employers as a result of the staff transfer.

## 9. LOCAL AUTHORITY PENSION FUND FORUM (LAPFF)

9.1 The LAPFF represents the interests of over 60 local authority pension funds with combined assets of around £120 billion. Its mission is to promote the highest standards of corporate responsibility amongst the companies in which member funds invest.

9.2 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.

9.3 During the last quarter, LAPFF activity has included:

- Meeting the chairmen of BP and Shell to discuss their carbon management strategy and promoting a resolution calling for Shell to disclose a longer term carbon strategy
- Holding conference calls held with various defence companies regarding the sale and production of cluster munitions
- Meetings with Kier and Carillion over alleged blacklisting of Trade Union members
- Successive meetings and calls with Trinity Mirror regarding the phone hacking scandal
- Meetings with the BG Group regarding the nature of their CEO's remuneration package

9.4 The LAPFF have signalled that corporate tax avoidance will be a focus of their activities in 2015.

9.5 Councillor Kieran Quinn, chairman of LAPFF, has agreed to attend the September meeting of the Pensions Committee / Board to talk about the work of LAPFF.

9.6 The LAPFF Annual Conference is being held in Bournemouth on 2nd – 4th December, 2015. Committee may wish to consider sending delegates to this event.

**10. PENSION FUND ANNUAL CONFERENCE**

10.1 The Fund Annual Conference is taking place on the morning of 16th April, 2015 at Callendar House, Falkirk. Formal invitations will be issued shortly.

10.2 Speakers will include representatives from Hymans Robertson, Northern Trust and Legal and General.

**11. RECOMMENDATION**

**11.1 The Pensions Panel and Committee are asked to note the contents of this report and invited to comment as appropriate.**

**Chief Finance Officer**

**Date: 27 February 2015**

**Contact Officer: Alastair McGirr**

**<u>LIST OF BACKGROUND PAPERS</u>**

NIL

**AGENDA ITEM 9**

# FALKIRK COUNCIL

**Subject:** PENSION FUND – BUDGET 2015/16
**Meeting:** JOINT MEETING OF PENSIONS PANEL AND COMMITTEE
**Date:** 12 MARCH 2015
**Author:** CHIEF FINANCE OFFICER

## 1. INTRODUCTION

1.1 This report presents the Pensions Panel and Pensions Committee with details of the Pension Fund's budget for 2015/16.

## 2. BACKGROUND

2.1 In its annual report on the 2013/14 accounts, Audit Scotland indicated that a budget for controllable administration costs should be presented to the Pensions Committee/Panel for approval and that the performance against budget be reported.

## 3. BUDGET

3.1 The budget for the Pension Fund in 2015/16 is as detailed below:

| | Budget for 2015/16 |
|---|---|
| Employee Expenses | £432,092 |
| Pensions Administration System | £455,100 |
| Supplies and Services – Indirect | £97,342 |
| Supplies and Services – Direct | £171,500 |
| Central Support Charges | £99,174 |
| Income | -£2,070 |
| **Benefits Administration Costs** | **£1,253,138** |
| | |
| Investment Management Costs | £5,160,283 |
| | |
| **Grand Total** | **£6,413,421** |

3.2 It is intended that performance against the budget will be reported at half year and at year end.

## 4. RECOMMENDATION

**4.1 The Pensions Panel and Pensions Committee are asked to note the pension fund budget for 2015/16, and that performance against the budget will be reported at half year and year end.**

**Chief Finance Officer**

**Date: 01 March 2015**

**Contact Officer: Alastair McGirr**

**<u>LIST OF BACKGROUND PAPERS</u>**

NIL

**AGENDA ITEM 10**

# FALKIRK COUNCIL

**Subject:** CLASS AND GROUP ACTIONS
**Meeting:** JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE
**Date:** 12 MARCH 2015
**Author:** CHIEF FINANCE OFFICER

## 1. INTRODUCTION

1.1 This report provides the Pensions Committee and Pensions Panel with information regarding two litigations in which the Fund may be eligible to participate.

1.2 The two companies concerned are Petroleo Brasiliero (Petrobras) and Tesco plc.

## 2. CLASS ACTIONS AND GROUP ACTIONS

2.1 From time to time, pension funds may feel justified in taking legal action against the companies in which they have invested. Usually, such action will be undertaken in conjunction with other investors in what are known as Class or Group Actions. Evidence shows that by working collectively, investors can obtain a better settlement than by bringing individual actions. It is also argued that the practice of taking collective action in the face of corporate malpractice can help maintain good standards of corporate governance.

2.2 A "Class Action" generally describes the situation where a group of investors take action against a publicly traded company under US federal law.. The "Class Members" will usually have purchased shares at a time when the company's value was inflated through some form of alleged misrepresentation. The Class is represented by an attorney who bears the cost if the action is lost, but shares in the proceeds if the action is successful. Despite legal challenges, the doctrine of "presumption of reliance", which deems that investors are entitled to rely on the integrity of the market when purchasing a security, still prevails.

2.3 For UK investors, it is important to note that only shares purchased on US Exchanges are covered by US Securities laws.

2.4 A "Group Action" tends to describe collective legal action that is not covered by US Class proceedings. With Group Actions brought in the UK, reliance on misstatements has to be proved and the loser of the action potentially has to bear the costs (rather than these being borne by a legal firm).

2.5 The Fund is advised on Class and Group litigation by international law firm Robbins Geller Rudman and Dowd.

2.6 Funds arguably owe a fiduciary duty to their stakeholders to engage in these types of legal actions in order to maximise fund income. However, participation has to be tempered with an assessment of the potential risks versus likely returns and the resource implications of supporting the action.

2.7 The legal complexities of constructing a Class or Group Action mean that investors may be asked at short notice for a final decision as to whether or not to participate.

## 3. PETROLEO BRASILIERO S.A. (PETROBRAS)

3.1 Petrobras is a Brazilian multinational energy company, which owns oil tankers and refineries as well as being a major distributor of oil products. It was formerly part of the portfolio managed for the Fund by Aberdeen Asset Management.

3.2 The complaint alleges that Petrobras has violated the terms of the Securities and Exchange Acts by issuing false and misleading statements causing its share price to trade at artificially inflated values. Allegations of money laundering, bribery and corruption have surfaced, involving both senior officials of Petrobras and Brazilian politicans. There has also been delays in filing accounts and, as a result , the share price has fallen by around 50%.

3.3 An action is being brought in the US and will therefore be covered by the US litigation rules. The loss to the Falkirk Fund has been calculated initially by Robbins Geller at $7m.

3.4 PIRC Ltd, who exercise voting rights on behalf of the Fund, have voted against company motions at past Petrobras AGMs on grounds of poor governance and the failure of a minority director to sign the accounts.

## 4. TESCO

4.1 Tesco is the well-known UK grocery retailer. In September, it emerged that Tesco had overstated its profits by £263m. A number of senior executives were suspended and the matter is now being investigated by the Financial Conduct Authority and the Serious Fraud Office. The news flow has caused the share price to more than halve in value.

4.2 Robbins Geller are seeking to orchestrate a Group Action for institutional investors with litigants having an option to participate. The case would be brought in the High Court of London. Investors who held shares between April 2013 and October 2014 would be eligible to join the action.

4.3 Tesco is part of Falkirk's ongoing investments within the Schroder UK Equity portfolio. The estimated loss based on the fall in share price between April 2013 and October 2014 is around £2m.

4.4 Unlike US Class Actions, the Fund Manager - in this case Schroder - would have to be able to prove that they had relied on Tesco's Accounts when purchasing the Tesco shares. Discussions would therefore have to take place with Schroder to determine if they were able to produce the necessary evidence and if they were prepared to disclose it.

4.5 Prior to being asked to join any action, a QC would be appointed to review the case and give an opinion on the chances of a successful outcome. "After the Event" insurance would be arranged in order to cover the risk of adverse costs.

## 5. CONCLUSION

5.1 The Fund's litigation adviser has indicated that legal action is being contemplated against two of the Fund's investee companies.

5.2 It is anticipated that the Fund will be asked to join legal actions in the coming weeks.

5.3 Before reaching a decision to join one or other of the actions, an assessment of risk and return will require to be undertaken.

## 6. RECOMMENDATIONS

**6.1 The Pensions Committee and Pensions Panel are asked to note the contents of this report and invited to comment.**

**6.2 The Pensions Committee is asked:**

**i) to consider joining these actions, and if supportive of joining,**

**ii) to delegate the final decision on participating to the Chief Finance Officer**

**Chief Finance Officer**

**Date: 1 March 2015**

**Contact Officer: Alastair McGirr**

**<u>LIST OF BACKGROUND PAPERS</u>**

NIL

**AGENDA ITEM 11**

# FALKIRK COUNCIL

**Subject:** FUND MANAGER PERFORMANCE REVIEW
**Meeting:** JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE
**Date:** 12 MARCH 2015
**Author:** CHIEF FINANCE OFFICER

## 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.

| Fund Manager | Benchmark |
|---|---|
| Aberdeen Asset Management (AAM) | MSCI All Countries World Index |
| Baillie Gifford Bonds (BGB) | Customised benchmark comprising UK Fixed Interest and UK Index Linked Bonds |
| Baillie Gifford Diversified Growth (BGDG) | UK Bank of England Base Rate |
| Legal & General (L&G) | Customised benchmark comprising UK and Overseas Equities |
| Newton Investment Management (NIM) | FTSE All World Index |
| Schroder Investment Management (SIM) UK Equities | FTSE All Share Index |
| Schroder Investment Management (SIM) Property | AREF/IPD UK Quarterly 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 attached.

## 2. MARKET REVIEW AND OUTLOOK

2.1 The final quarter of 2014 was very positive for owners of equity, bond and property assets while holders of US assets benefited from the continuing strength of the US dollar. In a world of very low interest rates, investors continue to search desperately for assets yielding more than cash.

2.2 Consensus economic thinking changed modestly with expectations for global growth for 2015 slightly higher (3.5% versus 3.2%) with much of this coming from China and the benefits of the lower oil price. The gradual improvement in the US economy continued and broadened, and it shows no signs of reversing in the near future. The ending of QE by the Federal Reserve was reassuringly a complete non-event. The appearance of incipient wage inflationary pressure means that the UK is perhaps the only other brightly shining star in the developed world firmament, and India occupies the same lonely position amongst emerging markets.

2.3 The rest of the world continues to struggle with anaemic economic growth, disinflation, and in many cases deflation. Worse still, certain countries, most notably Russia and Brazil, have sunk into stagflation.

2.4 However, the two big moribund economies - Eurozone and Japan - have been jolted positively by major policy initiatives. In Q1 2015, the ECB surprised investors with its own high octane version of QE, and Japan has reinforced its commitment to achieving a 2% inflation target by whatever means necessary. Both aim to reach their goals primarily through currency depreciation, an increasingly common strategy these days. Emerging markets are behind the curve in terms of proactive monetary and fiscal policies, but there are signs that an effective response will be forthcoming in some of these countries in the near future.

2.5 The level of geopolitical risk is now arguably higher than at any point since the fall of the Berlin Wall and the Cold War. Unfolding developments in Greece, the Ukraine, China and the Middle East are preying on investors' minds. They should all be manageable to the extent that it is nobody's interest that they spiral out of control. But if they do, then the world economy and risk assets could experience a setback, and the policy response might be muted by a shortage of central bank ammunition. However, the central case must be that these problems are (as usual) successfully muddled through in one way or another.

2.6 In the absence of a geopolitical shock, signs of the US expansion running out of steam could threaten asset prices and investors will have to assess the effect on financial markets of the policies of central banks and governments, which are dealing with unprecedented economic conditions and the usual unsettling election cycles.

2.7 Meantime, the agents of economic change are responding to policies in predictable ways. Negative interest rates and a lack of confidence in the robustness of economic growth support asset prices in the short term as merger & acquisition activity shrinks the supply of equity with a beneficial impact on valuations.

2.8 The distribution of global economic growth may be uneven, but a 3.5% improvement is forecast and this should be sufficient to generate solid profits growth. There are no obvious reasons for any change in valuation, suggesting that equity markets are capable of generating a mid-single digit return. And the search for yield continues to support other asset prices, including bonds and property. Long term, however, it is worth noting that government bond returns are expected to be negative in real terms.

## 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 31 December 2014 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 their 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 +4.6% in sterling terms over the fourth quarter of 2014. The FTSE All Stock Bond index performed even better rising +6.3% with index-linked gilts +9.4%. UK commercial property rose +4.6%.

3.3 The overall Fund's return of +3.1% over the quarter was ahead of the benchmark return by 0.1%. Over the 3 year period the Fund benefited from equity market strength, rising +12.4% per annum compared with the benchmark return of +10.2% per annum, an excess return of +2.1% per annum. Long term return data shows Fund appreciation of +10.2% per annum over 5 years and +7.4% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 Over the fourth quarter of 2014, the returns of the Fund's three active equity managers ranged from +0.2% to +5.8%. SIM and NIM outperformed their respective benchmarks, while AAM underperformed. The Fund's passive equity manager, L&G, produced a return of +3.1%, in line with its benchmark return, and so consistent with its mandate.

The return from BG's bond mandate was +5.2%, behind its benchmark by 0.7%. BG's other mandate, the Diversified Growth portfolio, rose 0.8%, ahead of its benchmark by 0.7%.

The property portfolio managed by SIM lagged its benchmark by 0.3%, but rose 4.3% in absolute terms.

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. Returns since inception in May 2010 slipped below the benchmark for the first time in the fourth quarter.

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 very strong. The excess return over the benchmark of +1.5% per annum comfortably exceeds 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 in line with its benchmark, but has fallen short of the objective by 0.7% per annum.

## 4. CONCLUSION

4.1 News flow in the final quarter of 2014 included an improvement in global growth expectations (from 3.2% to 3.5%), a falling oil price and increased geopolictical tensions. Japan and the Eurozone embarked on further quantitative easing, whilst the US Federal Reserve ended its own QE programme without any significant impact. Investment markets, including equities and bonds, generally had a positive quarter.

4.2 The overall Fund return during the quarter was marginally ahead of benchmark (3.1% v 3%). The underlying story was one of solid performances from Schroder UK equities and Newton global equities, but disappointing returns from Aberdeen global equities.

4.3 Aberdeen's performance from inception in May, 2010 is now below the benchmark (8.9% v 9.6%) with the risk that the sluggish performance could lead to outflows from Aberdeen funds further depressing asset values. For that reason, they have been reduced from "green" to "amber" status in terms of monitoring their ongoing performance. Aberdeen remain of the view that their investments are in good quality profit-making companies and that the underlying value of these assets will ultimately be recognised by the market.

## 5. RECOMMENDATIONS

**5.1 The Panel and Committee are asked to note:-**

**(i) the Managers' performance for the period ending 31 December, 2014; and**

**(ii) the action taken by Managers during the quarter to 31 December, 2014 in accordance with their investment policies.**

**Chief Finance Officer**

**Date : 26 February 2015**

## LIST OF BACKGROUND PAPERS

1. The Northern Trust Company – Fund Analytics 31 December 2014

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506304 and ask for Alastair McGirr

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

### Rates of Return by Manager with Excess Returns - 31 December 2014

| Manager | Market Value £ | Weight | Returns 3 months | 3 year | 5 year | Since inception | Inception Date |
|---|---|---|---|---|---|---|---|
| **Aberdeen Portfolio** | 222,879,286 | 13.2% | 0.2% | 10.2% | - | 8.9% | May-10 |
| Benchmark | | | 4.5% | 14.6% | - | 9.6% | |
| **Excess Versus Benchmark** | | | **-4.4%** | **-4.4%** | **-** | **-0.7%** | |
| **Excess Versus Objective** | | | **-** | -7.4% | **-** | -3.7% | |
| **Baillie Gifford Bond Portfolio** | 151,216,433 | 8.9% | 5.2% | 8.4% | 9.9% | 7.1% | Mar-07 |
| Benchmark | | | 5.9% | 6.9% | 8.4% | 7.3% | |
| **Excess Versus Benchmark** | | | **-0.7%** | **1.5%** | **1.5%** | **-0.2%** | |
| **Excess Versus Objective** | | | | **0.6%** | **0.6%** | **-1.1%** | |
| **Baillie Gifford Diversified Growth** | 199,118,612 | 11.8% | 0.8% | - | - | 6.9% | Feb-12 |
| Benchmark | | | 0.1% | - | - | 0.5% | |
| **Excess Versus Benchmark** | | | **0.7%** | **-** | **-** | **6.4%** | |
| **Excess Versus Objective *** | | | **-** | **-** | **-** | 2.9% | |
| **Legal & General** | 353,008,772 | 20.9% | 3.1% | 13.8% | 10.2% | 14.1% | Jan-09 |
| Benchmark | | | 3.1% | 13.7% | 10.1% | 14.0% | |
| **Excess Versus Benchmark** | | | **0.0%** | **0.1%** | **0.1%** | **0.1%** | |
| **Excess Versus Objective** | | | **-** | **0.1%** | **0.1%** | **0.1%** | |
| **Newton** | 253,211,061 | 15.0% | 5.8% | 15.8% | 11.8% | 9.1% | Jun-06 |
| Benchmark | | | 4.5% | 14.7% | 10.5% | 8.0% | |
| **Excess Versus Benchmark** | | | **1.3%** | **1.1%** | **1.3%** | **1.0%** | |
| **Excess Versus Objective** | | | **-** | **-** | **-1.7%** | **-2.0%** | |
| **Schroders UK Equity** | 229,767,768 | 13.6% | 2.6% | 19.0% | 12.1% | 9.3% | Sep-01 |
| Benchmark | | | 0.6% | 11.1% | 8.7% | 6.8% | |
| **Excess Versus Benchmark** | | | **2.0%** | **7.9%** | **3.4%** | **2.5%** | |
| **Excess Versus Objective** | | | **-** | **6.6%** | **2.2%** | **1.2%** | |
| **Schroders Property** | 126,292,812 | 7.5% | 4.3% | 8.0% | 7.5% | 2.9% | Nov-05 |
| Benchmark | | | 4.6% | 8.6% | 8.9% | 3.0% | |
| **Excess Versus Benchmark** | | | **-0.3%** | **-0.6%** | **-1.4%** | **0.0%** | |
| **Excess Versus Objective** | | | **-** | **-1.4%** | **-2.1%** | **-0.8%** | |
| **Total Fund** | 1,692,807,063 | 100.0% | 3.1% | 12.4% | 10.2% | 7.4% | Sep-01 |
| Benchmark | | | 3.0% | 10.2% | 8.4% | 7.0% | |
| **Excess Return** | | | **0.1%** | **2.1%** | **1.8%** | **0.4%** | |

*** Note that objectives are set over 3 or 5 year periods and Baillie Gifford's Diversified Growth mandate has not been in place for the requisite periods.**

**N.B. There are some small rounding differences in the table above.**

## APPENDIX 2 - INVESTMENT MANAGER COMMENTS

# Aberdeen Global Equity

(13.2% of Total Fund)

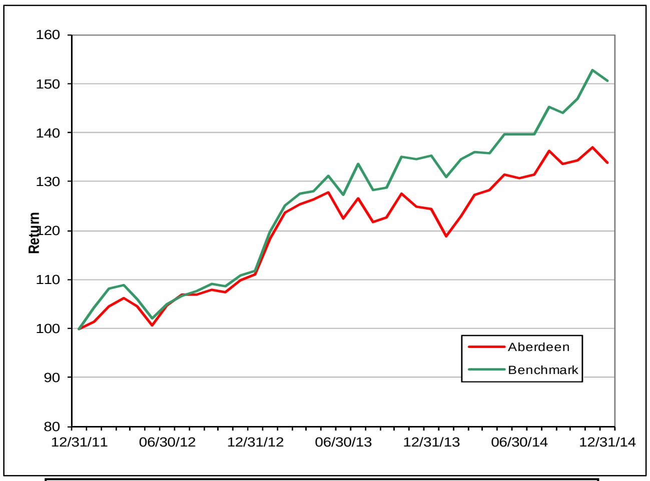
**Investment Approach:**

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.

**Investment Objective:**

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)

**3 Year Performance to 31 December 2014**




| | | |
|---|---|---|
| Q4 2014 | : | -4.4% excess return |
| 3 Years | : | -4.4% excess return |
| Since inception | : | -0.7% p.a. excess return |

**Summary**

A very poor 3 year performance could presage outflows from the product. Since inception performance is now behind benchmark performance too.

**Portfolio**

**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 currently at 3.2%.

Sector and country positioning remains very defensive and stable, with changes incremental. N. America represents 56% of the benchmark, but the portfolio is u/w by 20%. The fund is o/w the UK (+8%), Europe ex-UK (+5%, with Switzerland +11%), and LatAm (+5%). By sector, the portfolio remains o/w consumer staples (+8%), and has high relative exposure to energy (+5%) and materials (+5%). There is low exposure to cyclical earnings, such as consumer discretionary (-10%), although industrials and I.T. weights are now more neutral. Financials are also underrepresented (-6%). The portfolio is likely to perform relatively poorly in strong equity markets, but its defensive tilt should help protect it in the event of equity markets falling. Aberdeen’s views remain very cautious, especially on the valuation of the US market.

More than half the underperformance was attributable to regional and sector allocation, specifically being u/w North America, o/w Europe and o/w energy and materials as well as u/w consumer discretionary stocks. Stock selection was also poor, however, driven by weakness in Europe (Asian selection was positive and N. American was flat). By sector, the weakness from stock selection was predominantly down to poor stock picks in financials (Standard Chartered), energy (Tenaris, ENI, Petrobras, Schlumberger) and healthcare (Roche). There were few bright spots, though stock selection from I.T. was positive (Oracle, TSMC, Samsung Electronics), and there were strong individual performances from CVS Healthcare, Visa and United Technologies.

Aberdeen continue to follow their process investing in good quality companies with lower than average levels of debt and relatively stable earnings and cashflows. However, poor 3 year performance numbers means that there is a heightened risk of flows turning decisively negative, not least because consultants may well revisit Aberdeen’s position on their ‘buy’ lists. Should this occur, the sheer weight of assets means that the company is unlikely to be nimble enough to avoid a downward spiral. Portfolio activity was again limited, with Jardine Matheson added as a new stock and Petrochina & Petrobras sold into deteriorating performance/fundamentals.

**Key considerations/developments**

Ownership has not changed, but the acquisition of SWIP is large – it adds £138bn of assets under management taking the Group’s assets to £325bn - integration is largely complete now; the client base is stable with a net of 1 client gained (flow mildly positive again this quarter) and the investment process has not changed/is standardised across equity products although relies on country/regional team picks for opportunity set. Cross-fertilisation of ideas and a team-led approach is key selling point. Stable, well-resourced and experienced investment team (6 most senior team members average >19 years in industry and >12 years at Aberdeen), backed up by extensive and experienced regional teams.

# Baillie Gifford Bonds

(8.9% of Total Fund)

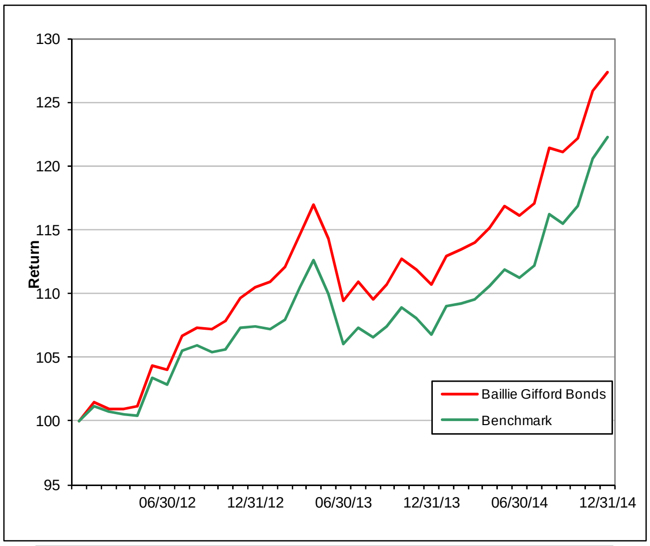
**Investment Approach:**

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.

**Investment Objective:**

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).

**3 Year Performance to 31 December 2014**




| | |
|---|---|
| Q4 2014 | : - 0.7% excess return |
| 3 Year | : + 1.5% p.a. excess return |
| Since inception | : - 0.2% p.a. excess return |

## Summary

A very good 3 and 5 year performance ahead of objective by 0.6%pa over both periods. 3 year performance is ahead of the objective. Exposure to recent currency weakness in oil-producing nations has caused a rethink of importance of politics in Rates and Currency team process.

**Portfolio**

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.

Bonds, led by an exceptional 9.4% gain from Index Linked Gilts, had another good quarter. With low UK inflation and the search for yield at virtually any price continuing, Corporate Bonds returned 4.3% and conventional fixed income bonds returned 6.3%.

However, in relative terms, the portfolio had a slightly disappointing quarter, returning 5.2% compared with 6.0% for the benchmark. The main culprit was the portfolio's currency positions, which detracted 1.1%., while stock selection continued to be positive as it has been all year. Falling oil prices affected long positions in the currencies of major oil producing countries, such as Norway, Colombia and the Mexican Peso, the largest overweight. The manager believes the movement has been overdone and so retains the overweight Mexican and Colombian positions and is considering adding to the Colombian Peso. A long US Dollar position was positive in the quarter. Looking forward, the Rates and Currency Team is reassessing the weight it places on political considerations.

In bonds, an underweight position in Turkey and an overweight in Russia both contributed to the negative relative return and have both subsequently been removed.

The portfolio is broadly diversified with only 8 non-sovereign issuers accounting for more than 1% of the portfolio. The tracking error increased slightly from 0.74% to 0.79%, and although Stock selection is still the main contributor to portfolio risk (47%), currency now accounts for 32% of the risk relative to the benchmark (Q3:25%).

**Key considerations/developments**

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 increased from £695m to £732m over the quarter. They are losing two clients (~£58m) from the Fund in Q1 2015. They explained that one was a small client transitioning to an LDI approach, and the other simply reducing their Bond exposure in light of the exceptional recent returns rather than moving to another Bond Manager.

# Baillie Gifford Diversified Growth

(11.8% of Total Fund)

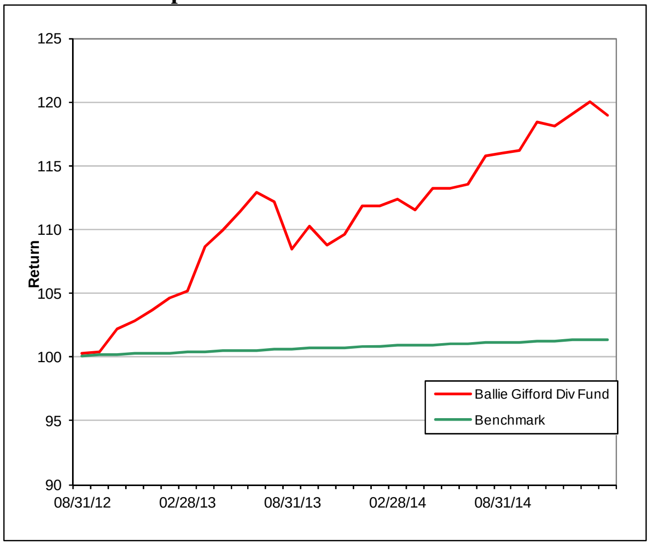
**Investment Approach:**

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 31 December 2014**




| | |
|---|---|
| Q4 2014 | : +0.7% relative to base rate |
| 1 Year | : +5.4% relative to base rate |
| Since inception | : +6.4% relative to base rate |

## Summary

Unexpected resignation of co-head of team (former head of risk at BG). Fund is ahead of modest risk/return objective since Falkirk first invested, but return target challenging and stated currency risk and predicted volatility look too low.

**Portfolio**

"Active Currency" risk is now stated at "-0.9% of assets" and "-0.6% of predicted volatility" (ie minus - 0.6% contribution to risk). In Q3 it was stated at "0.4% of assets" and "0.1% of predicted volatility". In Q2 it was stated at "-0.2% of assets" and "5% of predicted volatility". This fall in stated risk over Q3 and Q4 looks very odd given that in Q3 and Q4 "Active Currency" was by far the largest contribution to return: 1.3% gain out of the total 1.8% in Q3; -0.8% loss (from oil-related Mexico, Norway, etc) out of total 0.8% in Q4. 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. Obviously this stated risk looks wrong: ignoring possible big FX losses (as in Q4).

Insurance Linked bonds, are 5.3% of the fund but are quoted at "0.3%" of the risk. This also seems a very low figure for what is essentially writing "catastrophe" insurance.

While net performance beats the modest 4% pa target since inception, it has been falling; the 5 years to Q2 2014 return was 10.6% pa, but the last 3 year return was 7.1% pa; last year was 5.3% pa, and last quarter was 2.4% pa. The manager forecasts "lower returns than in recent years": that no asset class will achieve cash +3.5% net.

The stated predicted volatility is now 7.0% - with 62% of this from (listed and private) equities @24% of fund. Targeted maximum volatility is 10%. (Global equities are 16.9%)

**Key considerations/developments**

Mike Brooks – co-head of team and former head of risk at BG – resigned 21st Jan. But process remains unchanged.

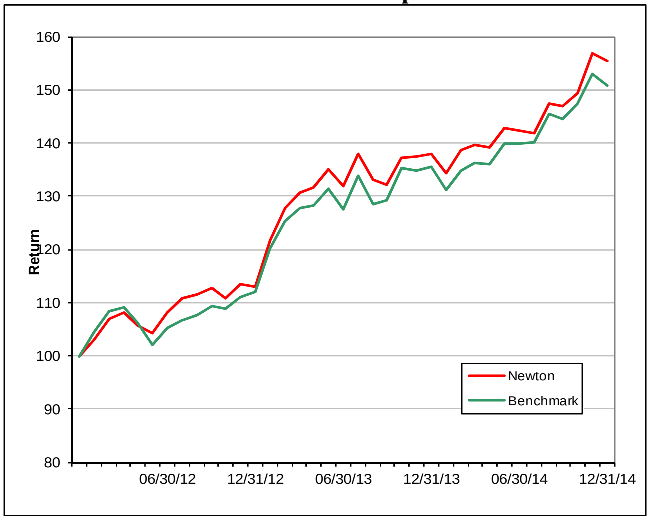
After 0.7% charges, none of the manager's 10-year expected returns on any asset class meet the net fund performance target of cash plus 3.5% net.

Baillie Gifford announced £5bn "capacity" in the strategy in Q4 2012, and "closure to all new clients" in June 2013. In Q4 2014 clients fell by 2 to 243. But on £14m net inflows in Q4, assets increased to £5.73bn - £952m net inflows since this "closure".

# Newton Global Thematic Equity

(15.0% of Total Fund)

**3 Year Performance to 30 September 2014**




| | |
|---|---|
| Q4 2014 | : +1.3% excess return |
| 5 Years | : +1.3% p.a. excess return |
| Since inception | : +1.0% p.a. excess return |

**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)

**Summary**

Portfolio not achieving objective, but is ahead of benchmark since inception. 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 equity markets.

**Portfolio**

The portfolio is fairly concentrated with 44 stocks, (the manager would like to reduce further), 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 9.6% 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.

The portfolio is overweight Europe/UK (+9%) equities and cash (+10%), and underweight all other regions. It has high exposure to companies in the consumer services sector, while financials and oil & gas companies are under-represented. The large underweight of a year ago in industrial shares has been eliminated and the consumer goods sector reduced in favour of consumer services. The portfolio's high cash position should continue to protect it if equity markets fall, but otherwise there is less of a defensive tilt than previously.

The portfolio beat its benchmark in Q4. The portfolio's underweight exposure to Oil & Gas was a key benefit. Stock selection in and high allocation to the consumer services (Walgreen, TJX) and healthcare (Express Scripts, Medtronic) sectors was positive. Offsetting these positives was the performance of Yamana Gold, Centrica, Vallourec and Mattel.

During the quarter, three new stocks were introduced: Google, Trimble Navigation and L'Oreal; Toyota, Air Liquide, Royal Dutch Shell and EMC were sold outright. Align Technology was bought and sold within the quarter for a substantial capital gain.

**Key considerations/developments**

Newton remains one of Bank of New York Mellon's asset management subsidiaries based in London; in the face of weak relative returns, management reassessed the investment process in 2011/12 and made some personnel changes to improve rigour, but did so without changing the key elements of the global thematic strategy; the client base is stable (no flows in or out).

# Schroders UK Equity

(13.6% of Total Fund)

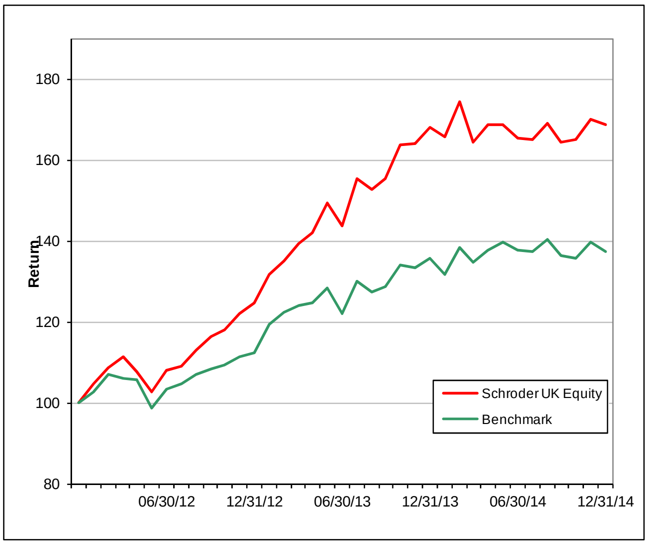
### Investment Approach:

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 31 December 2014**




| | |
|---|---|
| Q4 2014 | : +2.0% excess return |
| 3 Year | : +7.9% p.a. excess return |
| Since inception | : +2.5% p.a. excess return |

## Summary

Excellent long term performance puts manager comfortably ahead of the objective over all timeframes. Clearly articulated strategy with stable ownership, client base and investment team. Cash increased to 7% reflecting dearth of attractively valued new stocks.

**Portfolio**

The portfolio of 38 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 life insurance and food & drug retailers sectors, while mining is the biggest underweight. Relative returns in the fourth quarter were positive (+2.0%). Friends Life and Debenhams were the biggest positive contributors to relative returns in the quarter with the underweight in BG Group also adding relative value. The biggest detractors were Qinetiq and Darty.

The manager once again commented that, with the market close to all time highs, attractive new ideas in absolute terms are harder to identify. They have more sell ideas than buy ideas. With the cyclically adjusted P/E of the UK market slightly above its long term average, expected returns on a 10 year view are somewhat less than those achieved historically. The team are confident that their value discipline will result in outperformance over a similar timeframe.

With that market context in mind, it is perhaps unsurprising that cash has risen to almost 7% of the portfolio. Profits were taken in companies that have performed well with reductions in Direct Line, Dixons Carphone and Astrazeneca. Holdings in Centrica and Tesco were increased on share price weakness. The reduction in the Astrazeneca holding was the biggest single reduction the team have ever made and brings the weight back in line with other large positions.

Cyclically adjusted P/Es are a "phenomenally" good indicator on average but the manager suggested that while mining shares look cheap on this basis, the mining cycle is longer than 10 years so profits are essentially inflated. Areas that do look cheap are banks and supermarkets. At the other end of the spectrum, he cautioned that anything with perceived stability is "extraordinarily overvalued", examples being staples and tobacco.

**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 UK Value product, in which Falkirk is invested, runs approximately £5.5bn in assets split roughly 1/3rd institutional and 2/3rd retail. The investment team appears to be stable and demonstrates high conviction in its investment approach.

# Schroders Property Multi-Manager

(7.5% of Total Fund)

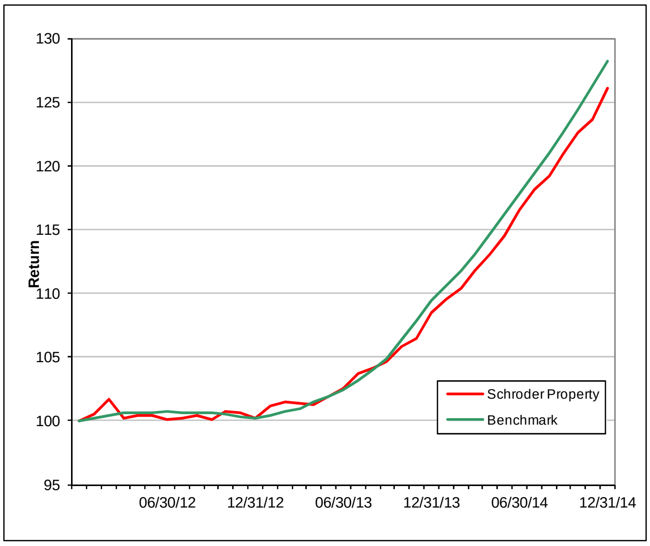
**Investment Approach:**

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 31 December 2014**




| | |
|---|---|
| Q4 2014 | : -0.3% excess return |
| 3 Year | : -0.6% p.a. excess return |
| Since inception | : +0.0% p.a. excess return |

## Summary

Latest 3 and 5 year performance remains weak – continental European exposure has been a major drag. The portfolio has been restructured. With 66% in large core UK funds, risk and return relative to benchmark have been reduced.

**Portfolio**

The portfolio is comprised of a diverse group of 15 funds investing in property assets largely in the UK. The portfolio is valued at £127m. Activity was fairly significant from 2009-2013, and there is now expected to be low levels of future transaction activity.

The manager is shifting to a neutral position in London offices by serving a redemption request on WELPUT and is re-investing in industrial property (via a new partnership managed by a specialist at Jones Lang).

The Continental European exposure underperformed and now amounts to approximately 5% of the portfolio. (Recap in '06-07, 10% of the portfolio was committed to Europe.) The poor three year relative performance has been dominated by exposure to Cont. Europe, which is not in the benchmark. In addition, transaction costs and cash drag in a rising market affected performance. Schroders is actively seeking divestment opportunities from its European portfolio.

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.

The portfolio now targets to hold minimal amounts of cash - which now represents 0.1%.

**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** appears to be stable, but the poor relative performance has put it on the defensive.

# 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.

**AGENDA ITEM 12**

**FALKIRK COUNCIL**

| | |
|---|---|
| **Subject:** | **PRIVATE EQUITY AND ALTERNATIVES UPDATE** |
| **Meeting:** | **JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE** |
| **Date:** | **12 MARCH 2015** |
| **Author:** | **CHIEF FINANCE OFFICER** |

## 1. INTRODUCTION

1.1 This report updates the Panel and Committee on the progress and key events arising from each Manager's investment programme for the three months to 31 December 2014.

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 |

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 converted to 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 In Q4, the 2006 and 2008 Funds comfortably outperformed the MSCI Europe Index of 0.8%, returning 2.6% and 3.0% respectively. The 2004 Fund declined by around 1%, whilst the ESF 1 Fund was largely unchanged. Total value to paid-in capital across the SL funds is around 1.2 and returns around 4%.

2.4 During the quarter nearly €7m was returned and €2m called. Returns were spread evenly across the 2004, 2006 and 2008 Funds with calls being made only to the 2008 Fund. There was no activity in the ESF 1 Fund. Highlights included increases in the value of the Sagard II Fund and in various co-investments including Basic Fit and the Harding Group. In the ESF 1 Fund, two new investments were made to Xenon Private Equity VI (a Primary Fund) and Herkules III (a Secondary Fund)..

2.5 The Manager considers that consumer spending and business output has weakened across the Eurozone, albeit with variations between northern and southern Europe.

## 3. WILSHIRE ASSOCIATES

3.1 During the period from 2004, the Fund has made various commitments to Wilshire Associates as follows:

| | | |
|---|---|---|
| European Funds | - | €10.9m |
| Dollar Funds | - | $72.0m |

3.2 In their quarterly update, Wilshire indicate that pricing in US private equity markets is historically high which should benefit exits from their maturing funds. They also highlight their philosophy of looking for quality managers who have a track record of investing in complicated markets and technologies, which, due to their complexity, may have been overlooked by the capital markets.

3.3 Q4 was relatively quiet for Wilshire with virtually no capital calls. Returns came mainly from the dollar funds and amounted around $2m. Around 90% of the Euro denominated funds have been drawn-down, whilst only 75% of the Dollar denominated funds have been drawn-down. This reflects the fact that the most recent commitment of $15m to Wilshire was to a dollar fund. Total value to paid in capital is between 1.3 and 1.4 for most Wilshire funds and returns in excess of 6 to 7%.

3.4 In terms of personnel, the business requires to be monitored in view of the recent departure of Kevin Nee, president of the Wilshire Private Markets business.

## 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. Recent purchases include a South Korean infrastructure secondary fund, a co-investment in Acciona Energia, and an investment in Heathrow Airport Holdings Ltd.

4.3 During the quarter, nearly $6m was returned and $2m called. Of the original commitment of $80m, $65m has now been drawn-down. As the mandate only began in 2011, deployment of capital has been relatively fast. Total value to paid-in capital is a healthy 1.4, up from 1.3 last quarter.

4.4 As previously outlined, Grosvenor Capital is fund raising for a second global infrastructure fund.

## 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 - 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 4.8 years and average credit rating of BB+. Within the portfolio, the credit ratings of Barrett and Taylor Wimpey have improved from BBB- to BB+.

5.4 For Fund II, the portfolio also consists of 8 loans but with an average repayment period of 6 years. This includes loans to Caffe Nero, Holidaybreak Limited and Workplace Group plc.

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

## 6. HEARTHSTONE SOCIAL AND AFFORDABLE HOUSING

6.1 Details of this mandate have been provided in the General Governance Report.

## 7. CONCLUSION

7.1 The investment outlook of the Fund's private equity managers is neutral in terms of Europe and mildly optimistic in terms of US markets. The danger of overpaying for assets is a common concern of both private equity managers. The infrastructure and credit market managers continue to source deals at a satisfactory rate.

7.2 There continues to be a positive flow of distributions across the various private equity funds as their programme matures, although the returns from Wilshire are better than those from SL Capital. In this regard, however, the gradual weakening of the Euro in recent times has not helped the Euro denominated funds. The performance of Grosvenor Capital continues to be very strong.

## 8. RECOMMENDATION

**8.1 The Panel and Committee are asked to note the progress of the Fund's Alternatives investments as at 31 December 2014 and invited to comment as appropriate.**

**Chief Finance Officer**

**Date: 1 March 2015**

**Contact Officer: Alastair McGirr**

**LIST OF BACKGROUND PAPERS**

NIL

## Appendix A

## Falkirk Council Pension Fund
## Alternative Markets Update - 31/12/2014

## 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 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Private Equity** | | | | | | | | | | | |
| SL Capital Partners | European Strategic Partners 2004 | € 30,000 | € 3,467 | € 26,533 | € 11,926 | € 8,679 | € 12,368 | € 32,973 | 1.24 | 5.6% | |
| SL Capital Partners | European Strategic Partners 2006 | 30,000 | 3,736 | 26,264 | 9,017 | 3,792 | 19,371 | 32,180 | 1.23 | 3.5% | |
| SL Capital Partners | European Strategic Partners 2008 | 27,000 | 8,771 | 18,229 | 2,779 | 509 | 18,537 | 21,825 | 1.20 | 1.5% | |
| SL Capital Partners | European Smaller Funds I | 15,000 | 10,172 | 4,828 | 0 | 0 | 4,374 | 4,374 | 0.91 | N/A | |
| | **SL Capital Partners Total** | **€ 102,000** | **€ 26,146** | **€ 75,854** | **€ 23,722** | **€ 12,980** | **€ 54,650** | **€ 91,352** | | | 25.6% |
| Wilshire Associates | Fund VI - Europe | € 3,600 | € 223 | € 3,377 | € 2,106 | € 1,336 | € 1,393 | € 4,835 | 1.43 | 7.9% | |
| Wilshire Associates | Fund VII - Europe | 3,600 | 221 | 3,379 | 1,097 | 507 | 2,436 | 4,040 | 1.20 | 0.9% | |
| Wilshire Associates | Fund VIII - Europe | 3,700 | 628 | 3,072 | 1,165 | 547 | 2,507 | 4,219 | 1.37 | 32.0% | |
| | **Wilshire Associates Europe Total** | **€ 10,900** | **€ 1,072** | **€ 9,828** | **€ 4,368** | **€ 2,390** | **€ 6,336** | **€ 13,094** | | | 9.8% |
| Wilshire Associates | Fund VI - US | $14,000 | $751 | $13,249 | $5,403 | $5,190 | $7,966 | $18,559 | 1.40 | 6.2% | |
| Wilshire Associates | Fund VII - US | 11,500 | 698 | 10,802 | 3,299 | 3,198 | 8,668 | 15,165 | 1.40 | 6.8% | |
| Wilshire Associates | Fund VIII - US | 12,700 | 1,319 | 11,381 | 3,736 | 2,309 | 9,978 | 16,023 | 1.41 | 10.6% | |
| Wilshire Associates | Fund VII - Asia | 1,800 | 166 | 1,634 | 864 | 554 | 947 | 2,365 | 1.45 | 8.4% | |
| Wilshire Associates | Fund VIII - Asia | 2,000 | 1,119 | 881 | 238 | 78 | 931 | 1,247 | 1.42 | -11.9% | |
| Wilshire Associates | Opportunities Fund II-B | 15,000 | 2,029 | 12,971 | 7,002 | 2,498 | 7,473 | 16,973 | 1.31 | 10.4% | |
| Wilshire Associates | Fund IX | 15,000 | 13,546 | 1,454 | 0 | 0 | 1,870 | 1,870 | | | |
| | **Wilshire Associates US and Asia Total** | **$72,000** | **$19,628** | **$52,372** | **$20,542** | **$13,827** | **$37,833** | **$72,202** | | | 27.3% |
| **Infrastructure** | | | | | | | | | | | |
| Grosvenor Capital | Customised Infrastructure Strategies | $80,000 | $14,907 | $65,093 | $12,683 | $3,506 | $74,671 | $90,860 | 1.40 | 9.7% | |
| | **Grosvenor Capital Total** | **$80,000** | **$14,907** | **$65,093** | **$12,683** | **$3,506** | **$74,671** | **$90,860** | | | 18.6% |
| **Credit Markets** | | | | | | | | | | | |
| Prudential/M&G | UK Companies Financing Fund | £11,835 | £0 | £11,835 | £4,943 | £0 | £8,718 | £13,661 | 1.15 | 4.7% | |
| Prudential/M&G | UK Companies Financing Fund II | 10,000 | 6,406 | 3,594 | 117 | 89 | 3,535 | 3,741 | 1.04 | 4.4% | |
| | **Credit Market Total** | **£21,835** | **£6,406** | **£15,429** | **£5,060** | **£89** | **£12,253** | **£17,402** | | | 29.3% |
| **Social / Affordable Housing** | | | | | | | | | | | |
| Hearthstone plc | Housing Fund for Scotland | £30,000 | £14,750 | £15,250 | £0 | £0 | £15,299 | £15,299 | | | |
| | **Social/Affordable Housing Total** | **£30,000** | **£14,750** | **£15,250** | **£0** | **£0** | **£15,299** | **£15,299** | | | 49.2% |

## Appendix B

# Falkirk Council Pension Fund
# Alternative Markets Update - 31/12/2014

| Exchange Rates | |
|---|---|
| $ | 1.5608 |
| € | 1.2841 |

## 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 | 79,433 | 20,361 | 59,072 | 18,474 | 10,108 | 42,559 | 71,141 | 1.20 |
| Wilshire Associates | 54,619 | 13,410 | 41,208 | 16,563 | 10,720 | 29,174 | 56,457 | 1.37 |
| Grosvenor Capital | 51,256 | 9,551 | 41,705 | 8,126 | 2,246 | 47,841 | 58,214 | 1.40 |
| M & G | 21,835 | 6,406 | 15,429 | 5,060 | 89 | 12,253 | 17,402 | 1.13 |
| Hearthstone plc | 30,000 | 14,750 | 15,250 | 0 | 0 | 15,299 | 15,299 | 1.00 |
| | £237,143 | £64,478 | £172,664 | £48,223 | £23,163 | £147,126 | £218,513 | |

| | |
|---|---|
| Allocation to Private Equity (based on unfunded commitment plus market value) | 6.2% |
| Allocation to Private Equity (based on market value only) | 4.2% |
| Allocation to Infrastructure (based on unfunded commitment plus market value) | 3.4% |
| Allocation to Infrastructure (based on market value only) | 2.8% |