DRAFT
AGENDA ITEM 3(a)

FALKIRK COUNCIL

MINUTE OF MEETING OF THE PENSIONS PANEL THURSDAY 11 SEPTEMBER 2014 AT 2.00 P.M. MUNICIPAL BUILDINGS, FALKIRK

PRESENT:- **Officers – Falkirk Council**

Jason Koumides, Pensions Accountant
Alastair McGirr, Pensions Manager
Antonia Sobieraj, Committee Services Officer

Organisations

Andrew Douglas, Unison
Councillor Archie Drummond, Clackmannanshire Council
Sandy Harrower, UCATT
Gordon Laidlaw, Scottish Autism
Ed Morrison, Scottish Children's Reporter Administration's (SCRA)
Susan MacKay, Clackmannanshire Council
Ian McLean, Pensioner Representative
Alistair Redpath, Pensioner Representative
Alison Stewart, Head of Finance, Forth Valley College.
William Watson, Stirling Council
Jennifer Welsh, SEPA (Convener)

Attending

Patrick Hand and Jamie Cumming, Aberdeen Asset Management (for agenda item 12) (minute item 12)
Catherine McFadyen, Hyman's Robertson (for agenda item 5) (minute item 6)
Allan MacDougall and Janice Hayward, PIRC Ltd (for agenda item 9) (minute item 10)
Bruce Miller, Investment Manager, Lothian Pension Fund

1. CONVENERSHIP OF MEETING

In terms of Standing Order 12.1, the Clerk presided at the start of the meeting in the absence of the Convener and invited a member of the Panel to take the Chair for the duration of the meeting. Jennifer Welsh, SEPA thereafter took the Chair with the consent of members present.

2. APOLOGIES

Apologies were intimated on behalf of Bryan Smail, Chief Finance Officer, Falkirk Council.

3. DECLARATIONS OF INTEREST

No declarations were made.

4. MINUTES

Decision

(a) The minute of the meeting of the Pensions Panel held on 29 May 2014 was approved; and

(b) The minute of the meeting of the Pensions Committee held on 5 June 2014 was noted.

5. PENSION FUND - UNAUDITED ANNUAL REPORT AND ACCOUNTS 2013/14

The Panel considered a report by the Chief Finance Officer on the Falkirk Pension Fund's Unaudited Annual Report and Accounts for 2013/2014 and (a) referring to Regulation 31A of the Local Government Pension Scheme (Administration)(Scotland) Regulations 2008, which requires administering authorities to publish a pension fund annual report, recognising that pension fund accounts are separate from other accounts of the administering authority, and (b) attaching as an appendix for inspection, a copy of the Fund's Unaudited Annual Report and Accounts for 2013/14.

Decision

The Panel noted the report and the publication of the Unaudited Falkirk Council Pension Fund Annual Report and Accounts for 2013/14.

6. LONGEVITY ANALYSIS REPORT - CLUB VITA - UPDATE BY HYMANS ROBERTSON

The Panel considered a report by the Chief Finance Officer on the initial findings of the Pension Fund's participation in the Club Vita longevity analysis.

The Committee had agreed at its meeting on 12 December 2013 to the proposal from Hymans Robertson for the Fund to participate in Club Vita. This would enable a detailed analysis of the Fund's longevity experience to be undertaken and allowed for the use of data which was specific to the Falkirk Pension Fund. The availability of the more accurate longevity data meant that Fund calculations, such as cessation valuations, bulk transfers and funding assessments would in future be of a more reliable nature. Other benefits included having robust evidence based longevity assumptions allowing the Fund to pay due attention to longevity risk

The Panel also heard from Catherine McFadyen, Hyman's Robertson who provided detail on the following:-

- The longevity risk including addressee and scope;
- The longevity, affluence, lifestyle, retirement health and occupational 'DNA' data;
- The concentration of longevity risk;
- The implications for funding; and
- The future longevity uncertainty.

The Convener thanked Ms McFadyen for her comprehensive presentation.

Decision

The Panel noted the report and presentation.

7. LOCAL GOVERNMENT PENSION SCHEME - NEW SCHEME DEVELOPMENTS

The Panel considered a report by the Chief Finance Officer providing an update on the recent developments in relation to 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 detailed that a Heads of Agreement on scheme design and governance had now been reached between COSLA, Trades Unions and the Scottish Government.

The statutory arrangements requiring to be set in place were as undernoted:-

- The main scheme regulations were made and described how benefits and contributions would be determined under the CARE arrangements. A number of defects had been identified in the Regulations and a set of amendments was awaited;
- The transitional regulations were made and described how existing members' accrued rights would be treated in the new scheme; and
- Governance regulations would be available in first draft in October 2014 with the final version expected in January 2015 and would specify how the governance requirements of the 2013 Act were to be applied in the LGPS.

The report thereafter highlighted that the necessary work on the main scheme and transitional regulations was unlikely to impede software development or Fund implementation plans. In contrast however the timetable for the production of the governance regulations meant that in order to comply with the April 2015 deadline, Funds would have to undertake their governance reviews in advance of final regulations being available.

The other pertinent developments included:-

- Employer training - training events for fund managers on 18 September and 2 October 2014 aimed mainly at Payroll and HR practitioners. Around 35 employer delegates were signed up for each event. A further resource for employers was provided at www.lgpsregs.org for scheme rules and explanatory guides;
- Employee information - the Fund members' information website www.scotlgps2015.org; and
- The new Pensions Administration System would replace the existing in-house system and was Heywood's "Altair" product used by the majority of Scottish and English/Welsh LGPS Funds.

Decision

The Panel noted the latest developments in relation to the implementation of the LGPS (Scotland) 2015.

8. LOCAL GOVERNMENT PENSION SCHEME - GOVERNANCE ISSUES

The Panel 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 detailed that a Heads of Agreement on scheme governance had now been reached between COSLA, Trades Unions and the Scottish Government and the statutory regulations underpinning governance rules would be finalised in early 2015.

The key milestones were as detailed below:-

- The consultation period for the draft regulations from 16 October to 27 November 2014;
- The Scottish Public Pensions Agency (SPPA) review of consultation comments from 28 November to 19 December 2014;
- The final drafting of regulations from 5 to 16 January 2015; and
- The ministerial signing off of the regulations on 27 January 2015.

The report thereafter detailed the following requirements within the Act for the operation of the Pensions Board including:-

- Ensuring the secure compliance with the scheme regulations and other legislation relating to the governance and administration of the scheme and the Pensions Regulator;
- To undertake any such other matters as the scheme regulations may specify;
- Having an equal number of employer and member representatives (a minimum of 4 trade union and 4 employer);
- That the scheme manager should be satisfied that members did not represent a conflict of interest; and
- That meetings should take place concurrently with the Pensions Committee.

In furtherance of the requirement to establish a Pension Board it was proposed to consult Fund Employers and Trade Unions for their views as to how the new arrangements could best operate and the report provided information on the consultation action plan and associated implementation timescales.

Decision

The Panel noted the report.

9. GENERAL GOVERNANCE MATTERS

The Panel 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:-

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

Decision

The Panel noted the report.

10. CORPORATE GOVERNANCE UPDATE

The Panel received a presentation by Allan MacDougall and Janice Hayward, PIRC Ltd

The presentation included information on the undernoted:-

- The value of corporate governance including the key milestones and fundamental objectives;
- The Regulators including the Financial Conduct Authority, the Prudential Regulatory Authority (PRA) and the Financial Reporting Council (FRC);
- The Boardroom themes; and
- Practice and Stewardship including shareholder engagement in terms of the UK Stewardship Code principles, responsible investment and the development of a broader Stewardship Plan and the protection of shareholder value.

The Convener thanked Mr MacDougall and Ms Hayward for their comprehensive presentation.

Decision

The Panel noted the presentation.

11. ORDER OF BUSINESS

In terms of Standing Order 14.2(i), the Convener 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.

12. FUND MANAGER REVIEW

The Panel received a presentation Patrick Hand and Jamie Cumming, Aberdeen Asset Management.

The areas covered by the presentation included:-

- Business Update;
- Performance and Attribution;
- Equity;
- Current Positioning; and
- Portfolio Review.

The Convener thanked Mr Hand and Mr Cumming for their comprehensive presentation.

Decision

The Panel noted the presentation.

13. PRIVATE EQUITY AND ALTERNATIVES UPDATE

The Panel 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 June 2014.

Decision

The Panel noted the progress of the Pension Fund's private equity, infrastructure and credit markets programme for the quarter ending 30 June 2014.

14. FUND MANAGER PERFORMANCE REVIEW

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

DRAFT
AGENDA ITEM 3(b)

FALKIRK COUNCIL

MINUTE of MEETING of the PENSIONS COMMITTEE held in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 25 SEPTEMBER 2014 at 9.30 A.M.

PRESENT:	Councillors: Jim Blackwood Steven Carleschi Tom Coleman Depute Provost Patrick (Convener) Craig Martin Councillor Callum Campbell, Stirling Council Mary Keggan Alistair Redpath
ATTENDING:	Jason Koumides, Pensions Accountant Alastair McGirr; Pensions Manager Bruce Miller, Investment Manager, Lothian Pension Fund Elliot Roy, Trainee Committee Services Officer Bryan Smail, Chief Finance Officer Antonia Sobieraj, Committee Services Officer
ALSO IN ATTENDANCE:	Christopher Down, Hearthstone Investment Management Bruce Miller, Investment Manager, Lothian Pension Fund Catherine McFadyen, Hyman's Robertson Allan MacDougall and Janice Hayward, PIRC Ltd Jim Rundell and Brendan Clark, Audit Scotland

PE15. APOLOGIES

No apologies were intimated.

PE16. DECLARATIONS OF INTEREST

No declarations were made.

PE17. MINUTES

Decision

(a) The minute of the meeting of the Pensions Committee held on 5 June 2014 was approved; and

(b) **The minute of the meeting of the Pensions Panel on 11 September 2014 was noted and that the Panel had during discussion indicated that it would be supportive of an independent review of the Fund's Private Equity programme should this be taken forward by the Pensions Committee.**

PE18. FALKIRK COUNCIL PENSION FUND – REPORT TO THOSE CHARGED WITH GOVERNANCE ON THE 2013/14 AUDIT

The Committee considered a report by the Chief Finance Officer on a report by Audit Scotland issued in accordance with the International Standard on Auditing (ISA 260) "Report to those charged with Governance on the 2013/14 Audit".

The report indicated that Regulation 31A of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 required administering authorities to publish a Pension Fund Annual Report and Accounts which were separate from the other accounts of the administering authority. The report and associated accounts were also subject to a separate audit. The Pension Fund's Unaudited Annual Report and Accounts for 2013/14 were submitted for audit on 30 June 2014 in line with the required statutory deadline.

Under the International Standard on Auditing 260 (ISA 260), auditors, before certifying the accounts, were required to communicate matters relating to the audit to those charged with governance. The report, referred to as the ISA 260, was to be provided in sufficient time to enable remedial action to be taken if necessary.

The ISA 260 reported that, subject to a final review, the audit would be unqualified.

The matters on which the auditor has specifically commented were as follows: -

- Investment Management Expenses;
- Presentational Matters;
- Employee/ Employer Contributions;
- Bank Account; and
- Cash Balances.

The Fund's external auditors, Audit Scotland, had completed their report to those charged with governance and anticipated being able to issue an unqualified audit certificate. Matters arising from the audit would be taken forward as appropriate in preparing the 2014/15 accounts.

Decision

The Committee noted the report.

PE19. PENSION FUND - ANNUAL ACCOUNTS 2013/14

The Committee considered a report by the Chief Finance Officer on the Falkirk Pension Fund's Annual Accounts for 2013/2014 and (a) referring to Regulation 31A of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, which requires administering authorities to publish a Pension Fund Annual Report, recognising that Pension Fund accounts were separate from other accounts of the administering authority, and (b) attaching as an appendix for inspection, a copy of the Fund's Audited Accounts for 2013/14.

Decision

The Committee agreed to approve the Falkirk Council Pension Fund Annual Report and Audited Annual Accounts for 2013/14.

PE20. LONGEVITY ANALYSIS REPORT - CLUB VITA - UPDATE BY HYMANS ROBERTSON

The Committee considered a report by the Chief Finance Officer on the initial findings of the Pension Fund's participation in the Club Vita longevity analysis.

The Committee had agreed at its meeting on 12 December 2013 to the proposal from Hymans Robertson for the Fund to participate in Club Vita. This would enable a detailed analysis of the Fund's longevity experience to be undertaken and allowed for the use of data which was specific to the Falkirk Pension Fund. The availability of the more accurate longevity data meant that Fund calculations, such as cessation valuations, bulk transfers and funding assessments would in future be of a more reliable nature. Other benefits included having robust evidence based longevity assumptions allowing the Fund to pay due attention to longevity risk

The Committee also heard from Catherine McFadyen, Hyman's Robertson who provided detail on the following:-

- The longevity risk including addressee and scope;
- The longevity, affluence, lifestyle, retirement health and occupational 'DNA' data;
- The concentration of longevity risk;
- The implications for funding; and
- The future longevity uncertainty.

The Convener thanked Ms McFadyen for her comprehensive presentation.

Decision

The Committee noted the report and presentation.

PE21. LOCAL GOVERNMENT PENSION SCHEME - NEW SCHEME DEVELOPMENTS

The Committee considered a report by the Chief Finance Officer providing an update on the recent developments in relation to 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 detailed that a Heads of Agreement on scheme design and governance had now been reached between COSLA, Trades Unions and the Scottish Government.

The statutory arrangements requiring to be set in place were as undernoted:-

- The main scheme regulations were made and described how benefits and contributions would be determined under the CARE arrangements. A number of defects had been identified in the Regulations and a set of amendments was awaited;
- The transitional regulations were made and described how existing members' accrued rights would be treated in the new scheme; and
- Governance regulations would be available in first draft in October 2014 with the final version expected in January 2015 and would specify how the governance requirements of the 2013 Act were to be applied in the LGPS.

The report thereafter highlighted that the necessary work on the main scheme and transitional regulations was unlikely to impede software development or Fund implementation plans. In contrast however the timetable for the production of the governance regulations meant that in order to comply with the April 2015 deadline, Funds would have to undertake their governance reviews in advance of final regulations being available.

The other pertinent developments included:-

- Employer training - training events for fund managers on 18 September and 2 October 2014 aimed mainly at Payroll and HR practitioners. Around 35 employer delegates were signed up for each event. A further resource for employers was provided at www.lgpsregs.org for scheme rules and explanatory guides;
- Employee information - the Fund members' information website www.scotlgps2015.org; and
- The new Pensions Administration System would replace the existing in-house system and was Heywood's "Altair" product used by the majority of Scottish and English/Welsh LGPS Funds.

Decision

The Committee noted the latest developments in relation to the implementation of the LGPS (Scotland) 2015.

PE22. LOCAL GOVERNMENT PENSION SCHEME - GOVERNANCE ISSUES

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 detailed that a Heads of Agreement on scheme governance had now been reached between COSLA, Trades Unions and the Scottish Government and the statutory regulations underpinning governance rules would be finalised in early 2015.

The key milestones were as detailed below:-

- The consultation period for the draft regulations from 16 October to 27 November 2014;
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- The ministerial signing off of the regulations on 27 January 2015.

The report thereafter detailed the following requirements within the Act for the operation of the Pensions Board including:-

- Ensuring the secure compliance with the scheme regulations and other legislation relating to the governance and administration of the scheme and the Pensions Regulator;
- To undertake any such other matters as the scheme regulations may specify;
- Having an equal number of employer and member representatives (a minimum of 4 trade union and 4 employer);
- That the scheme manager should be satisfied that members did not represent a conflict of interest; and
- That meetings should take place concurrently with the Pensions Committee.

In furtherance of the requirement to establish a Pension Board it was proposed to consult Fund Employers and Trade Unions for their views as to how the new arrangements could best operate and the report provided information on the consultation action plan and associated implementation timescales.

Decision

The Committee:-

(1) noted the report; and

(2) agreed that a joint meeting between the Committee and the Panel would be convened in December 2014 at a date to be confirmed.

PE23. 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:-

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

Decision

The Committee noted the report.

Councillor C Martin entered the meeting prior to consideration of the following item of business.

PE24. CORPORATE GOVERNANCE UPDATE

The Committee received a presentation by Allan MacDougall and Janice Hayward, PIRC Ltd

The presentation included information on the undernoted:-

- The value of corporate governance including the key milestones and fundamental objectives;
- The Regulators including the Financial Conduct Authority, the Prudential Regulatory Authority (PRA) and the Financial Reporting Council (FRC);
- The Boardroom themes; and
- Practice and Stewardship including shareholder engagement in terms of the UK Stewardship Code principles, responsible investment and the development of a broader Stewardship Plan and the protection of shareholder value.

The Convener thanked Mr MacDougall and Ms Hayward for their comprehensive presentation.

Decision

The Committee noted the presentation.

PE25. ORDER OF BUSINESS

In terms of Standing Order 14.2(i), the 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.

PE26. FUND MANAGER REVIEW

The Committee received a verbal update by Christopher Down, Hearthstone Investment Management which had been appointed by the Committee at its meeting on 17 March 2014 to manage a £30m investment in social housing and affordable housing.

The areas covered in the update included:-

- The investment of £15m in a Places for People Bond to back the social and affordable housing programme;
- The expected associated grant funding of £10m;
- The proposals for the first development at Bellsdyke, Larbert on a 50:50 ratio for social and affordable housing by early 2015;
- The development of other projects by 2016/2017 and that options included Bonnybridge, Stirling and Clackmannanshire; and
- The ongoing discussions with Castle Rock, Edinvar on future projects.

The Convener thanked Mr Down for his comprehensive presentation and welcomed further updates in due course.

Decision

The Committee noted the progress in relation to the investment in social and affordable housing.

PE27. PRIVATE EQUITY AND ALTERNATIVES UPDATE

The Committee Panel 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 June 2014.

Decision

The Committee:-

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

(2) agreed that it would be supportive of an independent review of the Fund's Private Equity programme.

PE28. 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 June 2014, in accordance with their investment policies.

AGENDA ITEM 4

FALKIRK COUNCIL

Subject: **PENSION FUND ANNUAL AUDIT REPORT – 2013/14**
Meeting: **JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE**
Date: **11 DECEMBER 2014**
Author: **CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report presents the Panel and Committee with details of the Audit Scotland Pension Fund report for 2013/14.

2. BACKGROUND

2.1 The audited Annual Report and Accounts were approved at the meeting of the Pensions Committee on 25 September 2014.

2.2 The Annual Report and Accounts have been posted on the Pension Fund website and brought to the attention of all fund employers. A copy of the Audit Report will be posted after this meeting. Publication of Annual Account and Audit Report ensures compliance with Regulation 30 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

3. AUDIT SCOTLAND REPORT

3.1 The Audit Scotland report provides a summary of the Fund's current standing as well as detailed comment on matters such as the Fund's financial position, governance and performance.

3.2 The most significant observations are as follows:

- the audit opinion for the 2013/14 Annual Report and Accounts was unqualified
- the funding level at 31 March 2014 was 84%
- falling bond yields have resulted in increased liabilities
- investment returns have outperformed benchmark targets over short, medium and long term
- the Fund has sound governance arrangements
- significant challenges lie ahead arising from the ongoing pensions reform agenda

3.3 The report highlights several areas where management action should be considered.

- Investment Management Expenses;
- Budgetary Control
- New Pensions Administration System
- New Career Average Scheme and Governance Arrangements
- Internal Audit activity

3.4 A number of these points were already part of the Pension Section's work plan for 2014/15 and will continue to be taken forward in preparing the next set of accounts.

3.5 The full Audit Scotland report is attached as an appendix to this report.

4. CONCLUSION

4.1 A report on the pension fund audit for 2012/13 has been completed by the Fund's external auditors, Audit Scotland.

4.2 A number of recommendations have been made and an action plan instituted to address the various issues.

4.3 Completion of Audit Scotland's report successfully concludes the audit process in respect of the 2013/14 accounts.

5. RECOMMENDATION

5.1 The Panel and Committee are asked to note Audit Scotland's Annual Report on the 2013/14 pension fund audit.

Chief Finance Officer

Date: 18 November 2014

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

NIL

AUDIT SCOTLAND

Falkirk Council Pension Fund

Annual report on the 2013/14 audit

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

October 2014

Contents

Key contacts

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Telephone: 0845 146 1010

Website: www.audit-scotland.gov.uk

Key messages

Financial statements	• We have given an unqualified opinion on the financial statements of Falkirk Council Pension Fund for 2013/14.
Financial position	• Fund net assets are £1,577 million at 31 March 2014. • The actuarial value of retirement benefits is £2,281 million. • The net liability of £704 million has increased from £548 million last year due to falling bond yields. • The funding level at 31 March 2014 was 84% (86% in 2011).
Governance & accountability	• The Falkirk Council Pensions Fund has sound governance arrangements that include a Pensions Committee supported by an advisory Pensions Panel. • Internal audit plans for 2014/15 do not include any provision for work on the Pension Fund and its systems.
Best Value, use of resources & performance	• Despite the funding gap increasing, investment returns have outperformed benchmark targets over the short, medium and longer term. • The rolling three year performance is also ahead of target.
Outlook	• The uncertainty in the global financial markets and the consequent effect on the stock market means that pension funds will require to remain vigilant and keep assessing their exposure to risk. • New governance arrangements come into force on 1 April 2015 as a result of the Public Services Pensions Act 2013. • Changes are needed for administering a career average scheme and auto enrollment for staff.

Financial Statements

1. We have given an unqualified audit opinion that the financial statements of Falkirk Council Pension Fund ('the Fund') for 2013/14 give a true and fair view of the state of affairs of the Fund as at 31 March 2014 and of the income and expenditure for the year then ended.

Financial position

2. The Fund had net assets of £1,577 million as at 31 March 2014. The actuarial value of promised retirement benefits at the accounting date has been estimated by the actuary, on an IAS 19 basis, as £2,281 million, giving a net liability of £704 million as at 31 March 2014 (£548 million as at 31 March 2013).

Funding position

3. The most recent triennial valuation was reported in January 2012. The report highlighted that the Fund's assets valued at 31 March 2011 (£1,199 million) were sufficient to meet 86% of its liabilities accrued up to that date, resulting in a funding shortfall of £194 million. This represents an improved position from the previous triennial valuation in 2008 that reported a funding position of 79% (a funding shortfall of £255 million).

4. However, the interim funding position at 31 March 2014, as advised by the Fund's actuary, shows a slightly weaker position with assets falling to 84% of liabilities. A recent review by Club Vita indicates that longevity assumptions used in the 2011 actuarial valuation over-estimated the life expectancy of the Fund's pensioners. Applying Club Vita's assumptions on longevity could result in the Funding position improving by around 6% and the deficit would reduce by £130 million.

5. The triennial valuation at 31 March 2014 which will set the employer contribution rates for the next three years starting from 1 April 2015 will incorporate the results of Club Vita. This and other measures such as annual funding reviews and cash flow modelling are designed to improve the management and oversight of the Fund in the longer term.

6. In addition, the Public Service Pensions Act 2013 will introduce changes to ensure the continued survival of the Local Government Pension Scheme. Notably the 'employer cost cap' will shift some of the risk of future rises in scheme costs onto members.

7. In recent times active membership of the Fund declined due to the recession which saw restrictions on recruitment and accelerated severance programmes. This has now been halted through the auto-enrolment initiative which has seen membership increase by approximately 2,000 in the last two years. The impact is being kept under review.

Governance and accountability

8. The Falkirk Council Pensions Fund has sound governance arrangements that include a Pensions Committee supported by an advisory Pensions Panel with representatives from fund employers, pensioners and trade unions.

9. We also concluded that the Pension Fund has adequate internal controls (including internal audit) and satisfactory arrangements for the prevention and detection of fraud and corruption.

Best Value and performance

10. Over the long term, the overall level of investment return achieved by the Fund is expected to exceed the rate of return assumed by the actuary in valuing the Fund. Investment returns of Falkirk Council Pension Fund have outperformed benchmark targets over the short, medium and longer term. The current rolling three year performance is also ahead of benchmark.

Outlook

11. Global financial markets in 2013/14 had to face a combination of political tensions in Ukraine and the Middle East, as well as the prospects of monetary policy tightening in the US and a loss of economic momentum. Particularly in China where policy makers are grappling with high levels of credit. With investment performance key to the Funding position of the LGPS, this may impact on employer contributions in the medium term.

12. The Fund will need to review its governance arrangements to comply with the Public Services Pensions Act 2013 which requires funds to establish a Pensions Board and take cognisance of relevant Codes of Practice for the Pensions Regulator. Challenges also arise from administering the staged implementation of auto-enrolment and the move to pensions based on average pay. The Fund is acquiring a new Pensions Administration system to help address these challenges.

Introduction

13. This report is a summary of our findings arising from the 2013/14 audit of the Falkirk Council Pension Fund. The purpose of the annual audit report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising from the audit. The report is divided into sections which reflect our public sector audit model.

14. Our responsibility, as the external auditor of Falkirk Council Pension Fund, is to undertake our audit in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

15. The management of Falkirk Council Pension Fund is responsible for:

- preparing financial statements which give a true and fair view
- implementing appropriate internal control systems
- putting in place proper arrangements for the conduct of its affairs
- ensuring that the financial position is soundly based.

16. This report is addressed to the members of Falkirk Council and the Controller of Audit and should form the basis of discussions with the Pensions Committee as soon as possible after it has been issued. Reports should be made available to stakeholders and the public, as audit is an essential element of accountability and the process of public reporting.

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

18. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. Local reports and relevant national reports are summarised at Appendix I. We do not repeat all of the findings in this report, but focus on the financial statements and any significant findings from our wider review of Falkirk Council Pension Fund.

19. The concept of audit risk is of key importance to the audit process. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements. We set out in our annual audit plan the related sources of assurance and the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix II sets out the significant audit risks identified at the planning stage and how we addressed

each risk in arriving at our opinion on the financial statements.

20. Appendix III is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed ‘management action/response’.

21. We recognise that not all risks can be eliminated or even minimised. What is important is that Falkirk Council Pension Fund understands its risks and has arrangements in place to manage these risks. The council and the Proper Officer should ensure that they are satisfied with proposed management action and have a mechanism in place to assess progress and monitor outcomes.

22. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures. Our comments should consequently not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

Acknowledgement

23. The co-operation and assistance given to us by officers during the conduct of our audit is gratefully acknowledged.

Financial statements

Performance	Net Assets	Investments	Funding Level
Return on investments 6.9%	Increase in Net assets £113.6m	Change in market value £75.3m	Net Assets £1,576.7m Fund Liabilities £1.872.6m Funding Position 84%
Benchmark 6.0%	Net assets £1,576.7m	Investment Income £26.5m	

Audit opinion

24. We gave an unqualified opinion that the financial statements of Falkirk Council Pension Fund for 2013/14 give a true and fair view of the state of the affairs of the Fund as at 31 March 2014 and of the income and expenditure for the year then ended.

Other information published with the financial statements

25. Auditors review and report on other information published with the financial statements, including the explanatory foreword and the annual governance compliance statement. We have nothing to report in respect of these statements.

Legality

26. Through our planned audit work we consider the legality of the pension fund's financial transactions. In addition the Chief Finance Officer has confirmed that, to the best of his knowledge and belief, the financial transactions of the pension fund are in accordance with relevant legislation and regulations. There are no legality issues arising from our audit which require to be brought to the attention of those charged with governance.

Accounting issues arising

Presentational and monetary adjustments

27. A number of presentational adjustments were identified during the course of the audit. These were discussed and agreed with management who agreed to amend the unaudited financial statements.

28. Additionally, there was one monetary error identified during the course of the audit. This related to the duplication of a lump sum payment offset by other payments not included in the accounts. If the error had been adjusted it would have resulted in the net assets of the Fund increasing by £30,000. However, the error was immaterial to the financial statements and we concurred with management that the accounts should not be amended.

29. Local authority bodies in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and the Service Reporting Code of Practice 2013/14 supported by International Financial Reporting Standards (IFRS). We concluded that the financial statements have been prepared in accordance with extant guidance.

Report to those charged with governance

30. We presented our report to those charged with governance (ISA 260) to the Pensions Committee on 25 September 2014. The primary purpose of that report is to communicate the significant findings arising from our audit prior to finalisation of the independent auditor's report. The main points are set out in the following paragraphs.

31. **Investment management expenses**: Investment management expenses recorded in the Pension Fund Account are incomplete. They exclude indirect investment manager fees that arise from the 'fund of funds structures'. These fees are accounted for within 'Profit and losses on disposal of investments and changes in market value of investments'. However, the calculation of the fees is a complex area, particularly in regard to pooled investment funds, and it is not possible to separately identify these fees. This matter does not relate solely to Falkirk Council Pension Fund but also applies to other pension funds in Scotland.

32. The Pension Fund has sought to address this issue by attaching an estimate of these expenses to note 15 to the accounts.

Recommendation no.1

33. **Bank account**: Under the terms of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 pension funds are required to maintain a separate bank account. Falkirk Council Pension Fund operates a separate bank account although certain transactions are processed through the main council bank accounts and then monies are transferred in or out of the pension fund bank account. This does not fulfil the requirement in our opinion.

34. As a result of transactions being passed through the council's bank account it is difficult to determine at any given point the status of the account i.e. is the balance due to the council or to the pension fund. If the balance is due to the pension fund then the council is liable to pay interest to the Fund at no less than a commercial rate.

35. **Employer/employee contributions**: The data return submitted by one large employer was received late and was inaccurate. A return by another employer indicated the amount remitted by the employer was £36,000 in excess of the amount included in the pension fund accounts.

36. **Cash balances**: The cash balances in the Net Asset Statement include £301,000 described as balances held by Falkirk Council. This amount is a balancing figure after accounting for all transactions relating to the council, and management have advised that all except £3,000 of this amount can be attributed to the pension fund.

37. Of the remaining balance, management has confirmed that it is likely to be fully attributable to the pension fund but this has yet to be fully verified. Based on management assurances and work completed to verify the balance to date we have not treated this as an unadjusted error.

Outlook

38. The financial statements of the Fund are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The main new standards to be adopted in 2014/15 include:

- IFRS 13 Fair value measurement
- IAS 32 Financial Instruments: Presentation
- Annual improvements to IFRSs 2009-2011 cycle

39. The revised Local Authority Accounts (Scotland) Regulations 2014 apply to financial years 2014/15 onwards.

40. The regulations set out in more detail what is required in respect of financial management and internal control, and in respect of the annual accounts themselves. The significant changes include:

- the requirement for the unaudited accounts to be considered by the Pensions Committee. This can take place following submission to the auditor and up to 31 August if necessary. In addition the audited accounts must be considered and approved for signature by the Pensions Committee by 30 September with publication on the Council's website by 31 October
- the Pensions Committee will be required to carry out an annual review of the Fund's system of internal control, together with the requirement to approve an annual governance statement or equivalent
- the Pensions Committee will be required to consider the efficiency and effectiveness of internal audit.

41. The draft programme of meetings for 2015 has a Pensions Committee meeting scheduled for 4 June 2015 to approve the unaudited accounts. This is very tight as the 2013-14 unaudited accounts were not available until the end of June 2014. The next available meeting in 2015 would not be until 25 September 2015. In terms of the accounts regulations the absolute deadline for approval of the unaudited accounts would be 31 August 2015. Given these dates there is a risk that the unaudited accounts may not be available for consideration by the Pensions Committee within the prescribed timescale.

42. We have raised our concerns about the planned meetings of the Pensions Committee in 2015 with the Democratic Services Manager who co-ordinates and compiles the Committee meetings timetable.

Recommendation no.2

43. Moreover, the Pensions Accountant recently resigned to take up a position with another pension fund. The Pensions Accountant plays a key role in preparing the unaudited accounts. This represents a significant loss of financial accounting knowledge and expertise. Management recognise this risk and are planning to address it through a combination of recruitment and some sharing of resources with another Fund.

Recommendation no.3

Financial position

44. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.

45. Auditors consider whether audited bodies have established adequate arrangements and examine:

- financial performance in the period under audit
- compliance with any statutory financial requirements and financial targets
- ability to meet known or contingent, statutory and other financial obligations
- responses to developments which may have an impact on the financial position
- financial plans for future periods.

46. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the Fund.

Financial results

Budgetary control

47. The pension fund prepared an annual budget for its administration costs in 2013/14, although the budget is not disclosed in the financial statements and performance against budget is not routinely reported to the Pensions Committee.

Recommendation no.4

Financial position

48. The overall position at 31 March 2014 is that the Fund has net assets of £1,577 million. The financial statements do not take account of the obligations to pay pensions and other benefits which fall due after the end of the year. The actuarial position of the scheme, which does take account of such obligations, is disclosed in Note 25 to the accounts. When taking into account these obligations (£2,281 million) the overall funding position of the Fund, on an IAS 19 basis, is 69% which equates to a deficit of £704.3 million.

Funding position

49. The most recent triennial valuation was reported in January 2012. The report highlighted that the Fund's assets valued at 31 March 2011 were sufficient to meet 86% of its liabilities accrued up to that date, resulting in a funding shortfall of £193 million. This represents an improved position from the previous triennial valuation (as at March 2008) which reported a funding position of 79% (a funding shortfall of £255 million).

50. Since this time, the Funding position has seen some fluctuation in its position. This is monitored on a regular basis as part of the administering authorities risk management programme. The interim funding position as at 31 March 2014 is 84%. The movement in valuations is summarised in table 1 below, updated with fund values as determined by the Actuary for the year ending March 2013/14:

Table 1: Movement in valuations 2008 to 2014

Fund Details	2008 £ million	2011 £million	2014 £million
Assets	947	1,199	1,577
Liabilities	(1,203)	(1,392)	(1,872)
Net Liability	(255)	(193)	(295)
Funding Level	79%	86%	84%

Source: previous reports and advice from the Fund's actuary

51. At a local level, the sustainability of the Fund is managed in a number of ways including annual funding reviews, cash flow modelling and the re-assessment of employer contribution rates at the triennial valuation. Also, any employers seeking to exit the Fund must secure their liabilities.

52. Furthermore, the Public Service Pensions Act 2013 is designed to ensure the continued sustainability of the Local Government Pension Scheme. In particular, the *employer cost cap* measures about to be introduced will shift some of the risk of future rises in scheme costs onto members.

53. Recent turmoil in the Middle East and Ukraine as well as the general slowdown in global economic recovery has been impacting on financial markets and the funding position may be affected by falling asset values in the short term. This is closely monitored by the Fund and the Pensions Committee to ensure there is no lasting impact.

54. The actuarial value of promised retirement benefits at the accounting date has been estimated by the Fund Actuary as £2,281 million (2012/13 £2,011million), giving a net liability of £704 million as at 31 March 2014 (£548 million as at 31 March 2013). The increase in the net liability is mainly due to a fall in real bond yields. The liability is an estimate of the present value of future liabilities of the Fund, based on the Fund actuary's assumptions regarding the future discount rate, longevity of members and rate of inflation.

55. Actuarial assumptions include retirement rates, numbers and age of members within their valuations, and although the position is challenging the Fund reviews its position on a regular basis. Work is currently underway with the Fund employers and actuary in preparation for the 2014 triennial actuarial valuation.

56. The Fund has joined Club Vita, an organisation which advises funds on managing longevity risk. A report from Club Vita submitted to the Pensions Committee on 25 September 2014 indicated that the longevity assumptions used in the 2011 triennial valuation over estimated the life expectancy of the Fund's pensioners.

57. Applying the longevity assumptions from Club Vita could result in a reduction in the Fund's liabilities by £130 million and improve the Funding position by around 6%. This information will be considered when the actuary comes to set the contributions rates for the three years starting from April 2015.

Outlook

58. Looking ahead it is clear that the outlook for public spending remains very challenging as significant budget reductions are required in future years. Spending constraints are set to continue and pressures on the Fund will increase as scheduled and admitted bodies seek to deliver efficiencies through reductions in staffing levels.

59. In recent years there has been a decline in active members due to the recession which saw restrictions on recruitment and accelerated severance programmes. This has now been halted through the auto-enrolment initiative which came in on a staged basis mid-way through 2012/13 as illustrated below:

Table 2: Fund membership 2010 to 2014

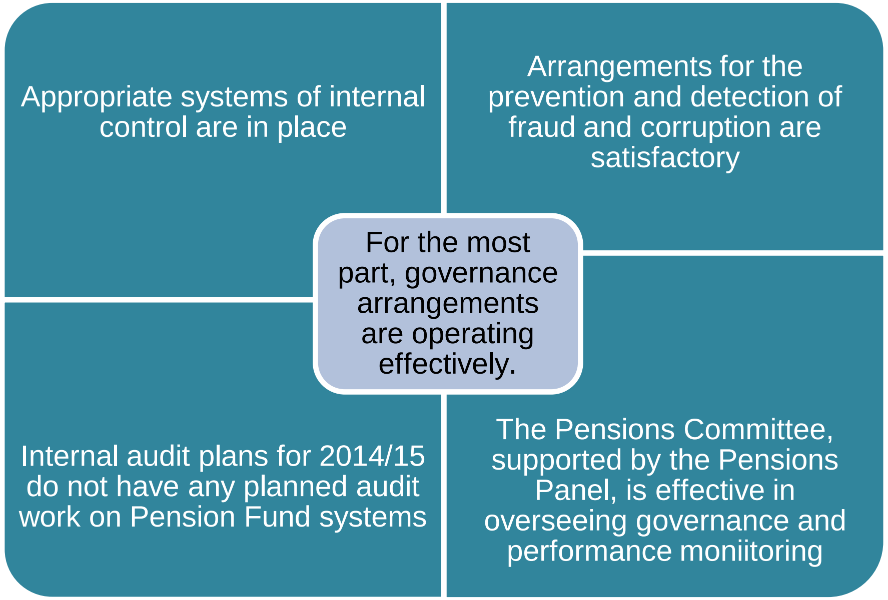
Scheme members	Scheme membership				
	31/3/10	31/3/11	31/3/12	31/3/13	31/3/14
Active members	13,305	12,939	12,668	12,880	14,690
Deferred	4,551	4,869	5,085	5,204	5,320
Pensioners	7,090	7,600	8,119	8,372	8,693
Total	24,946	25,408	25,872	26,456	28,703

Source: Annual report and accounts 2012/13 and 2013/14

60. The increase in membership is estimated to have resulted in annual employee contributions rising from £16 million to £17 million. The modest rise reflects the fact that many of those auto enrolled were part-time members. This is an area for management to monitor closely to ensure that the increase in number of active members is sustained.

61. The volatility in the global financial markets and the effect on the stock market makes it important for pension funds to have a wide range of investment vehicles including hedging against currency fluctuations. Pension funds will have to remain vigilant and keep assessing their exposure to risk.

Governance and accountability



62. Members of the council and the Proper Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of Falkirk Council Pension Fund and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

63. The corporate governance framework within Falkirk Council Pension Fund is centred on the Pensions Committee which is supported by the Pensions Panel.

64. Based on our observations and audit work our overall conclusion is that the governance arrangements within Falkirk Council Pension Fund are operating effectively.

Governance processes and committees

65. Falkirk Council acts as the Administering Authority for the Pension Fund. It is responsible for managing and administering the scheme for scheduled and admitted bodies.

66. The council has delegated the administration, management and investment of the Pension Fund to the Pensions Committee. The committee comprises six councillors from Falkirk Council and three co-opted members. Co-opted members are nominated by the Pensions Panel to represent the interests of scheme members, employers and pensioners. The responsibilities of the Pensions Committee are set out in Falkirk Council's scheme of delegation.

67. The Pensions Panel exists to enhance participation in the

development and scrutiny of matters relating to the Pension Fund. The panel consists of 15 members representing the interests of three groups within the Fund - scheme members, employers and pensioners.

68. The Pension Fund will require to review its governance arrangements as a result of the Public Services Pensions Act 2013. The Act requires at a national level the establishment of a Scheme Advisory Board to provide advice and guidance with regard to the management and administration of the LGPS.

69. At a local level, the Act requires the establishment of a Pensions Board to support the Scheme Manager (i.e. Administering Authority). The Pensions Board must contain an equal number of employer and member representatives.

70. A Heads of Agreement on governance matters has been concluded between COSLA and the trade unions. However, the statutory regulations underpinning the new governance requirements will not be available until early 2015. To enable the new governance arrangements to be in place by the specified date of 1 April 2015 consultation on the new arrangements will have to be undertaken in advance of the final regulations being known. There is a risk that the Fund will not have appropriate arrangements in place by 1 April 2015.

Recommendation no.5

Governance Compliance Statement

71. Pension administration regulations require an administering authority to prepare and publish a governance compliance statement to measure their pension fund's governance arrangements against the standards set out in the guidance issued by the Scottish Ministers. Having reviewed the governance compliance statement we are satisfied that it complies with the guidance issued by the Scottish Ministers.

72. Of the nine principles for compliance only one area has been classified as not compliant and this has mitigating arrangements in place. The governance structures have been seen to be working well with no issues with regard to openness, reporting or scrutiny. From attendance at meetings, our review of papers and minutes the information reported in the Governance Compliance Statement appears to be accurate and appropriate.

73. The Code of Practice on local authority accounting in the United Kingdom 2014/15 has been amended to require the inclusion of a separate statement on system of internal financial control (SSIFC) or additional disclosures, reports or statements as necessary in order to meet the requirements of that statement. Internal audit will play an important role in giving assurances in relation to the SSIFC or equivalent.

Internal control

74. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. The extent of this work is also informed by an assessment of risk and the activities of internal audit.

75. As part of our work we took assurance from key controls within the Fund's systems. We relied on our systems work carried out in 2012/13 supplemented by a high level review of controls using walk through tests to confirm that controls were operating as documented. In addition, substantive checking of transactions was carried out at the year end. No significant control weaknesses were identified during this work.

Internal audit

76. Internal audit is an important element of the Fund's governance structure. The internal audit service is provided by the council's internal audit section. We reviewed internal audit in terms of ISA 610 and concluded that they operated in accordance with the Public Service Internal Audit Standards and had sound documentation standards and reporting procedures in place.

77. Internal audit carried out comprehensive testing of pension payments, collection of contributions and transfers in 2012-13 which confirmed that there were no significant internal control issues. In terms of ISA 330 (A*uditors responses to assessed risks*) we are able to place reliance on audit evidence from a previous audit year.

78. We noted that Internal Audit's plans for 2014/15 do not include any work on pension systems. We can place some reliance on prior years' work but going forward internal audit's plans should include specific work on Pension Fund systems in order to provide the Pensions Committee the necessary assurances on the adequacy of the control environment.

Recommendation no.6

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

79. The Falkirk Pension Fund complies with the relevant fraud and irregularity policies of Falkirk Council and these have been reviewed as part of the council wide audit. We concluded that these arrangements were satisfactory.

80. Falkirk Council Pension Fund participates in the National Fraud Initiative (NFI). The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

81. As part of our local audit work we monitor the Fund's approach to participation in NFI both in terms of the submission of the required datasets and strategies for investigating the subsequent data matches. No potential fraud has been identified in the current year although two cases are still under investigation.

82. Pension fund staff are proactive in reviewing data matches and ensuring that potential frauds are investigated.

Outlook

83. There are a number of challenges for the Fund including the move to pensions on a career average basis and revised governance arrangements as such as the requirement to establish a Pensions Board as described at paragraph 64.

84. Auto enrolment is now being implemented across employers who are members of Falkirk Council Pension Fund. This will inevitably have an impact on administrative workloads, but early preparation and changes to work flow have been put in place to minimise the impact of change.

85. The Fund must also be well prepared for the introduction of career average pensions. There will be a requirement to maintain pension records for each individual that will bring together a range of entitlements arising from benefits built up under different pension regimes. This will not only increase administrative workload initially, but will also undoubtedly generate many more queries and enquiries from fund members seeking clarification on their benefits on an ongoing basis.

Recommendation no.7

86. A new Pensions Administration System is being implemented during 2014/15 to meet these challenges. The Fund is currently implementing a new Pensions Administration Service (Altair) which is due to be completed by February 2015. The cost of the new system is currently estimated at £1.5 million for a contract lasting four years. It is anticipated that administration costs will rise from £16 per member to £22 per member as a result of the implementation of the new system once start up costs have been absorbed.

87. The implementation of the new system will involve migration of data from the old system. In these situations there is always the risk that data could be corrupted during the transfer.

Refer to action plan point no.8

Best value, performance and use of resources

Best Value

88. The pension fund has not been subject to a Best Value review, however, it is covered by the overall Best Value arrangements of the administering authority.

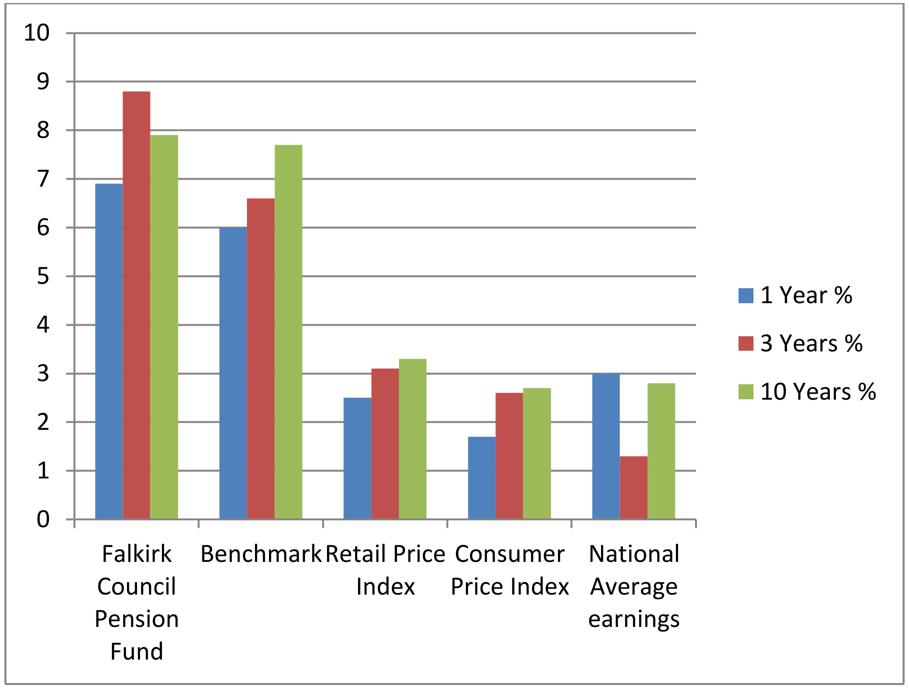
Performance

Investment performance

89. The main mechanism for measuring investment performance is through an analysis of the returns achieved by each of the Fund's external fund managers. The manager's performance, in terms of achieving benchmarks, is subject to independent verification by the Fund's custodian and is regularly reported to the pensions committee.

90. Over the long term, the overall level of investment return achieved by the Fund is expected to exceed the rate of return assumed by the actuary in valuing the Fund. Investment returns of Falkirk Council Pension Fund have outperformed benchmark targets over the short, medium and longer term. The current rolling three year performance is also ahead of benchmark as illustrated in table 2.

Table 2: Investment Performance



Source: Falkirk Council Pension Fund Annual Report & Accounts 2013/14

91. The table shows that over a period of one, three and ten years the pension fund has outperformed National Average Earnings, the Consumer Price index, the Retail Price Index and Benchmark performance.

Fund manager performance

92. Each Active Investment Manager has a defined performance benchmark and objective against which performance will be measured.

Table 3: Fund managers' performance 2013-14

Fund Manager	Mandate	Performance Benchmark	Actual Performance
Aberdeen Asset Mgt	Global Equities	6.72	1.58
Baillie Gifford	Bonds	(0.85)	(0.61)
Baillie Gifford	Diversified Growth	0.5	1.63
Legal & General	Passive Equities	7.92	8.11
Newton	Global Equities	6.75	6.79
Schroder	UK Equities	8.81	17.91
Schroder	Property	11.87	10.26
Alternatives	Private Equity/Infrastructure	0.35	2.09

Source: Falkirk Council Pension Fund Annual Report & Accounts 2013 - 14

93. Investment fund mangers mostly exceeded their performance benchmark for 2013-14 although two did not achieve their benchmark with one of these disclosing a significant underperformance. We have been advised that this manager has been placed 'on watch' to ensure better performance is achieved in future.

Administration performance

94. The Fund reports administration information to the CIPFA Pensions Benchmarking Club and the Scottish Government on an annual basis. A range of service standards have also been developed by the Pensions Section and these are monitored on a regular basis by the Pensions Manager. Administration indicators are now reported more regularly to members.

95. Three complaints were received in year, one of which was not responded to within three days. Targets were not met for responding to estimate requests and ad-hoc enquiries.

96. These two areas will face increasing pressure as pension details become more complicated after the effects of both auto enrolment and the change from pensions based on final salary to average pay. Individuals will now have multiple entitlements which could add confusion on the part of the individual and an increased workload for the pensions' administration staff in bringing this information together.

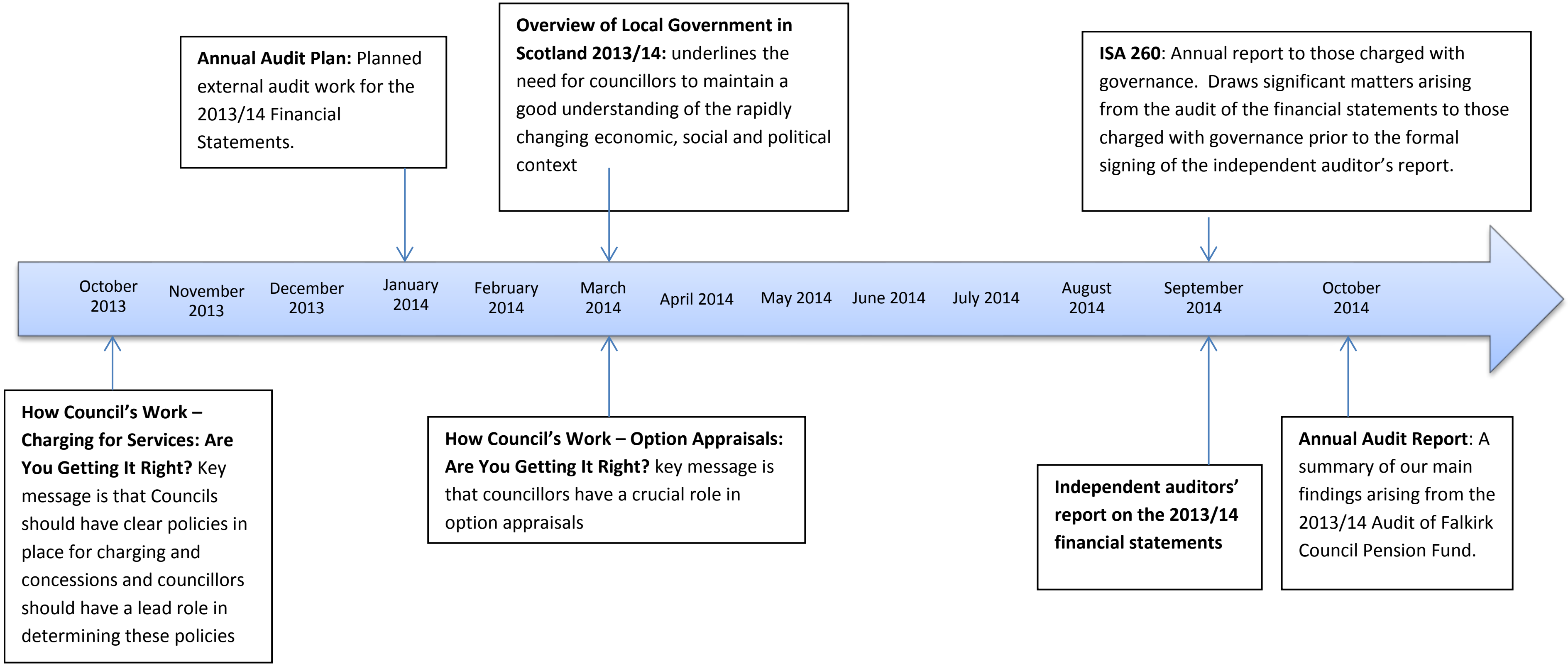
National performance reports

97. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are included in Appendix 1 along with locally produced audit reports.

Use of resources

98. In response to comments made in our 2012-13 Annual Audit report management agreed to develop a timetable for tendering and re-tendering of services during 2013 to 2015 including the re-tendering for Custodian Services and Lost Member Tracing. These are now underway.

Appendix I – Summary of Falkirk Council Pension Fund local audit and National reports 2013/14



Appendix II – Significant audit risks

The table below sets out the key audit risks identified at the planning stage and it details the assurances that we have received on completing our audit work in these areas.

Audit Risk	Assurance
Investment manager expenses Investment management expenses recorded in the Pension Fund Account exclude investment manager fees arising from 'fund of fund structures'. **Risk:** *members cannot gauge whether best value is being obtained.*	Management have made progress in identifying separately investment manager fees arising from 'fund of fund structures'. This resulted in an estimate of these expenses in the notes to the accounts. The Fund plans to implement the best practice recommended by CIPFA which is being currently developed and should be available for 2014-15.
Working paper requirements A trial balance should be produced as part of a year-end working paper package. This enables all balances within the Fund to be easily reconciled to the financial statements, and ensures all transactions have been included within the accounts. ***Risk**: account balances cannot be fully reconciled to the financial statements.*	A good year-end working papers package was prepared in support of the unaudited 2013-14 accounts. A trial balance was produced for all accounts, excluding investments that enabled fund balances to be readily reconciled to the financial statements. Investment balances were agreed to the custodian reports.

Audit Risk	Assurance
Pension reform The Fund faces a number of challenges in order to comply with requirements of the CARE scheme to be introduced by 1 April 2015, and the demands of auto enrolment. It is intended that a new administration system will be introduced, in order that the Fund can meet these administrative requirements. ***Risk**: appropriate systems are not in place to meet increasingly complex administrative and workload demands.*	A new pension administration system based on Altair is being developed by Heywood and is due for implementation by February 2015. Training events are being scheduled for the pensions' team and employers to ensure they are familiar with the operation of the new system.

Audit Risk	Assurance
Governance requirements The Public Service Pensions Act 2013 states that a fund should either have a separate Committee and Pension Board, or a combined arrangement. Currently there is a separate Pensions Committee and Pensions Panel in place. However, these arrangements do not meet the requirements of the Act. If a separate Pensions Board is maintained then it will require equal numbers of employer and member representatives. ***Risk**: appropriate governance arrangements are not in place by 1 April 2015.*	A report was submitted the Pensions Committee on 25 September which outlined the proposals to go out for consultation with stakeholders as follows: • How many employer and trade union representatives should sit on the new Pensions Board? • How will employer and union representatives be selected? • What will the term of appointment be for Board members? • How will the Board Chair be appointed (if there are equal member numbers)? • Should substitute Board members be permitted? • Should non-Falkirk Council elected members continue to sit on the Pensions Committee? If so is the current configuration of one employer, one union and one pensioner representative appropriate? • Should an independent specialist be formally invited to sit on the Committee (such persons can only have observer status on the Board)? Per current plans the consultation is due to end by 30 November 2014 to allow responses to be considered by Committee. The statutory regulations underpinning the new governance rules will not be available until early 2015 and consequently the consultation process will have to be undertaken in advance of the final regulations.

Audit Risk	Assurance
Training In a period of change it is important that members receive on-going training on the impact of pension reforms to ensure their knowledge and understanding is up to date. ***Risk****: members will not be able to perform there scrutiny function effectively without appropriate training.*	A programme of training events will be made available to the Pensions Panel and Pensions Committee. Amongst other issues, this will cover the new version of the scheme being introduced from 2015. There will also be training put in place for any members of the Pension Board, once membership is confirmed and taking into account members skill sets.

Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
1/32	**Investment managers' expenses** Investment management expenses recorded in the Pension Fund Account exclude indirect investment manager fees that arise from the 'fund of funds structures'. **Risk** Management may not be able to determine whether they are securing best value for the services they receive in the absence of incomplete information on fund managers' fees. **Recommendation** Implement best practice, in relation to the disclosure of fund managers' expenses, as recommended by CIPFA.	The Fund will monitor guidance issued by CIPFA in relation to indirect fees and will continue to engage with relevant Managers to provide sufficient information.	Pensions Manager (Alastair McGirr)	April 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
2/42	**Accounts regulations 2014** The timescale for the Pensions Committee (or its successor) approving the 2014/15 unaudited accounts is very tight. **Risk** The unaudited pension fund accounts may not be available for approval by the Pensions Committee within the timescale prescribed in the 2014 Accounts Regulations. **Recommendation** Review the scheduled meetings of the Pension Committee in 2014-15 to ensure there is sufficient time to comply with the timescale for submitting the unaudited accounts in terms of the 2014 accounts regulations.	Arrangements have been made to re-schedule the June Pensions Committee to 26 June 2015 to ensure sufficient time is available to submit the unaudited accounts in terms of the 2014 Accounts Regulations.	Pensions Manager (Alastair McGirr)	Immediate

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
3/43	**Pension fund accountant** The pension fund accountant has resigned his position to take up another post with another Pension Fund. **Risk** Loss of accounting knowledge and expertise that could adversely impact on the production of the 2014/15 annual report and accounts. **Recommendation** Ensure that sufficient accounting support is put in place to allow the 2014/15 unaudited accounts to be prepared on time for auditing.	The critical importance of the accounting process is recognised and as a consequence, the Fund would intend to address the loss of its Accountant through a combination of either like for like recruitment or some sharing of resources with the Lothian Pension Fund.	Pensions Manager (Alastair McGirr)	31 Dec 2014

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
4/47	**Budgetary control** The Fund does not disclose its budget for administration costs in the financial statements and performance against budget is not routinely reported to the Pensions Committee. **Risk** Performance against budget is not monitored effectively. **Recommendation** The budget for administration costs should be disclosed in the financial statements and members should receive regular budget monitoring reports.	The per member administration cost of the Falkirk Council Fund is the lowest amongst Scottish funds. However, the point is accepted and steps will be taken to report the administration budget to the Pensions Committee.	Pensions Manager (Alastair McGirr)	31 Mar 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
5/70	**Public Services Pensions Act 2013** New governance arrangements, in terms of the 2013 Act, come into force on 1 April 2015 although the statutory regulations underpinning these new arrangements will not be available until early 2015. Consultations with existing Pension Panel and Pension Committee members will also have to be carried out in advance of the final regulations being known. **Risk** The pension fund may not have appropriate governance arrangements in place by 1 April 2015. **Recommendation** Robust plans should be put in place to ensure that new governance arrangements are implemented by 1 April 2015.	A timetable setting out the key milestones in establishing the new governance arrangements has been reported to the August / September round of the Pensions Panel and Committee. A consultation exercise is being undertaken with stakeholders and responses will be considered further at a joint meeting of the Panel and Committee on 11 December 2014. Subject to the receipt of final Governance legislation, this will enable the revised governance framework to be established prior to the deadline of 1 April, 2015.	Pensions Manager (Alastair McGirr)	31 Mar 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
6/78	**Internal audit** Internal audit's plans for 2014/15 do not include any provision for work on the pension fund. **Risk** Internal audit may not be available to give management or the Pensions Committee assurance on the adequacy of controls in place within pensions' systems. **Recommendation** Internal audit plans should include work specific to the Pensions Fund and its systems and controls.	Although internal audit work on Fund matters is limited during 2014/15 (NFI activity being the exception), significant work on systems and controls has been undertaken in previous years and can still be used to provide some assurance. The changing pensions landscape in terms of governance, systems and scheme changes make it appropriate that pension fund activity is more heavily scrutinised. This will be reflected in the internal audit work plan for 2015/16 as already discussed with the Internal Audit Manager.	Gordon O'Connor (Internal Audit Manager)	31 Jan 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
7/85	**Career average pensions** With the introduction of career average pensions there will be a requirement to maintain pension records for each individual that will bring together a range of entitlements arising from benefits built up under different pension regimes. This will not only increase administrative workload initially, but will also undoubtedly generate many more queries and enquiries from fund members seeking clarification on their benefits on an ongoing basis. **Risk** The Fund will have insufficient staff to deal with the increased workload leading to delays in providing information to members. **Recommendation** The pensions section should review whether it has sufficient resources to deal with the expected increase in enquiries from members of the pension fund.	It is accepted that the transition from Final Salary to Final Salary / Career Average will place significant demands on the Pensions administration team. In the longer-term, it is expected that efficiencies will be wrung out of the new Pensions Administration System. However, in the short term it may be necessary to increase the staffing resource to deal with demand.	Pensions Manager (Alastair McGirr)	31 Jan 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
8/87	**New pension administration system** A new pension administration system (Altair) is being implemented with work due to be completed by February 2015. This will involve the migration of data from the old to the new system. **Risk** There is a risk that some data may be corrupted during the migration process. **Recommendation** Controls should be put in place to ensure that data transferred from the old pension administration system to the new one is complete, accurate and reliable.	Although the timescale for migration is extremely tight, significant preparatory work has been undertaken as a result of the project to migrate Police and Fire Pension Scheme records to SPPA. Heywood (suppliers of Altair) are experienced in migrating data and their processes include significant validation checkpoints to ensure that all data is comprehensively uploaded and mapped by the time the system goes live. Pensions staff continue will continue to have access to the existing Pensions administration system in the event that membership queries arise.	Pensions Project Officer (David Cunningham)	28 Feb 2015

AGENDA ITEM 5

FALKIRK COUNCIL

Subject: GENERAL GOVERNANCE MATTERS
Meeting: JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE
Date: 11 DECEMBER 2014
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

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

2. RISK REGISTER

2.1 The Committee has asked officers to provide a regular update on any significant changes in risk. The following item is considered worthy of reporting:

Identified Risk per Risk Register	Reason for Change in Risk Rating
Member data is inaccurate Confidential data is lost	The process of migrating data from the in house pensions administration system to the "Altair" system has begun. This involves successive transmissions of data between Falkirk Council and the contractor Heywood. Around 48,000 member records require to be uploaded. The risk is that data is inaccurately transferred or is lost or infected in transit. Risk is mitigated by the fact that Heywood have considerable experience in undertaking data transfers. Before data is accepted by Haywood, it is subject to a series of validations to ensure that the record is clean and properly constructed. Reconciliations are scheduled to ensure that key components such as dates of birth and service are synchronised between the two systems. A data sharing agreement is in place between Falkirk and the contractor and the actual data transmission is made via a secure point to point web connection.

3. SOCIAL HOUSING

3.1 The legal documentation relating to the Social/Affordable Housing mandate has now been completed and the initial drawdown of £15m made at the beginning of November. This is being used to secure a Bond from the Places for People Group / Castle Rock Edinvar (CRE) which in turn will be used to deliver the Social Housing part of the mandate. The remaining £15m will be drawn down as opportunities for investment in affordable housing materialise. It is noted that discussions between the three local Councils, CRE and Scottish Government are ongoing.

4. LOCAL INFRASTRUCTURE

4.1 In relation to the decision of the Pensions Committee at its meeting of 5 June 2014 to invest £30m in UK infrastructure projects in collaboration with the Lothian Pension Fund (LPF), paperwork relating to the joint venture is in the process of being signed. Identification of a suitable investment is now awaited.

5. PRUDENTIAL – ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVC)

5.1 Prudential were formally appointed as one of the Fund's AVC Providers during the summer.

5.2 In an effort to promote the AVC facility, Prudential have been delivering a number of information sessions to the scheme members of SEPA, Falkirk and Clackmannanshire Councils. Sessions have covered both AVCs and LGPS benefits generally and have been very well received.

5.3 Since their appointment around 50 members have signed up to pay AVCs with Prudential.

6 . STAFF TRANSFER – SIGN FACTORY

6.1 Agreement has been reached in principle for staff of the Falkirk Council Sign Factory to be transferred to Haven Products Limited. Haven is a not for profit social enterprise, which specializes in providing disabled individuals with workplace opportunities. They already have a significant presence in Scotland and employ over 200 disabled persons across their packaging, textile, recycling and logistics businesses in Hillington, Stirling and Inverness.

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

6.3 Where a local authority employer is entering into a contract with a third party such as Haven and the local authority wishes its staff to have continued access to the Scheme, then the Fund is obliged to agree to access being given.

6.4 As Falkirk Council has accepted responsibility for Haven's participation in the Scheme, there is no financial risk to other fund employers as a result of this staff transfer.

6.5 A draft admission agreement has been prepared by the Pensions Section and is with Haven and Falkirk Council for comment.

7. LOCAL AUTHORITY PENSION FUND FORUM (LAPFF)

7.1 The LAPFF represents the interests of 58 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.

7.2 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.

7.3 During the last quarter, LAPFF activity has included:

- attending AGMs of Vodafone, BT Group and Burberry to challenge the company over excessive executive remuneration;
- engaging with Palm Oil producers to better manage environmental risks
- addressing the Chairs of British Land and National Grid on the extent to which climate risk has been considered in developing business objectives; and.
- meeting the Chair of BAE to discuss pay, anti-corruption processes and gender diversity

7.4 The LAPFF are also in the process of meeting with Shell and BP as part of the "Aiming for A" coalition of UK asset owners and mutual fund managers that have been engaging with the ten largest UK-listed extractives and utilities companies to assess and encourage them to make preparations for a low carbon operating environment.

8. RECOMMENDATION

8.1 The Pensions Committee is asked to note the contents of this report and invited to comment as appropriate.

Chief Finance Officer

Date: 27 November 2014

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

NIL

AGENDA ITEM 6

FALKIRK COUNCIL

Subject:	**PENSION FUND – VALUATION AND STRATEGIC REVIEW**
Meeting:	**JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE**
Date:	**11 DECEMBER 2014**
Author:	**CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report provides the Panel and Committee with an update on the progress of the 2014 Fund Valuation together with consideration of the pending review of the Fund's investment strategy.

2. BACKGROUND

2.1 The rules of the Local Government Pension Scheme require that a fund valuation is undertaken by an independent actuary on a three yearly basis. Accordingly, a valuation of the Fund is being conducted as at 31 March 2014 by the fund's actuary, Hymans Robertson.

2.2 The purpose of the valuation is to establish the financial position of the Fund in terms of its assets and liabilities and, for this valuation, to set an appropriate rate of employers' contribution for the three years' commencing 1 April 2015.

2.3 The conclusion of the valuation process is invariably the starting point for a review of investment strategy. However, on this occasion, it has been possible for Hymans Robertson to undertake some initial high level strategy work in parallel with the valuation workstream.

3. FUNDING CONSIDERATIONS

3.1 The key elements that are fundamental to the actuary in determining the solvency of the Fund are the Fund's assets (i.e. its investments) and the Fund's liabilities. Liabilities are essentially the benefits that the Fund will be obliged to pay in the future. The actuary has therefore to assess the amount of money that the Fund needs to hold now in order to pay the benefits as they fall due, taking into account such factors as salary growth, price inflation, interest rates, longevity and the rate of return expected on investments.

3.2 In undertaking the valuation, the actuary must take account of the Fund's funding objectives as set out in its Funding Strategy Statement. The key funding objectives of the Falkirk Fund are to:

- Target a funding level of 100% (so that liabilities are fully matched by assets);
- Ensure there are sufficient funds to pay benefits as they arise;
- Maintain as stable an employer contribution rate as possible;
- Recognise the different characteristics of Fund employers when setting rates: and

- Use reasonable measures to reduce the risk of employers defaulting on their pension obligations.

4. 2014 VALUATION

4.1. Catherine McFadyen of Hymans Robertson is attending the Joint Meeting of Panel and Committee and will give details of the Fund's position at 31 March 2014.

4.2 The Fund's standing at the 2008 and 2011 valuations and at the valuation midpoint of September 2012 was as follows:

	Funding Level	Deficit
2008 Valuation	79%	£256m
2011 Valuation	86%	£194m
2012 Inter Valuation	77%	£381m

4.3 For the past six years, the actuary has permitted employers with strong covenants to pay less than the theoretically required employers' contribution rate. For example, in 2011, the theoretical contribution rate for Councils was in the range of 22-23% of pay, whereas actual rates over the 3 years of the valuation period have been successively 19.5%, 20% and 20.5%.

4.4 The actuary has been able to sanction this approach – known as a contribution stabilisation strategy – on the understanding that "stabilised" employers will increase their contribution rates by 0.5% on an annual basis. Actuarial modelling had also shown that the stabilised approach still gives these employers a better than 50:50 chance of returning to the 100% funding level over a twenty year period.

4.5 Based on the 2014 valuation data, the actuary has confirmed that the stabilisation strategy can be continued for the next three years. Contribution rates for the smaller fund employers will continue to be determined by pooling together their assets and liabilities in order to deliver a more stable contribution rate for that grouping. The remaining employers, including the larger admission bodies, will have their rates determined according to their individual circumstances and characteristics.

4.6 Employers will be notified of their funding position in the coming weeks and given the opportunity to discuss their individual contribution strategies with the actuary.

5. INVESTMENT STRATEGY

5.1 Contribution and Investment strategies are inextricably linked. A higher level of employer contribution means that an investment strategy with less risk could potentially be adopted, whereas a lower contribution rate strategy could signal the need for an investment strategy targeting assets with a higher risk return profile.

5.2 Where a fund is targeting a return to full funding over a lengthy period (e.g. 20 years), there can be circumstances where increased contributions will not materially improve the Fund's chances of it achieving funding success. Similarly, there can also be circumstances where a more defensive investment strategy (i.e. with less risk) does not reduce the Fund's chances of achieving its funding objectives.

5.3 The Fund's current investment strategy sees around 90% of assets in a "growth bucket" and 10% in a "defensive bucket". The results of the 2014 Valuation suggest that if the current investment strategy were to be maintained in conjunction with a stabilised contribution strategy, there is an 80% chance of the Fund achieving full funding in around 20 years. Reducing growth assets to 70% and increasing defensive assets to 30% leaves the Fund with the same probability of meeting its funding target but with significantly less risk.

5.4 If the Fund were seeking to achieve full funding over a shorter period – say 15 years – then a reduction in growth assets has a slightly more significant impact. Over a 15 year recovery period, the current investment strategy and stabilised contribution approach gives a 75% probability of achieving full funding, whereas with a 70/30 mix of growth and defensive assets, the probability reduces to 70%.

5.5 If the Committee was minded to adopt a lower risk approach, this could be seen as the starting point for a de-risking strategy, so that if a specific funding level was achieved in future, then action would be triggered to further reduce the Fund's exposure to riskier assets. Such a strategy could work in the opposite direction so that a deterioration in the funding level would trigger a re-risking.

6. THE WAY FORWARD.

6.1 A review of investment strategy requires the following questions to be determined in turn:

- What probability of success is the Committee comfortable with?
- What mix of growth and defensive assets should the Fund deploy?
- Which assets should the Fund hold in order to meet its objectives?
- Which managers should manage the assets?

6.2 Panel and Committee should also consider the following themes which could be of relevance in shaping the overall strategy. These include:

- Passive v Active Management
- Market Cap Passive v "Smart Beta" Passive
- Composition of Bond Portfolio
- Place of Private Equity in Strategy
- Alternative Asset Classes (Hedge Funds, Currency)
- Costs of re-aligning the portfolio
- Overhead of monitoring a range of asset managers

6.3 This review will also pick up on issues previously identified by the Panel and Committee, notably the performance of Schroders Property Mandate and Private Equity in general.

6.4 In order for these issues to be fully considered it is proposed to hold a ½ day session for Panel and Committee in late January/early February, with input from specialist practitioners including Hymans Robertson and the Lothian Fund.

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7. CONCLUSION

7.1 The outcome of the 2014 valuation and the accompanying investment review will determine the broad contribution and investment strategy for the Fund for the next few years.

7.2 The initial findings of the valuation indicate that the existing stabilisation strategy may be continued for employers with strong covenants. Discussions will commence shortly with all employers regarding their individual contribution rates.

7.3 The valuation results also suggest that there are opportunities for the Fund to reduce its exposure to growth assets and volatility without materially affecting the prospect of it achieving its funding objectives.

7.4 A workshop to consider strategy options is being arranged for a date in January.

8. RECOMMENDATION

8.1 The Panel and Committee are asked to note the developments outlined in this report regarding the Fund's ongoing Contribution and Investment Strategy.

Chief Finance Officer

Date: 24 November 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

FALKIRK COUNCIL

Subject: PENSION FUND – GOVERNANCE ARRANGEMENTS
Meeting: JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE
Date: 11 DECEMBER 2014
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

1.1 The purpose of this report is to provide Panel and Committee with information regarding the revised pension fund governance arrangements to be put in place by April, 2015. The report makes reference to the national and local consultations held recently on the subject.

2. CURRENT GOVERANCE ARRANGEMENTS

2.1 Falkirk Council is designated as an Administering Authority within Local Government Pension Scheme legislation with responsibility for maintaining and managing the Falkirk Council Pension Fund.

2.2 Under current governance arrangements, Falkirk Council has delegated pension fund business to its Pensions Committee. In addition, an advisory Pensions Panel, made up of Employer, Union and Pensioner representative groups, has been established to support the Committee.

2.3 The Pensions Committee consists of nine members – six elected members from Falkirk Council and three members drawn from the Panel. The Committee meets on a quarterly basis with all members having voting rights and access to papers.

2.4 The Panel comprises 15 members with one member from each of the representative groups sitting on the Pensions Committee. The Panel normally meets on a quarterly basis approximately two weeks prior to the Committee.

2.5 The Panel's role is to provide advice, guidance and opinion to the Pensions Committee on all matters relating to the business of the Falkirk Council Pension Fund. The Committee remains the decision making entity.

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3. PUBLIC SERVICE PENSIONS ACT 2013

3.1 The current round of pension reform began in 2011 with the publication of the Hutton report. This set out proposals for the establishment of a common UK-wide framework for public sector pensions in a bid to ensure that going forward the schemes were affordable, sustainable, fair and transparent. These proposals were carried forward in the Public Service Pensions Act 2013 ("the 2013 Act") and have been amplified more recently through draft Governance regulations and associated agreements.

3.2 In essence, the 2013 Act requires that from April, 2015, each Fund must have:

- a Scheme Manager – the legally constituted decision making body; and
- a Pension Board – a supporting entity

3.3 At a national level, the Act also requires that the Scheme is overseen by an Advisory Board, made up of Employer and Trades Union representatives.

3.4 For the Falkirk Fund, the "Scheme Manager" will be Falkirk Council, in its capacity as a corporate body. Pension fund business will continue to be delegated to the Pensions Committee.

3.5 Whilst there are differences between the existing Pensions Panel and the Pension Board, it would seem impractical to go forward with both a Board and a Panel given the overlap in roles and the skills and knowledge requirements. Consequently, this report seeks approval for the Pensions Panel to be discontinued with effect from 1st April, 2015 and alternative governance arrangements put in place.

4. SCOTTISH MINISTERS CONSULTATION

4.1 As mentioned above, Scottish Ministers recently issued, for consultation, draft Regulations which seek to expand on the core governance requirements set out in the 2013 Act.

4.2. The full Falkirk Council response on behalf of the Fund is attached at Appendix A.

5. PENSION BOARDS

5.1 It is important to recognise that under the 2013 Act, the Pension Board has a specific statutory role, namely:

- securing compliance with the rules relating to scheme governance and administration;
- securing compliance with requirements imposed by the Pensions Regulator; and
- such other matters as the may be specified.

5.2 This role is expanded in the draft Governance regulations so that effectively the Board has a locus over most pension fund business.

5.3 The Governance regulations also make provision regarding the practical operation of the Pension Board, as follows:

- the Board should have an equal number of employer and trade union representatives with a minimum of 4 members from each group;
- the Scheme Manager must be satisfied that a person appointed to the Board does not at any time have a conflict of interest;
- the Board should normally meet together at the same place and at the same time as the Pensions Committee and consider the same agenda, in which case the Chair of the Pensions Committee should act as chair of both meetings.

- The Chair of the Board will rotate on an annual basis between employer and trade union representatives
- The administration costs of the Pension Board shall be met by the Fund.

5.4 Further direction as to how a Pension Board should operate is contained in the Governance Heads of Agreement and Model Constitution authorised by the Scottish Local Government Pensions Advisory Group (SLOGPAG). A copy of the model constitution is attached at Appendix B

5.5 The fact that the Regulations require the Board to have its own Chair (separate from the Pensions Committee Chair) would imply that it can meet on its own.

5.6 The statutory role of the Board means that it is not possible for persons to be simultaneously both members of the Board and Committee.

6. FALKIRK COUNCIL PENSION FUND CONSULTATION

6.1 As the final Governance regulations will not be published until late January, 2015 (too late to begin the Board appointment process in time for April, 2015), the Fund has conducted its own consultation with stakeholders (Fund Employers, Trade Unions contacts, Scheme Members and Pensioners). A letter of comfort indicating that final regulations will not deviate materially from the draft regulations has been provided by the Scottish Ministers.

6.2 A copy of the Falkirk Governance Consultation Paper is attached at Appendix C. The key questions raised in the consultation were as follows:

a) How many member and employer representatives do you feel should sit on the Board?

b) Which of the following Board models would you support in relation to employer representation?

- 4 members (e.g. one from each of the 4 largest employers in the Fund), or
- 4 members (e.g. two "Council" reps, a scheduled body rep and an admitted body rep) or
- 5 or more employer representatives

(As Falkirk Council will have a majority position on the Pensions Committee, a further variation would be not to have any Falkirk representation on the Board?)

c) Should member representatives be limited to Trade Union representatives or should they potentially include other member representatives such as pensioner or deferred member representatives? (At present, the draft governance regulations only refer to Trade Union representatives).

d) Would your organisation be prepared to nominate someone to sit on the Pension Board?

e) Would your organisation be prepared to nominate a substitute? A substitute would have to undergo the same knowledge and understanding regime as the lead representative. Having an available substitute could help ensure that Board meetings were quorate.

f) The proposed term of office for a Board Member is 4 years, with the option of re-appointment. How should any re-appointment request be processed?

g) Thinking about the configuration of the Pensions Committee, do you think there should continue to be non-Falkirk Council representation (e.g. Falkirk Council elected members being supported by a Pensioner or Other Stakeholder representative).

h) Should an independent specialist be formally invited to sit on the Committee (such a member would bring specialist skills to discussions but would require to be paid)?

7. CONSULTATION RESPONSES

7.1 Responses have been received from the following organisations:

SEPA
SCRA
Scottish Autism
Stirling Enterprise (STEP)
Falkirk Community Trust

Responses have also been received from Mr Redpath (Committee member) and a Mr Gower (Pensioner).

7.2 The response from Falkirk Community Trust indicated that they would expect their interests to be catered for through Falkirk Council representation. The response from STEP was simply to confirm they would not seek to participate in the Pension Board.

7.3 The other responses have been summarised as follows:

	Board Size	Board Composition (Employers)	Board Composition (Members)	Prepared to sit on Board	Committee to have non Falkirk representation	Independent member to sit on Committee
SCRA	6 + 6	5 Scheduled + 1 Admitted	Include Pensioner & Deferred Pensioner	Yes	Yes	Yes
Autism	6 + 6	Places to go to larger employers	Supports more than just Trade Union	Yes, subject to time commitment	Yes, but maybe less important given joint meetings	Depends on costs / value of contribution
SEPA	8 + 8	2 Council + 4 Scheduled + 2 Admitted	Supports more than just Trade Union	Yes	Yes	Yes

Mr A Redpath	5 + 5	2 Council + 2 Scheduled + 1 Admitted	Support more than just Trade Union	N/A	Depending on joint meetings and Board structure, would support Committee being Falkirk only	Not convinced this is required
Mr Gower	6 + 6	2 Council + 2 Scheduled + 2 Admitted	Support more than just Trade Union	N/A	Minimum of 3 non Falkirk members on Committee	No

7.4 One employer stressed the importance of the Code of Conduct (including confidentiality) being explicitly brought to the attention of new Board members.

7.5 Notwithstanding that the level of response was small, there appears to be support for:

- the Board to be slightly smaller than the existing Panel;
- the Committee to retain some non-Falkirk representation; and
- Board composition for members to be broader than Trade Unions.

7.6 A significant obstacle to finalising Board arrangements is the uncertainty as to whether member representatives will be limited to Trade Union appointees only or whether they will encompass some broader form of member representative, such as a pensioner representative. As this issue may not be settled until late January/early February 2015, the Committee may need to consider options for both scenarios.

8. PENSIONS COMMITTEE

8.1 The introduction of a Pension Board means a fundamental change in the Fund's Governance arrangements. Given the scale of the change, the Committee may wish to consider whether any changes should be made to the Pensions Committee itself. These could include consideration of:

- Committee size
- Committee composition
- Co-opted members

8.2 Any changes to the Committee and the wider governance structure would require to be approved by the Council.

9. SCHEME ADVISORY BOARD

9.1 An overview of the Governance landscape would not be complete without a brief mention of the national Scheme Advisory Board, whose role it will be to provide advice to the Scottish Ministers on the desirability of changes to the LGPS.

9.2 The Board may also be called upon to provide advice to the scheme managers or the pension boards in relation to the effective and efficient administration and management of the Scheme or its Pension Funds. Conceivably, this could include intervening in disagreements between Pension Boards and Committees.

9.3 In Scotland, the Scheme Advisory Board is expected to be based on the existing Scottish Local Government Pensions Advisory Group (SLOGPAG), except that, unlike SLOGPAG, which has Scottish Government representation, the Scheme Advisory Board will be a bipartite entity with representation from local government and trade unions only. The Scottish Government will however have observer status.

10. NEXT STEPS

10.1 Subject to the Committee reaching a decision regarding the size and composition of the Pension Board, the next stage in the process would be to contact the organisations being represented on the Board and to invite them to put forward their nominees (and possibly substitutes).

10.2 The Committee would then need to ensure that any individuals nominated did not have a conflict of interest that could prejudice their role as a Board member.

10.3 With Board members in place, consideration could be given to implementing a training programme.

11. CONCLUSION

11.1 The Public Service Pensions Act 2013 and associated legislation requires local authority pension funds to put revised governance arrangements in place from 1st April, 2015.

11.2 The main requirement is for a Pension Board to be established. For the Falkirk Council Pension Fund, this means that the Pensions Panel will be discontinued and a Pension Board formed to support the work of the Pensions Committee.

11.3 The Committee and Panel should seek to construct a Pension Board that is large enough to undertake its duties and provide fair representation but which recognises the costs of running a Board and the practicalities in populating it.

11.4 Given the major governance changes underway, consideration should be given as to whether any changes are required in relation to the Pensions Committee itself.

11.5 The period during which the new governance arrangements require to be established is compressed owing to the delay in final regulations being produced.

12. RECOMMENDATIONS

12.1 The Panel and Committee are asked to note the contents of this report and invited to comment.

12.2 The Committee is asked:

a) to agree that the Pensions Panel should be discontinued with effect from 1st April, 2015;

b) to determine the number of employer and member representatives who should sit on the Pension Board;

c) to determine the individual employers who should be represented on the Pension Board

d) in the event that final Governance Regulations extend the definition of member representatives to members other than trade union representatives, to determine the number and composition of the non-Union member(s);

e) to consider whether, in consequence of the replacement of the Pensions Panel by the Pension Board, it considers that its own structure and composition should change and, if so, to make recommendations thereon;

f) to refer the its recommendations on the governance structure of the pension to the Council; and

g) to request the Chief Finance Officer to report on progress in establishing the new governance arrangements to the next meetings or joint meeting of Panel and Committee

Chief Finance Officer

Date: 18 November 2014

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

The Draft Local Government Pension Scheme (Governance) (Scotland) Regulations 2014

Enquiries to: Alastair McGirr
Telephone: (01324) 506304 Fax: (01324) 506303
Your Ref:
My Ref: Supn/AM
Date: 11 November, 2014
E-mail: alastair.mcgirr@falkirk.gov.uk

Falkirk Council
Chief Executive Office
(Finance Services)

Kim Linge
Policy Manager
Scottish Public Pensions Agency
7 Tweedside Park, Tweedbank
Galashiels
TD1 3TE

Dear Kim,

Local Government Pension Scheme
Draft Governance Regulations – Consultation

Thank you for your letter of 30th September, 2014 inviting comments on the draft Local Government Pension Scheme (Governance) (Scotland) Regulations 2014.

In addition to supporting the submissions made by the LGPS Pension Fund Conveners Group and by the LGPS Investment and Governance Group, I would make the following comments:

- Member representation on Pension Boards should not be confined to Trade Union representatives. I make this contention on the basis that i) a large section of the scheme membership is not affiliated to a Trade Union and may therefore feel marginalised from the governance process and ii) restricting member representation to Trade Union representatives' unnecessarily limits the pool of talent from which Board members may be drawn (i.e. the opportunity to recruit retired officers / persons with relevant experience may be lost).

- The regulations should be more explicit regarding the Board's responsibilities over investment matters. Regulation 8(2) makes it mandatory for the Board to monitor fund investments, whereas Regulation 5 singularly omits any reference to Fund Investment regulations - this seems contradictory.

- Regulations 6(6) – any variations to the Model Constitution sought by the Pension Board should be subject to the agreement of the Scheme Manager.

- Regulation 2(2)(a) - the Scheme Advisory Board should be able to make representations to the Scottish Ministers without having to be asked.

I hope you find these remarks useful and look forward to having sight of final regulations in due course. If you have any further queries regarding this matter, please contact Alastair McGirr on the above telephone number.

Yours sincerely,

Alastair J. McGirr

Chief Finance Officer

INVESTORS IN PEOPLE

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SLOGPAG
Pension Boards: Model Constitution

1. Introduction

1.1 Each Local Government Pension Scheme Manager in Scotland is required to establish a Pensions Board separate from the .... Pensions Committee that acts as the Scheme Manager.

1.2 The .... (*name of fund*) Pension Board is established under the provisions of the .... Regulations 2015.

2. Objectives

2.1 The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator.

2.2 The Pension Board will determine the areas they wish to consider including, amongst others:

- Reports produced for the pensions committee
- Seek reports from the scheme managers on any aspect of the fund
- Monitor investments and the investment principles/strategy/guidance
- The fund annual report
- External voting and engagement provisions
- Fund administrative performance
- Actuarial reports and valuations
- Funding policy
- Any other matters that the pensions board deem appropriate

3. Membership

3.1 Membership of the Pension Board will consist of equal numbers of trade union representatives and employer representatives, drawn from councils and scheduled or admitted bodies in membership of the fund. Pension Board representatives must not also participate in or act as members of the pensions committee. Local Authority employer representatives will normally be Elected Members serving as part of the Council.

(As a minimum there will be 4 trade union and 4 employer representatives with the expectation that larger funds will require greater numbers. Numbers from organisations on either side will broadly reflect respective membership in the scheme.)

3.2 There will be .... (*number*) trade union representatives appointed by the trade unions as follows:

GMB ....
UCATT ....
UNISON ....
Unite ....

3.3 There will be .... (*number*) employer representatives appointed by the respective employer organisations as follows:

Councils ......
Scheduled bodies ......
Admitted bodies ......

(In smaller funds it may be possible to name the councils and other bodies. In larger funds describe the way representatives of these groups are appointed e.g. at the pension fund annual meeting)

3.4 Pension Board representatives will serve for a period of four years and may be reappointed to serve further terms. Timescales for organisations to notify the Pension Board of their representatives shall be locally determined. Employer bodies and organisations retain the right to withdraw representatives and identify replacements on occasion.

3.5 Appointing bodies can appoint a named substitute for their representative. Such substitutes must undertake the same training as set out in (6) below.

3.6 Advisors may attend meetings of the Pension Board in a non-voting capacity.

3.7 No person may be appointed to the Pension Board that has a significant conflict of interest. A conflict of interest is defined as a financial or other interest which is likely to prejudice a person's exercise of functions as a member of the Pension Board. It does not include a financial or other interest arising merely by virtue of that person being a member of the scheme or any connected scheme for which the board is established. The Pension Board will adopt policies and protocols for handling any conflicts that were unanticipated and might arise during membership.

4. Meetings

4.1 The Chair of the Pension Board will be rotated on an annual basis between the trade union and employer sides of the Pension Board.

4.2 Pensions Board meetings will be administered by .... (*pension fund or administering authority depending on local practice*) as agreed with Joint Secretaries appointed by the trade union and employers sides of the Pension Board. All reasonable administration costs shall be met by the fund.

4.3 The Pensions Board should meet at least quarterly. A majority of either side may requisition a special meeting of the Pension Board in exceptional circumstances.

4.4 The Pensions Board may establish sub-committees.

4.5 While the statutory roles and function of the pension committee and pensions board are separate, the normal practice will be that both bodies will meet at the same time to consider the same agenda, with the Chair of the pension committee chairing the concurrent meeting. The aim is to engender a positive and proactive partnership culture where in practice the two bodies act as one.

5. Dispute resolution

5.1 If the Pension Committee and Pension Board cannot reach joint agreement on any matter the process for resolving any differences between the two bodies will be as follows. Whilst this process is undertaken the decision of the Pension Committee is still competent.

5.2 In the first instance, if at least half of the members agree, then the pension board can refer back a decision of the pensions committee for further consideration if any of the following grounds are met:

- That there is evidence or information which it is considered needs re-evaluating or new evidence or data which the Pensions Committee did not access or was not aware of at the point of decision making and which is considered material to the decision taken;

- That the decision of the Pensions Committee could be considered illegal or contrary to regulations;
- That the decision of the Pensions Committee is contrary to a relevant Code of Practice published by the Pensions Regulator; or
- That the decision is not in the interest of the continued financial viability of the Scheme or is against the principles of proper and responsible administration of the Scheme

5.3 If there is no agreement after the matter has been referred back to the pensions Committee, then the difference in view between the Pension Board and the Pension Committee will be published in the form of a joint secretarial report on the fund website and included in the fund annual report.

5.4 The Scottish LGPS Scheme Advisory Board may also consider and take a view on the matter and, if considered appropriate, provide advice to the Scheme Manager or the pension board in relation to the matter.

6. Training

6.1 All members (and named substitutes) of the Pensions Board must undertake a training programme in accordance with any guidance issued by the pensions regulator and complying with best practice training requirements of the Pensions Committee.

6.2 The Pensions Board shall agree policies and arrangements for the acquisition and retention of knowledge and understanding for pension board members

6.3 The Scheme Manager will keep an updated list of the documents with which they consider pension board members need to be conversant to effectively carry out their role and make sure that both the list and the documents are accessible.

7. Access to Information

7.1 The Scheme Manager and Pensions Board will together ensure that information is published about the activities of the board including:

- the full terms of reference for the pension board, including details of how they will operate
- the pension board appointment process
- who each individual pension board member represents and
- any specific roles and responsibilities of individual pension board members.

7.2 The minutes of the Pension Board will be published on the fund website. The Pensions Board may undertake such communications and stakeholder engagement as it deems appropriate to perform its functions.

LOCAL GOVERNMENT PENSION SCHEME
FALKIRK COUNCIL PENSION FUND

CONSULTATION ON FUTURE GOVERNANCE ARRANGEMENTS

1. INTRODUCTION

1.1 This consultation invites respondents to comment on the revised Governance Arrangements that require to be put in place by 1st April, 2015 as a result of the Public Service Pensions Act 2013 and related regulations. This is separate from the Scottish Ministers consultation which is outlined in Section 4.

2. EXISTING GOVERNANCE ARRANGEMENTS

2.1 Falkirk Council is designated as an Administering Authority within Local Government Pension Scheme legislation with responsibility for maintaining and managing the Falkirk Council Pension Fund.

2.2 Under current governance arrangements, Falkirk Council has delegated pension fund business to its Pensions Committee. In addition, an advisory Pensions Panel, made up of Employer, Union and Pensioner representatives, has been established to support the Committee.

2.3 The Pensions Committee consists of nine members – six elected members from Falkirk Council and three members drawn from the Panel. The Committee meets on a quarterly basis with all members having voting rights and access to papers.

2.4 The Panel comprises 15 members and includes Employer, Trade Union, and Pensioner representatives. One member from each of these groups sits on the Pensions Committee. The Panel normally meets on a quarterly basis approximately two weeks prior to the Committee.

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

3. REQUIREMENTS OF THE PUBLIC SERVICE PENSIONS ACT 2013

3.1 The current round of pension reform began in 2011 with the publication of the Hutton report. This set out proposals for the establishment of a common UK-wide framework for public sector pensions in a bid to ensure that going forward the schemes were affordable, sustainable, fair and transparent. These proposals were carried forward in the Public Service Pensions Act 2013 ("the 2013 Act").

3.2 In the context of the LGPS, the 2013 Act requires that each Fund will have:

- a Scheme Manager – the legally constituted decision making body; and
- a Pension Board – a supporting entity which must established by 1st April, 2015.

3.3 For the Falkirk Fund, the Scheme Manager will be Falkirk Council in its capacity as a corporate body, albeit that pension fund business will continue to be delegated to the Pensions Committee.

3.4 It is important to recognise the distinction between the existing Pensions Panel, which is a non-statutory body charged with supporting the Pensions Committee, and the soon to be established Pensions Board which has a specific statutory remit.

3.5 Other features of the 2013 Act are that:

- the Scheme will be overseen **nationally** by a Scheme Advisory Board, made up of Employer and Trades Union representatives, and
- the role of the Pensions Regulator in making Codes of (Best) Practice has been extended to cover public sector schemes, including the LGPS.

4. SCOTTISH MINISTERS CONSULTATION

4.1 Scottish Ministers have recently issued for consultation, draft Governance Regulations which expand on the core requirements set out in the 2013 Act

4.2 **A copy of the draft regulations is attached for ease of reference. Please note that the Scottish Ministers consultation ends on 11th November.** All papers pertaining to the consultation can be found at www.sppa.gov.uk by following the links to Local Government – Consultations.

4.3 Negotiations relating to Scheme Governance (and Scheme design) have been undertaken by COSLA, the Trade Unions and the Scottish Government at the SLOGPAG Forum. The Group has produced **a Governance Heads of Agreement and a model Pension Board constitution**, both of which are attached to assist you in framing your response. These two documents have still to be ratified by the Scottish Government.

5. PENSION BOARDS

5.1 Under the 2013 Act, the role of the Pension Board is to assist the Scheme manager in:

- securing compliance with the scheme regulations and other legislation relating to the governance and administration of the scheme;
- securing compliance with requirements imposed by the Pensions Regulator; and
- undertake any such other matters as the scheme regulations may specify.

5.2 The 2013 Act also requires that:

- the Board has an equal number of employer and member representatives;
- the scheme manager is satisfied that a person to be appointed to the board does not at any time have a conflict of interest: and
- the Board meets concurrently with the Pensions Committee.

5.3 Both the Act and the Heads of Agreement provide that the Pension Board will:

- have a minimum of 4 trade union and 4 employer representatives; and
- rotate the Chair of the Board annually between Union and Employer (which implies that the Board may choose to meet separately on occasion).

5.4 The Model Constitution confirms that due to their differing statutory roles, individuals will not be able to be members of both the Pension Board and Pensions Committee. This has implications for the three co-opted members who currently sit on both the Falkirk Council Pensions Panel and Committee.

6. SCHEME ADVISORY BOARD

6.1 The role of the national Scheme Advisory Board is to provide advice to the Scottish Ministers on the desirability of changes to the LGPS.

6.2 The Board may also be called upon to provide advice to the scheme managers or the pension boards in relation to the effective and efficient administration and management of the Scheme or its Funds.

6.3. In Scotland, the Scheme Advisory Board is expected to be based on the existing Scottish Local Government Pensions Advisory Group (SLOGPAG), except that, unlike SLOGPAG, which has Scottish Government representation, the Scheme Advisory Board will be a bipartite entity with representation from local government and trade unions only. The Scottish Government will however have observer status.

7. FALKIRK COUNCIL PENSION FUND CONSULTATION

7.1 As intimated in Paragraph 4.1, Scottish Ministers are presently consulting on draft Governance Regulations. As the final regulations will not be published until late January, 2015 (too late to begin the Board appointment process in time for April, 2015), Falkirk Council is conducting a separate consultation with its stakeholders to gauge opinion as to how the governance arrangements can best operate in the Falkirk Fund.

7.2 Appendix A sets out some of the key questions that require to be considered. It would be much appreciated if you could respond to each of these, together with any other general comments you wish to make. Your comments should be received by the Pensions Manager, Falkirk Council by no later than 24th November, 2014 to allow time for collation and presentation of responses to the forthcoming Pensions Panel and Committee.

Chief Finance Officer
Date: 31 October 2014

APPENDIX A

FALKIRK COUNCIL PENSION FUND
GOVERNANCE ARRANGEMENTS

CONSULTATION RESPONSE

1. Name/Organisation

Organisation Name

Surname

Title / Forename

2. Contact Details

Phone	
Email	

3. Basis of Response

As an individual	**YES / NO**
For the Organisation named above	**YES / NO**

Your comments will assist the Council in formulating its revised governance arrangements for the Fund.

CONSULTATION – KEY QUESTIONS

1. Thinking about the Pension Board, including:

- the need for it to provide broad stakeholder representation
- the running costs
- the knowledge and understanding thresholds to be met by Board members, and
- the personal commitment required from members to prepare for and attend meetings

how many member and employer representatives do you feel should sit on the Board? (minimum is 4 member representatives plus 4 employer representatives).

2. Which of the following Board models would you support in relation to **employer** representation:

a) 4 representatives (e.g. one from each of the 4 largest employers in the Fund)
b) 4 representatives (e.g. two "Council" reps, a scheduled body rep and an admitted body rep)
c) 5 or more employer representatives (please give preferred configuration below)

As Falkirk Council will have a majority position on the Pensions Committee, it is an option not to have Falkirk representation on the Board. You may wish to comment on this option.

3. Should member representatives be limited to Trade Union representatives or should they potentially include other member representatives such as pensioner or deferred member representatives? (At present, the draft regulations only refer to Trade Union representatives).

4. Would your organisation be prepared to nominate someone to sit on the Pension Board?

5. Would your organisation be prepared to nominate a substitute? A substitute would have to undergo the same knowledge and understanding regime as the lead representative. Having an available substitute could help ensure that Board meetings were quorate.

6. The proposed term of office for a Board Member is 4 years, with the option of re-appointment. How should any re-appointment request be processed?

7. Thinking about the configuration of the Pensions Committee, do you think there should continue to be non-Falkirk Council representation (e.g. Falkirk Council elected members being supported by a Pensioner or Other Stakeholder representative).

8. Notwithstanding the Fund already pays for professional advice from Hymans Robertson (Fund actuary and investment adviser), should an independent specialist be formally invited to sit on the Committee (such a member would bring specialist skills to discussions but would require to be paid)?

AGENDA ITEM 8

FALKIRK COUNCIL

Subject: **FUND MANAGER PERFORMANCE REVIEW**
Meeting: **JOINT MEETING OF PENSIONS PANEL AND COMMITTEE**
Date: **11 December 2014**
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 enclosed.

2. MARKET REVIEW AND OUTLOOK

2.1 In the third quarter, global equity markets ran out of steam. Sterling investors may not have noticed - the MSCI All Country World Index rose 2.5% in sterling terms - but US dollar investors certainly noticed - the same index fell 2.8% in US dollars. The US dollar had strengthened sharply from \$1.71 to \$1.62 Small and mid cap stocks were hit harder, as were emerging markets. (A minor panic ensued in October, when stock markets corrected briefly, but surprisingly violently, causing a flight to safety to high quality government bonds.)

2.2 The consensus expectation of a continuing and robust US economic expansion, an orderly increase in US interest rates and a gradual improvement in the Japanese and European economies was undermined by disappointing Eurozone and emerging market data that seemed to signal stagnation, and rekindled fears of price deflation.

2.3 Evidence of deep divisions within the Governing Council of the European Central Bank suggested that it would fail to act in advance of deflation, and that its policies would turn out to be half-hearted and ineffective. Falling commodity prices and continued shrinkage of the Chinese credit bubble added to the air of pessimism, as did geopolitical issues (most notably Ukraine, Middle East, Brazilian elections) and a minor panic over the Ebola epidemic spreading beyond West Africa.

2.4 Commodity price weakness is clearly negative for most emerging markets: commodity exports for this region excluding China are equivalent to 4.8% of GDP, and falling prices have a severe impact on fiscal and current account balances, as well as on GDP growth. In emerging markets, there are very few winners from lower commodity prices, only India, Philippines, Thailand and Turkey. A strong dollar is also bearish for most emerging countries, restricting credit flows, increasing the value of $ denominated debt and interest costs, and adding to downward pressure on commodity prices. And of course weakening economies tend to undermine reform programmes and lead to political turmoil.

2.5 There is still good news for equity investors. Greater fiscal restraint will surely emerge from France and Italy, and economic growth has clearly returned to countries such as Ireland, Spain, the UK and the USA. The Federal Reserve ended its QE programme, but many other central banks are still cheerfully expanding their balance sheets, and this is supportive for equities. Bond yields remain low relative to the dividend yields available in stock markets. And of course lower commodity prices are incredibly beneficial for developed economies, boosting consumer spending and corporate profitability, and encouraging loose monetary policy by reducing inflationary pressures.

2.6 The correction in equity markets in October was not the only big surprise. The US$ appreciated dramatically against most currencies, reflecting underlying strengths of the US economy and capital markets, and the expectation that US interest rates will be higher than in other major economies which continue with monetary easing policies. Japan is a case in point where the authorities announced aggressive policies aimed at further weakening the Yen, achieving the 2% inflation target and boosting the equity market.

2.7 In summary, the equity markets currently have considerable fundamental support, but will be hit from time to time by price volatility as investor sentiment responds to blips in economic data. Unanticipated setbacks of around 10% are fairly frequent in mature bull markets, but they generally resume a positive trend quite quickly.

3. ANALYSIS OF PERFORMANCE RESULTS

3.1 The total fund and individual external manager returns are shown in the table in Appendix 1. The returns for the quarter ending 30 September 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 +3.1% in sterling terms over the third quarter of 2014. Bond indices were led higher by index-linked gilts +5.9% with conventional government bonds +3.7% and corporate bonds +2.9%. UK commercial property rose +4.0%.

3.3 The overall Fund's return of +2.4% over the quarter was ahead of the benchmark return of 1.9%. Over the 3 year period the Fund benefited from equity market strength and SIM's outperformance in UK equities, rising +13.2% per annum compared with the benchmark return of +11.3% per annum, an excess return of +1.8% per annum. Long term return data shows Fund appreciation of +10.0% per annum over 5 years and +7.3% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 Over the third quarter of 2014, the returns of the Fund's three active equity managers ranged from -0.6% to +3.1%. Although SIM's return was negative, it outperformed its benchmark, the FTSE All Share Index, which fell 1.0%. Both AAM and NIM lagged their benchmark of global equities. The Fund's passive equity manager, L&G, produced a return of +1.8%, in line with its benchmark return, and so consistent with its mandate.

The return from BG's bond mandate was +4.3%, ahead of its benchmark by 0.6%. BG's other mandate, the Diversified Growth portfolio, rose 1.9%, ahead of its benchmark by 1.7%.

The property portfolio managed by SIM lagged its benchmark by 0.3%, but rose 3.8% 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. After a very poor 2013, performance is lagging the benchmark and objective over 3 years. After an excellent start to the mandate, returns are still ahead of benchmark by 0.3% per annum since inception in May 2010, but lag the objective by 2.7% per annum.

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 +1.8% 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 The third quarter of the year was characterised by a divergence of economic news between, on the one hand, the UK and US with their improved trading conditions and, on other hand, the Eurozone and Japan which experienced growth grinding to a halt and in the case of Japan economic activity actually contracting.

4.2 Over the quarter, most managers struggled to meet their benchmarks, Baillie Gifford being the exception with both the Bond and Diversified Growth mandates meeting their return targets. Schroders UK Equity mandate also beat its benchmark, but the overall return was negative. By contrast, the Schroder Property mandate narrowly missed its benchmark, but added £4.2m over the quarter in absolute terms. Newton narrowly missed their benchmark with Aberdeen slightly further adrift.

4.3 The forthcoming review of investment strategy will be an opportunity to re-examine the Fund's asset allocation and by extension the worthiness of current Managers.

5. RECOMMENDATIONS

5.1 The Committee is asked to note:-

(i) the Managers' performance for the period ending 30 September 2014; and

(ii) the action taken by Managers during the quarter to 30 September 2014 in accordance with their investment policies.

Chief Finance Officer

Date: 1 December 2014

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

1. The Northern Trust Company – Fund Analytics 30 September 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 - 30 September 2014

Manager	Market Value £	Weight	Returns 3 months	3 year	5 year	Since inception	Inception Date
Aberdeen Portfolio	222,532,708	13.6%	2.1%	13.4%	-	9.4%	May-10
Benchmark			3.2%	15.7%	-	9.0%	
Excess Versus Benchmark			**-1.1%**	**-2.3%**	**-**	**0.3%**	
Excess Versus Objective			**-**	-5.3%	**-**	-2.7%	
Baillie Gifford Bond Portfolio	143,730,496	8.8%	4.3%	8.3%	8.9%	6.6%	Mar-07
Benchmark			3.7%	6.5%	7.1%	6.7%	
Excess Versus Benchmark			**0.6%**	**1.8%**	**1.8%**	**-0.1%**	
Excess Versus Objective				**0.9%**	**0.9%**	**-1.0%**	
Baillie Gifford Diversified Growth	197,595,482	12.0%	1.9%	-	-	7.2%	Feb-12
Benchmark			0.1%	-	-	0.5%	
Excess Versus Benchmark			**1.7%**	**-**	**-**	**6.7%**	
Excess Versus Objective *			**-**	**-**	**-**	3.2%	
Legal & General	342,445,275	20.9%	1.8%	15.4%	10.4%	14.2%	Jan-09
Benchmark			1.8%	15.4%	10.3%	14.0%	
Excess Versus Benchmark			**0.1%**	**0.1%**	**0.1%**	**0.1%**	
Excess Versus Objective			**-**	**0.1%**	**0.1%**	**0.1%**	
Newton	239,254,590	14.6%	3.1%	15.6%	11.3%	8.6%	Jun-06
Benchmark			3.2%	15.7%	10.3%	7.7%	
Excess Versus Benchmark			**-0.1%**	**-0.2%**	**1.0%**	**0.9%**	
Excess Versus Objective			**-**	**-**	**-2.0%**	**-2.1%**	
Schroders UK Equity	224,007,164	13.7%	-0.6%	20.1%	11.3%	9.3%	Sep-01
Benchmark			-1.0%	13.9%	9.7%	6.9%	
Excess Versus Benchmark			**0.4%**	**6.1%**	**1.5%**	**2.4%**	
Excess Versus Objective			**-**	**4.9%**	**0.3%**	**1.1%**	
Schroders Property	121,147,857	7.4%	3.8%	6.8%	7.7%	2.5%	Nov-05
Benchmark			4.0%	7.5%	9.6%	2.5%	
Excess Versus Benchmark			**-0.3%**	**-0.7%**	**-1.9%**	**0.0%**	
Excess Versus Objective			**-**	**-1.4%**	**-2.7%**	**-0.7%**	
Total Fund	1,639,892,999	100.0%	2.4%	13.2%	10.0%	7.3%	Sep-01
Benchmark			1.9%	11.3%	8.6%	6.9%	
Excess Return			**0.5%**	**1.8%**	**1.4%**	**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.**

<u>There are small rounding effects in the table above.</u>

Aberdeen Global Equity

(13.6% 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 30 September 2014

Q3 2014	:	-1.1% excess return
3 Years	:	-2.3% excess return
Since inception	:	+0.4% p.a. excess return

Summary

Performance turned down again this quarter after a decent H1. Mid-term numbers deteriorating as decent 2011 numbers drop out. Long term performance remains (just) positive, but below target.

Portfolio

The portfolio is genuinely unconstrained, which indicates that it should be able to achieve its objectives. 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 3.3%.

The portfolio is more geographically diverse than the benchmark. North America represents >50% of the benchmark, but the portfolio is u/w by >20%. The fund is o/w the UK (+8%), Europe ex-UK (+6%, mainly the defensive Swiss market), and LatAm (+6%). By sector, the portfolio remains heavily o/w consumer staples (+7%), and has high relative exposure to energy (+7%) and materials (+4%). There is low exposure to cyclical earnings, such as consumer discretionary (-10%) and I.T. (-3.5%), although the industrials weight is now approaching neutral. Financials are also underrepresented (-6%). Consequently, 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 rhetoric and portfolio positioning remain very cautious.

Underperformance was entirely attributable to North American positioning, with the underweight allocation and poor stock selection detracting from relative returns. By sector, the overweight positions in energy and materials were major drags, as was the underweight in IT. Moreover, stock selection within the I.T. sector was poor (Samsung Electronics, Apple). The sharp fall in the oil price caused EOG Resources and Schlumberger to fall by ~10% each, while global growth downgrades led to weakness in Materials holdings such as Vale and BHP Billiton. Conversely, there was strength in the Fund's defensive plays, such as Canadian National Railway, CVS Healthcare, Novartis, Pepsico and Johnson & Johnson, many of which achieved double digit returns.

Aberdeen continue to follow their process investing in quality companies with lower than average levels of debt and relatively stable earnings and cashflows. In the absence of major price volatility, portfolio activity has been, and can be expected, to be low. Portfolio initiated positions in Japan Tobacco and Rolls Royce but there were no outright sales.

Key considerations/developments

Ownership has not changed, but the acquisition of SWIP is very 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 lost (flow mildly positive this quarter after big Q2 loss) and the **investment process** has not changed/is standardised across equity products. This facilitates cross-fertilisation of ideas and a team-led approach. 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. Andy Brown (senior inv mgr) transferred from the GEM team on 1 August.

Baillie Gifford Bonds

(8.8% of Total Fund)

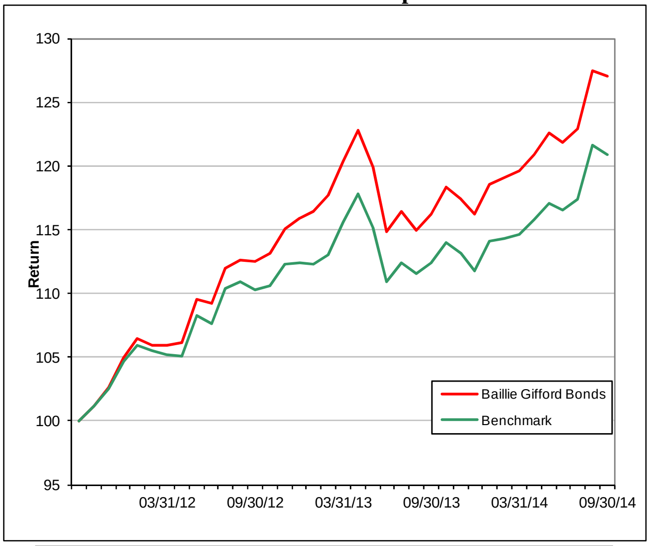
Investment Approach:

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 30 September 2014



Q3 2014	: + 0.6% excess return
3 Year	: + 1.8% p.a. excess return
Since inception	: - 0.1% p.a. excess return

Summary

3 year performance is ahead of the objective.

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, particularly corporate bonds, had another good quarter as the search for some yield at virtually any price continued. Corporate Bonds returned 2.9%, conventional bonds returned 3.7% and Index Linked Gilts returned an exceptional 5.9% over the quarter.

The Portfolio had another quarter of positive relative performance, returning 4.3% over the quarter against a benchmark return of 3.8%. Stock Selection has been the dominant factor in the outperformance over both the quarter and the year. Over the quarter, 0.2% of the 0.3% outperformance produced by stock selection came from the Russian position. Other smaller positive contributions came from currency and asset allocation. The biggest currency position relative to the benchmark (overweight USD) has reduced from +2.5% to +1.8%. The Mexican peso is the next largest overweight position at +1.7% showing that BG is maintaining its relatively positive outlook on US growth prospects.

The portfolio is broadly diversified with only 8 non-sovereign issuers accounting for more than 1% of the portfolio. Stock selection accounts for 60% and currency 25% of the risk relative to the benchmark.

Looking forward, BG is concerned that high yield spreads have further to widen, particularly in the 'BB' category, so investments with this rating are only held when BG assesses that they are good credits with the potential to be re-rated up to Investment Grade in due course.

BG considers government and corporate bond markets are roughly fairly priced relative to one another, so there are not currently major opportunities to gain from asset allocation.

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 £613m to £695m over the quarter. However, this was mainly due to general allocation of client monies, rather than any specific new monies for bond mandates. There were no changes to the investment staff in the quarter.

Baillie Gifford Diversified Growth

(12.0% of Total Fund)

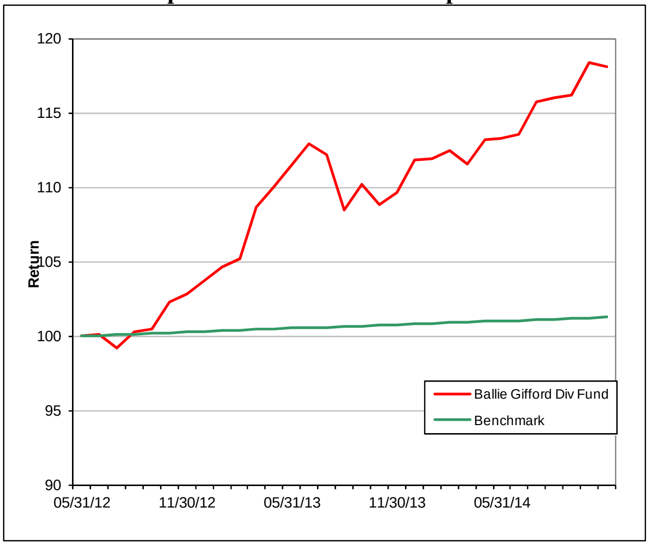
Investment Approach:

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

Investment Objective:

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

Since Inception Performance to 30 September 2014



Q3 2014	: +1.7% relative to base rate
1 Year	: +7.1% relative to base rate
Since inception	: +6.7% relative to base rate

Summary

Since Falkirk invested in Feb 2012, the risk/return is beating the modest fund objectives of (0.5% + 3.5% =) 4% pa net return with less than 10% volatility, by realising 6.7% pa net return with 4.7% delivered volatility.

Portfolio

In the Q2 report, "Active Currency" risk appeared understated at "-0.2% of assets", and "5% of predicted volatility". They have net long and short FX bets both over 45% of the fund. The Q3 report shows their Risk Attribution Source has changed (as Moody's Analytics has taken over Barrie & Hibbert) and now says "Active Currency" is "0.4% of assets" and just "0.1% of predicted volatility"! Yet in Q3, "Active Currency" contributed 1.3% gain out of the total 1.8% - ie >70% of the return. The next largest asset class contribution was 0.2%. The short Australian Dollar position alone contributed 0.4% of gain (from a 7% fall). While, it is somewhat churlish to criticise unexpectedly big profits on FX, it does obviously highlight the risk of unexpectedly big losses on FX.

Insurance Linked bonds, which are 4.7% of the fund, are still quoted at "0.4%" of the risk. This still seems an extraordinarily low figure for what is essentially writing "catastrophe" insurance.

While net performance beats the modest 4% pa target since inception, it has been falling; over the 5 years to Q2 2014 it was 10.6% pa, but over the last 3 years to Q3 2014 it was 7.2% pa. Cash and equivalents is now 9.1%, plus 3% in "Allianz Merger Arbitrage Strategy" fund (now in loss). BG remain cautious on returns from here.

Their stated predicted volatility is now 6.2% - with 56% from (listed and private) equities. Targeted maximum volatility is 10%. (cf global equities are 16.4%).

Key considerations/developments

Baillie Gifford announced £5bn "capacity" in the strategy in Q4 2012, and "closure to all new clients" in June 2013. In Q3 2014 clients increased by another 1 to 245, and assets increased to £5.67bn - £938m net inflows since this "closure".
There have been no changes to the organisation, the investment process, or the four fund managers in the team. The 2/3rds "fund of funds" structure blurs objectives and adds hidden charges. The 1/3rd in Baillie Gifford funds have zero fees but still pay (0.2%) expenses, while the 1/3rd invested in other managers' funds bear full double-charging.

Newton Global Thematic Equity
(14.6% of Total Fund)

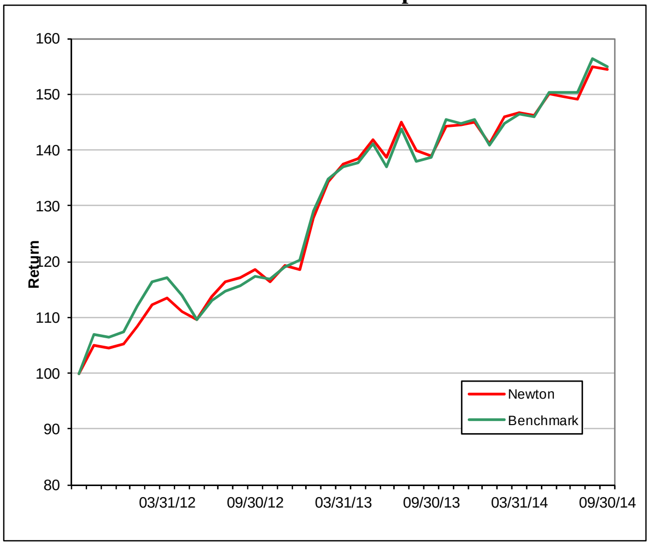
Investment Approach:

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

Investment Objective:

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

3 Year Performance to 30 September 2014



Q3 2014	: - 0.1% excess return
5 Years	: + 1.0% p.a. excess return
Since inception	: + 0.9% p.a. excess return

Summary

Portfolio not achieving objective, but is ahead of benchmark since inception. It has been constructed to take advantage of weak equity markets.

Portfolio

The portfolio is genuinely unconstrained (47 stocks), indicating that it should be able to achieve its objectives. This is an equity portfolio, but the manager is able to hold up to 10% in cash. The manager continues to take a very defensive stance and cash (mostly short term US Treasuries) was 9.0% 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 (+10%) equities, and underweight North America (-6%), Pacific (-5%) and other/emerging markets (-6%). The Japanese underweight has been reduced. It has high exposure to companies in the healthcare and consumer goods/services sectors, while financials, industrials and oil and gas companies with cyclical earnings are under-represented. The portfolio is likely to perform relatively poorly during strong equity markets, but its defensive tilt and high cash position should protect it if equity markets fall.

The portfolio performed in line with benchmark in Q3. Stock selection in the technology (Microsoft, EMC, Intuit and Apple), financials (Citigroup and Equifax) and consumer services (TJX and eBay) sectors was positive. The portfolio's underweight exposure to Oil and Gas also benefited performance as the oil price slumped. Offsetting the above, performance from stocks such as AGCO, GlaxoSmithKline, Brenntag, Continental and Yamana Gold was weak.

During the quarter, five new stocks were introduced: Discovery Communications (media), Yum Brands (fast food restaurants), Walgreen (pharmacy chain), Softbank (internet holding company) and specialist steel pipe maker Vallourec; three stocks were sold outright (National Oilwell Varco, Compass and Belle International, while the positions in Apple and eBay were reduced.

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
(13.7% of Total Fund)

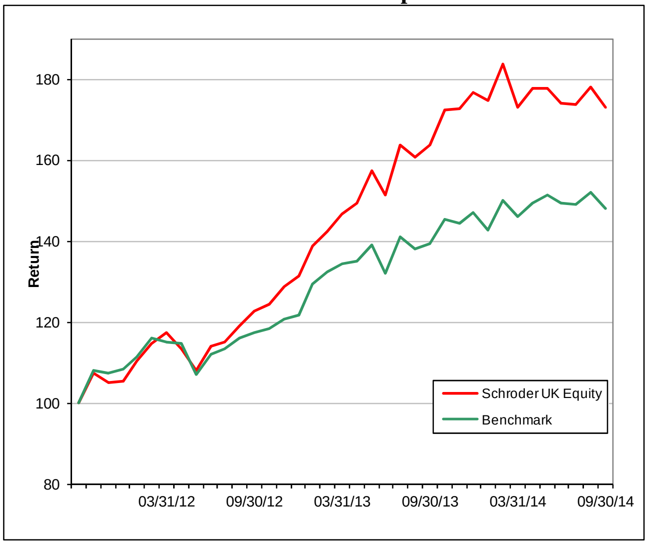
Investment Approach:

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

Investment Objective:

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

3 Year Performance to 30 September 2014



Q3 2014	: +0.4% excess return
3 Year	: +6.1% p.a. excess return
Since inception	: +2.4% p.a. excess return

Summary

Short term returns (Q3 & 12 months) in-line with benchmark though manager comfortably ahead of the objective over 3 years. Clearly articulated strategy with stable ownership, client base and investment team.

Portfolio

The portfolio of 37 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 third quarter were modestly positive (+0.4%) and over the most recent 12 months modestly negative (-0.3%). BAE Systems and RBS were the biggest positive contributors to relative returns in the quarter with Direct Line, Rentokil and AstraZeneca positions also adding relative value. The two biggest detractors were Darty and Tesco in the retail sector.

The team initiated a new position in Sainsbury, highlighting their continued belief in the underlying value within the sector but conscious of the need to diversify risk across stocks. Current share prices within the sector reflect what the team see as an unlikely and overly pessimistic long term outlook. It was noted that the sector represents only 6.8% of the portfolio. AstraZeneca was highlighted as a significant outlier within the portfolio in terms of position size. Andrew Williams commented that this has been reduced notably since quarter end.

A chart showing the cyclically adjusted P/E (CAPE) for the FTSE100 highlighted that while the market is close to recent highs once again, the valuation on this measure is notably lower than it has been at previous peaks (and is currently only marginally above its long term average). Within the market, banks are still the cheapest sector (summer results show UK banks well capitalised even versus recent stress test results) and food retailers are also very attractive. While materials also appear cheap, super normal profits earned in the 2000s result in the team continuing to adopt more of a "wait and see" approach.

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

(7.4% of Total Fund)

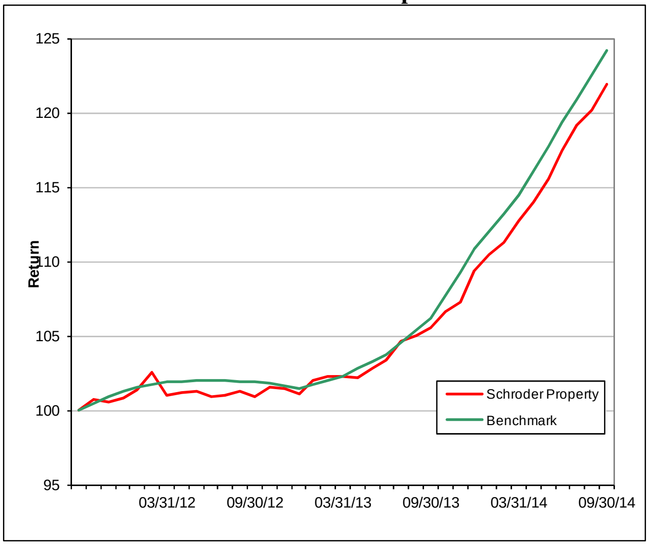
Investment Approach:

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

Investment Objective:

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

3 Year Performance to 30 September 2014



Q3 2014	: -0.2% excess return
3 Year	: -0.7% p.a. excess return
Since inception	: +0.0% p.a. excess return

Summary

Latest 3 year performance remains weak (-0.7% pa relative). Since inception the performance is in line with the benchmark, but less than the objective. The portfolio has been restructured and is now positioned for the future.

Portfolio

The portfolio is comprised of a diverse group of 15 funds investing in property assets largely in the UK. The portfolio is valued at £122m. Activity was fairly significant from 2009-2013, and now there is now expected to be low levels of future transaction activity.

The manager is shifting to a neutral position in London offices through serving a redemption request on WELPUT and 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.

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 0.5%.

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 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 9

FALKIRK COUNCIL

Subject: **PRIVATE EQUITY AND ALTERNATIVES UPDATE**
Meeting: **JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE**
Date: **11 DECEMBER 2014**
Author: **CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report updates the Committee on the progress and key events arising from each Manager's investment programme for the three months to 30 September 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

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 schedule gives details of the current valuations and commitment levels.

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 (£81m)**, 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 The third quarter of 2014 has seen the manager remain reasonably active. The Fund continues to benefit from its maturing investments in the 2004 and 2006 ESP funds, receiving **distributions of €2.9m (£2.3m)** during the quarter. As in the previous quarter, there was **€1.4m of calls (£1.1m)**, the majority relating to ESP 2008 and ESF 1 funds, which are in the seed/growth stage of their investment lifecycles.

2.4 All funds comfortably outperformed the MSCI Europe Index of 2.6% for the quarter. Highlights included increases in the value of the Alchemy and Altor III Funds and rises in the value of various co-investments including HSS Hire, Unifeeder and the Spotless Group. In the 2008 Fund, a new co-investment was made in Parques Reunidos, a Spanish leisure facilities operator. In the ESF 1 Fund, a new commitment has been made to a France Special Situations Fund II.

2.5 There has been little change in manager sentiment from the previous quarter with the northern part of the Eurozone giving grounds for optimism and the southern part being more of a challenge - the exception being Spain where some signs of recovery have been evidenced..

3. WILSHIRE ASSOCIATES

3.1 During the period from 2004, the Fund has made various commitments to Wilshire Associates covering several geographical areas as follows:

European Funds	-	€10.9m
US Funds	-	$53.2m
Asian Funds	-	$ 3.8m
Global (Fund IX)	-	$15.0m
Dollar Funds		$72.0m
Total Commitment		£54.4m

3.2 In their quarterly update, Wilshire highlight the dangers of overpaying for assets in the US and the formation and challenges of a new US regulatory group reporting on how Private Equity and Hedge Funds value assets, disclose fees and communicate with investors. Nevertheless, Wilshire remain cautiously optimistic of the global macroeconomic environment, albeit wary of rising geopolitical tensions.

3.3 During the quarter, **€817k (£650k) was distributed** from the Euro funds while **€192k (£150k) was called**. As one would expect, given the larger allocation to dollar funds, **$2.9m (£1.8m) was distributed** and **$775k (£490k) called**. The majority of distributions this quarter have come from the US Funds VI, VII and VIII.

3.4 In terms of personnel, Kevin Nee, president of the Wilshire Private Markets business has departed and his role taken up by the existing Chief Investment Officer, Karl Beinkampen. Wilshire are comfortable that the change in personnel can be absorbed having had a strategy of strengthening their global senior management team over the past couple of years.

4. GROSVENOR CAPITAL

4.1 The Fund's global infrastructure investments are made via a commitment of **$80m (£51m)** to the Customised Infrastructure Strategies (CIS) Fund managed by the Grosvenor Capital Customised Fund Investment Group (CFIG). The Fund has now funded around 80% of its commitments.

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. A pipeline of deals is in the process of being evaluated. These focus on Northern America and Europe in the transportation and energy delivery sectors.

4.3 Although no distributions were made in Q3, a major distribution of around **$7m** is expected in Q4. Capital calls in Q3 amounted to **$2.5m.** Total value to paid-in capital stands at over 1.20 and CFIG are confident that the 10% IRR target for the fund will be comfortably achieved.

4.4 The CFIG team are raising capital for a second infrastructure fund and are seeking commitments for a first close. Hymans remain positive about the CFIG team. They are performing well and although a Fund of Funds structure, they target a high proportion of co-investments and secondaries, in order to mitigate costs and the J-curve impact. Hymans do point out however that any commitment would effectively be a commitment to an illiquid asset and consequently the Committee may prefer to await the outcome of the impending strategy review before making any financial decision.

4.5 Details of the CFIG Investment proposition are attached as an Appendix to this report. Not for Publication.

5. M&G UK COMPANIES FINANCING FUNDS

5.1 The M&G UK Companies Financing Funds provide the pension fund with exposure to UK credit markets. The Funds play a valuable economic 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 - **£390k** being drawn down in the quarter.

5.3 For Fund 1, the portfolio consists of 8 loans with an average repayment period of 5.3 years and average credit rating of BB+. For Fund II, the portfolio now consists of 7 loans with an average repayment period of 6 years. The latest loan is £20m to Holidaybreak Leisure, a provider of educational activity holidays.

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

6. CONCLUSION

6.1 The investment outlook of the Fund's private equity managers remains broadly optimistic, with valuations in recent quarters being ahead of listed equity markets and merger and acquisition activity on the increase. The infrastructure and credit market managers continue to source deals at a satisfactory rate.

6.2 It is noticeable that rates of return on individual funds are gradually improving as distributions increase from the more mature private equity funds. The cash thrown off by these funds has helped maintain Fund liquidity generally and will help investments such as the Social Housing mandate and local Infrastructure to be invested without other assets having to be liquidated.

6.3 It remains the intention to commission further analysis of the Fund's private equity performance as part of the broader review of strategy.

7. RECOMMENDATIONS

7.1 The Panel and Committee is asked to note the progress of the Private Equity, Infrastructure and Credit Markets Programmes as at 30th September and invited to comment as appropriate.

7.2 The Committee is asked agree that a decision to invest in the Second Infrastructure Fund of Grosvenor / CFIG be delayed until the Fund's strategic investment review has been completed.

Chief Finance Officer

Date: 30 November 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

Appendix to this Report Not for publication by virtue of Paragraph 9 of Part 1 of Schedule 7A of the Local Government (Scotland) Act 1973.

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506304 and ask for Alastair McGirr

Appendix A

Falkirk Council Pension Fund
Alternative Markets Update - 30/09/2014

Exchange Rates	
$	1.5723
€	1.2598

Alternative Assets Summary - Approx Sterling Value

Manager	Fund	Commitment £,000	Unfunded £,000	(a) Cost £,000	(b) Return of Cost £,000	(c) Distrbtn Gains £,000	(d) Market Value £,000	(b + c + d) Total Value £,000	Total Value to Paid in Cap.	Inception Rate of Return
Private Equity										
SL Capital Partners	European Strategic Partners 2004	23,813	2,753	21,060	8,016	6,449	11,844	26,309	1.25	5.9%
SL Capital Partners	European Strategic Partners 2006	23,813	3,052	20,761	5,726	2,126	17,075	24,927	1.20	3.2%
SL Capital Partners	European Strategic Partners 2008	21,432	8,352	13,080	1,212	107	14,265	15,584	1.19	1.3%
SL Capital Partners	European Smaller Funds I	11,907	9,020	2,887	-	-	2,559	2,559	0.89	N/A
	SL Capital Partners Total	80,965	23,177	57,788	14,954	8,682	45,743	69,379		
Wilshire Associates	Fund VI - Europe	2,858	177	2,681	1,646	1,023	1,177	3,846	1.43	7.2%
Wilshire Associates	Fund VII - Europe	2,858	208	2,650	778	367	1,957	3,102	1.17	0.5%
Wilshire Associates	Fund VIII - Europe	2,937	650	2,287	596	410	2,087	3,093	1.35	31.9%
Wilshire Associates	Fund VI - US	8,904	522	8,382	3,242	3,050	5,514	11,806	1.41	5.7%
Wilshire Associates	Fund VII - US	7,314	455	6,859	2,013	1,900	5,645	9,558	1.39	5.8%
Wilshire Associates	Fund VIII - US	8,077	852	7,225	2,271	1,292	6,394	9,957	1.38	9.8%
Wilshire Associates	Fund VII - Asia	1,145	113	1,032	521	352	607	1,480	1.43	6.8%
Wilshire Associates	Fund VIII - Asia	1,272	713	559	151	37	586	774	1.38	-14.2%
Wilshire Associates	Opportunities Fund II-B	9,540	2,162	7,378	4,181	1,518	3,971	9,670	1.31	9.7%
Wilshire Associates	Fund IX	9,540	8,668	872	0	0	1,432	1,432		
	Wilshire Associates Total	54,445	14,520	39,925	15,399	9,949	29,370	54,718		
	Private Equity Total	**135,410**	**37,697**	**97,713**	**30,353**	**18,631**	**75,113**	**124,097**		
Infrastructure										
Credit Suisse/Grosvenor	Customised Infrastructure Strategies	50,881	10,767	40,114	3,710	2,037	43,069	48,816	1.22	8.0%
	Infrastructure Total	**50,881**	**10,767**	**40,114**	**3,710**	**2,037**	**43,069**	**48,816**		
Credit Markets										
Prudential/M&G	UK Companies Financing Fund	11,835	0	11,835	4,747	0	8,822	13,569	1.15	4.9%
Prudential/M&G	UK Companies Financing Fund II	10,000	6,696	3,304	0	89	3,330	3,419	1.03	6.0%
	Credit Market Total	**21,835**	**6,696**	**15,139**	**4,747**	**89**	**12,152**	**16,988**		
	Total Alternative Fund Value	**208,126**	**55,160**	**152,966**	**38,810**	**20,757**	**130,334**	**189,901**		

Note: This appendix has not been published as part of the public agenda as it is considered that it contains exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973.

Successor Fund

Fund Overview

The Successor Fund seeks to provide investors with a comprehensive infrastructure solution through a single commitment.

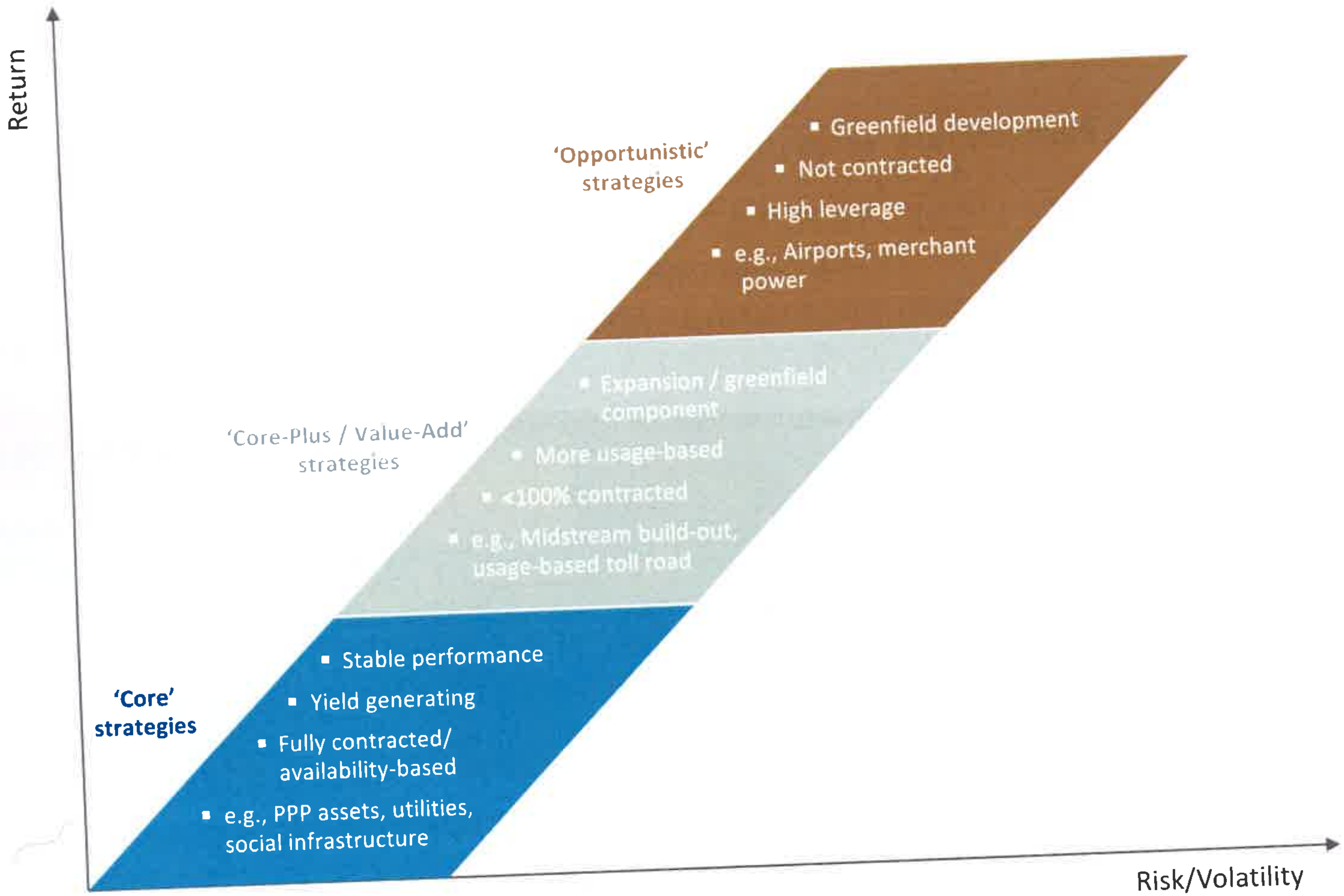
- Successor Fund is targeting total commitments of $650 million
  - Target diversification across core, core-plus/value-add and select opportunistic infrastructure assets
  - Geographic focus on North America, Western Europe and primarily OECD countries in the rest of the world
  - Predominantly brownfield investments, with small potential allocation to greenfield
- The Fund will target investments in primary infrastructure funds, secondary fund purchases, direct/co-investments, and infrastructure debt investments
- The Fund will take a defensive approach to the asset class, emphasizing current yield
- Target net return of 10%+; cash yield of 3% - 5%[1]
- Continue successful CIS I strategy

1 Target returns and risk parameters are hypothetical in nature and are shown for illustrative, informational purposes only. See the "Target Returns and Risk Parameters – Private Markets" Notes and Disclosures following this presentation for additional information. **THERE CAN BE NO ASSURANCE THAT ANY GCM GROSVENOR PRIVATE MARKETS FUND OR STRATEGY PURSUED BY ANY GCM GROSVENOR PRIVATE MARKETS FUND WILL ACHIEVE ITS OBJECTIVES OR AVOID LOSSES.** Additional detail concerning the methodology used and assumptions is available upon request.

Note: This appendix has not been published as part of the public agenda as it is considered that it contains exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973.

Infrastructure Risk-Return Spectrum

The Fund will target core, core-plus and limited opportunistic investments and strategies, as shown below.



This chart is for illustrative purposes only and may not reflect the actual risk-return profile of infrastructure as an asset class or the various infrastructure sub-sectors.

Note: This appendix has not been published as part of the public agenda as it is considered that it contains exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973.

Fund Advantages

GCM Grosvenor Private Markets believes that the Fund is a unique way for investors to obtain the benefits of a diverse infrastructure portfolio while potentially mitigating some of the challenges of infrastructure investing.

Challenges to Infrastructure Investing

- Emerging asset class
- Large number of first-time funds
- Ability to create a diversified portfolio
- Expensive fee structure; deep J-Curve
- Transparency/knowledge of the asset class
- High investment minimums

the Fund Advantages

- Access to information and opportunities
- Extensive, specialized due diligence
- Prudent diversification
- Appropriate fee structure and lower cost strategies such as direct/co-investments
- Potential to enhance returns and mitigate the J-Curve through direct/co-investments and secondary purchases
- Scale benefits

No assurance can be given that any investment will achieve its objectives or avoid significant losses.

Note: This appendix has not been published as part of the public agenda as it is considered that it contains exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973.

Summary of Select Terms and Conditions[1]

Successor Fund

Name	Successor Fund (the "Fund")
Organization	Delaware limited partnership for U.S. investors; additional structures may be created for non-U.S. and ECI sensitive investors.
Minimum Commitment	$5 million, subject to waiver by the General Partner
General Partner	GCM Grosvenor Fund Partners I, L.P., or an affiliate of GCM Grosvenor Private Markets
Investment Period	Three years from Final Closing
Term	The fifteenth anniversary of the final closing date plus two successive one-year extensions at the discretion of the General Partner
Management Fee	0.60% per annum of aggregate commitments during Investment Period; thereafter, 0.60% per annum of invested, committed and reserved capital
Carried Interest	Primary Fund Investments – 2.5% Secondary Funds and Direct/Co-Investments – 7.5%
Preferred Return	8.0% per annum, compounded annually

1 Preliminary, subject to change. This summary of selected terms and conditions is qualified in its entirety by reference to the Fund's limited partnership agreement and other operative documents, copies of which will be provided to prospective investors upon availability and request.