

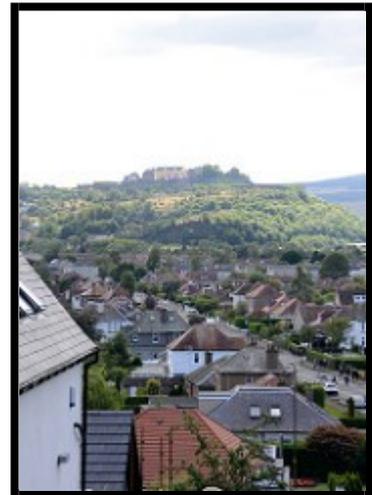


# Falkirk Council Pension Fund

## Audited

# Annual Report and Accounts

## 2016/17



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## Foreword from the Chair of the Pensions Committee



As Chair of the Pensions Committee with responsibility for overseeing the investment management and administration of the Falkirk Council Pension Fund, I am delighted to introduce the 2016/17 Annual Report and Statement of Accounts.

The past year has been dominated by the political phenomena of the UK's historic decision to leave the European Union and the election of US President Trump. At each turn, financial markets have held their breath, taken stock, and then continued on an inexorable upwards trajectory. Markets cannot, of course, rise indefinitely and, in such an environment, it is more important than ever that investors such as the Falkirk Fund are invested in a wide range of diverse (and, as far as possible, uncorrelated) asset classes in order to reduce risk and protect against market corrections.

Diversification has therefore been a significant theme for 2016/17 with the Fund determining to allocate monies to both the Property and the Private Debt asset classes, as well as increasing its allocation to UK infrastructure investments. In anticipation of allocating capital to these areas and with a view to some "taking of profits", around £60m has prudently been taken back from our Fund's managers. Additionally, in an effort to take advantage of the lower fees offered by passive investment, the Fund has followed through on its commitment of last year to make an investment in a "Smart Beta" product.

I recognise that the strong financial returns enjoyed by the Fund in 2016/17 should not mask the difficulties which employers face in the coming months as the results of the 2017 Fund valuation are unveiled. The low interest rate environment and the prospect of lower investment returns going forward will inevitably put an upward pressure on employer contribution rates and present considerable challenges to all of us.

With the array of products and strategies now available to investors, it is important for the sake of consistency and transparency that investment decision making is soundly based. For that reason, the Fund has incorporated a core set of investment beliefs within its Statement of Investment Principles. Our beliefs include concepts such as "Long term investing provides opportunities for enhancing returns", and that "Active management can add value but this is not guaranteed" and, of course, a belief in diversification.

Mention of beliefs reminds me that the Fund devoted much time and effort in 2016/17 to Environmental, Social and Governance (ESG) matters, hosting a seminar for stakeholders and receiving a highly informative presentation from Faith Ward of the Environment Agency. The subject of climate change was very much to the fore with the Fund committing to carrying out research into its own "carbon footprint" and reserving the right to disinvest from a company or sector making insufficient progress to cutting emissions over a 5 year period.

The circumstances in which a Fund can refuse to invest in a lawful profit making activity (e.g. tobacco) without risking challenge takes us into the territory of fiduciary duty owed by the Fund to stakeholders. Case law, Law Commission findings and now a report commissioned by the national Scheme Advisory Board all indicate that outright disinvestment can only be made on non-financial grounds (e.g. climate change, reputation, regulation) if these factors represent an unacceptable risk to a company or sector's financial wellbeing.

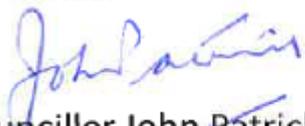
On a more positive note, all of our Investment Managers generally performed well in 2016/17 on the back of the very strong market tailwind. It was also heartening to see our UK infrastructure portfolio – developed in conjunction with the Lothian Pension Fund - being built out further, with the connection of the Harburnhead Wind Farm in West Lothian to the National Grid being a particular highlight.

Recognising the success of our collaboration with the Lothian Fund over the past 5 years and the need to maximise opportunities for efficient and effective working, the Fund has agreed to adopt a new governance model. This will allow the Pensions Committee to focus on developing investment strategy – which is of paramount importance – with the implementation of strategy being delegated to the Chief Finance Officer. In turn, the Chief Finance Officer will be advised by professionally qualified officers and specialist independent advisers. The new model which offers the possibility of some Fund assets being managed by Lothian's in house investment resource will, I hope, lead to better investment outcomes for the Fund at lower cost.

Other notable developments in 2016/17 have included the Fund's tendering for actuarial service with Hymans Robertson being re-appointed as Pension Fund actuaries. Additionally, Ernst and Young have taken over from Audit Scotland as Fund auditors. We look forward to working with both these parties for the betterment of the Fund.

During 2016/17, the Pensions team oversaw the successful migration of the 11,000 strong pensioner payroll to a new platform within the Altair pensions administration system, the latter being procured in 2014 following the introduction of the career average version of the Local Government Pension Scheme. Pension payments over the 12 months amounted to around £50m underlining the continued relevance of the Fund and the important role it plays in the lives of many, providing stability and security of income for pensioners and a comprehensive and cost effective means of saving for employees.

As another busy year draws to a close for the Fund, can I take this opportunity to thank my colleagues on the Pensions Committee, Pension Board, the Pensions staff and all our advisors for their commitment over the past year. Can I also offer my best wishes and support to Councillor Tom Coleman as he assumes the role of Chair of the Pensions Committee.



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

## Contact Us

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

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Enquiries about pension benefits: Falkirk Council Pension Fund

Tel: 01324 506329  
Fax: 01324 506303  
Email: [pensions@falkirk.gov.uk](mailto:pensions@falkirk.gov.uk)  
Post: Pensions Section  
PO Box 14882  
Falkirk Council  
Municipal Buildings  
Falkirk  
FK1 5ZF

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

General Enquiries: 01324 506329  
Retirement/Death Enquiries: 01324 506325  
Strategic and Policy matters: 01324 506333  
Accounting and Investment matters: 01324 506338

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

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

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

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

# Management Structure

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

The Auditor appointed by the Accounts Commission for Scotland for the purpose of auditing the annual report and accounts is Ernst & Young LLP.

## Management Commentary

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### Introduction

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

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

### Overview of Fund Business

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

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

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

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

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

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

## Business Model and Risk

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

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

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

Pension Fund activity can be split into the following categories:

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

**Membership and Benefits Administration** is undertaken internally by the Council's Pensions Section. For more detailed information on this activity, turn to the Administration Section on Page 25.

**Investment Management** of the Fund's assets is undertaken by external fund managers and overseen by the Pensions Section with the support of Hymans Robertson, the Fund's Investment Advisor. A review of Investment activity is provided on Page 32.

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

**Governance** is undertaken by the Pensions Committee to whom Fund business has been delegated by Falkirk Council. This includes the appointment and monitoring of investment managers. The Committee is supported by a Pension Board to ensure that its decisions are made within the terms of the Scheme rules and in accordance with good practice. More information on the Governance process can be found in the Governance Section on Page 20.

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

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

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

A risk register is maintained and can be viewed at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications section. An update on risk is a standing item at quarterly Pensions Committee meetings. More information on Risk can be found at Page 30 of this report.

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

## Financial Performance

Riding a wave of strong market performance during the year, the Fund achieved a return of 20% during 2016/17 which was 1.6% above the Fund benchmark of 18.4%. The return compared favourably with the Fund's long term strategic funding requirement of 6% per annum.

One year is a very short period over which to assess performance with 3 and 5 year returns being a more realistic timeframe. In each of these cases, the 3 year and 5 year performance has been 11.4%. Further performance information is available on Page 32.

Fund assets at 31 March 2017 were approximately £2.2 billion, an increase of approximately £380m over the year, reflecting the positive market conditions for investors.

Fund liabilities also increased and were estimated to have risen from £2.4bn at 31 March 2016 to £2.9bn at 31 March 2017 mainly as a result of the persistent decline in gilt yields. The liabilities have been estimated by the Fund Actuary rolling forward cash flows and investment returns from the 2014 triennial valuation. The £2.9bn does not appear in the financial statements as the statements do not take account of the Fund's obligations to pay pensions after the 31 March 2017.

The net increase in liabilities means that the deficit has increased from an estimated £550m at the 31 March 2016 to £686m. Despite the increase, the Fund has a robust funding strategy in place and regular funding reviews are undertaken to ensure that the Fund's deficit remains manageable.

On the benefits side, contributions increased by £2m mainly as a result of higher employer contributions.

## Actuarial Valuation as at 31 March 2014

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

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

	Valuation at 31/03/2014	Estimated Funding Position at 31/3/2017
<b>Past Service Liabilities</b>	£1,860m	£2,897m
<b>Assets</b>	£1,577m	£2,219m
<b>Funding Deficit</b>	£283m	£678m
<b>Funding Level</b>	84.8%	76.6%

<b>Future Service Cost</b>	17.9% of pay	31.5% of pay
<b>Past Service Cost</b>	5.5% of pay	13.3% of pay
<b>Total Employer Contribution</b>	23.4% of pay	44.8% of pay

The next valuation of the Fund, which is scheduled for 31 March 2017, will set employer contribution rates for the period 1 April 2018 to 31 March 2021. Initial work undertaken by the Actuary indicates that employer contributions will almost certainly have to increase due to the combination of higher fund liabilities and lower future investment returns.

In terms of asset growth, the Fund has achieved an average return of 11.4% p.a. over the three years from April 2014 to March 2017. Despite this, the funding position has worsened due to the fall in gilt yields from 5.1% to 3.3%. Lower yields mean a higher value being placed on Fund liabilities. In addition, as the actuarial assumption for future investment returns is based on a "gilts plus" model, the fall in yields means a lower investment return outlook. Collectively, this has the effect of pushing up the cost of funding both future service accrual and the past service deficit, hence the increase in the theoretical employer contribution rate.

Although the funding position at 31 March 2017 has worsened since the 2014 valuation, it does remain within the range of tolerable outcomes envisaged within the Funding policy.

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

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

## Funding Strategy Statement

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

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

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

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

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

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

## Investment Strategy

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

The Fund's longer term strategy is to reduce its exposure to more volatile asset classes to a point where there is parity between the growth-seeking and defensive assets. The reduction in growth seeking assets will however only take place when market conditions are attractive and the Fund is ahead of schedule in repairing its funding deficit which, at the 31 March 2017 is estimated to be £678m.

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

### Short Term Objective

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

## Long Term Objectives

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

A review of asset allocation and manager performance was undertaken during 2015/16 by a subgroup comprising Committee members, officers and advisors. The sub group met on 5 separate occasions with members of the Board also attending in an observer capacity. The key recommendations adopted by the Committee were to increase the proportion of Fund assets allocated to infrastructure and property, and to undertake factor based investments. Since then, the Committee has further agreed to make an allocation to private debt.

## Performance Standards

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

The performance of the Pensions Section against key standards in 2016/17 was as follows:

Membership and Benefits Administration Cost to be less than £25 pa per member	
Achieved in Full	Per member cost was £19.25

Meet deadlines for accounts, benefit payments, statistical returns and remittances	
Achieved in Part	All of the above were made within statutory time limits. Only 70% of benefit statements were issued by 31 August 2016 with the remainder being issued over the subsequent two months.

Fund to achieve its benchmark return	
Achieved in Full	Fund returned 20.0% against a benchmark of 18.4%

Fund Managers to achieve their individual benchmark returns	
Achieved in Part	Benchmark was exceeded in 5 out of 9 mandates – but all managers bar one delivered positive absolute returns

- The cost per member has reduced from £29.08 in 2015/16 to £19.25 in 2016/17. The reduction in costs is due to the one-off implementation costs associated with the new pensions administration system having been met in 2015/16.
- The requirement to focus resources on payroll migration and benefit statement production, together with the strong demand for severance estimates continued to place a pressure on turnaround times for lesser priority activities such as transfers and deferred benefits.
- The Fund has outperformed its benchmark in each of the past 5 years.

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

The Pensions Section prepares an Annual Budget which is reviewed and approved by the Pensions Committee. Details of the budget for 2017/18 and costs for 2016/17 are provided on Page 27 of the Annual Report and on Page 63 in Note 12 in the Accounts Section of this report.

## **Trends and Influences - Administration**

- The complexities arising from the LGPS containing both a final salary and a career average element continued to be a significant factor affecting the activities of the administration team.
- To enable compliance with the career average arrangements, a new administration system – *Altair* - was introduced in March, 2015. The system was procured using a national framework agreement and is supported and maintained by Pension Consultants, Heywood. It is the system used by the majority of UK local authority funds.
- During 2016/17, further strands of the Altair project were rolled out including the transfer of the pensioner payroll to Altair and incorporation of it into the main Altair database.
- The UK Government's pension initiatives - freedom and choice, auto enrolment and the abolition of contracting out – mean that the tempo of pensions reform remains brisk with challenges on a variety of fronts.
- The additional scrutiny of administration activities by the Pension Regulator and the drive to hold better quality data has led the Fund to review and increase its staffing complement. It will therefore be looking to add to the existing Pensions team during 2017/18.
- During 2017/18 the Fund is looking to move employers to an electronic platform (i-connect) to enable data to be exchanged more timeously and accurately.
- The pressures on public spending mean that a high volume of member and employer retirement estimates continue to be experienced.
- Looming contribution rate increases have already prompted some employers to start to explore leaving the scheme. The Fund will work with employers to ensure that any exits are carefully managed in order to minimise the impact on remaining employers.

## Trends and Influences - Investment

- During 2016/17 markets have continued to rise buoyed by anticipation of global growth and a continuing environment of low interest rates and relaxed monetary policy. As markets reach record highs and valuations creep upwards, doubts remain as to whether these are sustainable and based on fundamentals.
- In the face of momentous political events in 2016/17 (Brexit and the election of US President Trump) markets have generally paused for breath, kept calm and carried on, even taking a modest US interest rate rise in its stride.
- Thus far markets have been unfazed by the unexpected announcement in 2017 of a UK General Election, terror attacks in Manchester and London and the US decision to walk away from the 2016 Paris Climate Change agreement. Wider geo-political tensions including the Brexit negotiations between the UK and Europe and the trade policies of the Trump administration will however continue to have a bearing on financial markets.
- Managers are likely to face the same challenges in generating returns in 2017/18 that they encountered in 2016/17, including over dependence on Quantitative Easing, stuttering global growth, sluggish demand in China and depressed oil and commodity prices.
- Technological advances and cyber security will continue to be important themes in 2017/18.
- An initiative by the UK Government to improve investment manager selection, reduce costs and create a platform from which greater scaled infrastructure investment may be made is currently underway in England and Wales. Developments will doubtless influence Government policy north of the border. In this regard, the Scottish Scheme Advisory Board has been reviewing the structure of the Scheme in Scotland and will be providing the Scottish Government with an options paper.
- The new governance model adopted by the Falkirk Fund is likely to lead to consideration as to whether mandates still require to be delivered by external managers or could be undertaken more cost effectively in house.
- 2017/18 is expected to see the further deployment of capital in relation to the Fund's Affordable Housing mandate and the UK Infrastructure mandate, the latter being undertaken in collaboration with the Lothian Pension Fund.
- A more detailed review of global market conditions in 2016/17 can be found on Page 40.

## **Trends and Influences – Governance**

- The Fund has agreed to enter into a collaborative arrangement with the Lothian Pension Fund to align the investment governance of the two funds. Going forward, the Pensions Committee will agree investment strategy but will delegate the implementation of strategy, including selection of investment managers, to the Chief Finance Officer on the basis of proper advice being given by a Joint Investment Strategy Panel (JISP). The JISP will consist of FCA accredited officers and specialist external advisers. The first meeting of the JISP is scheduled to take place in July, 2017.
- Training arrangements for Committee and Board members will continue to be a priority to enable appropriate knowledge and understanding obligations to be met. This is particularly pertinent as a number of new members will be joining the Pensions Committee following the local government elections of May, 2017.

## Environmental, Social and Corporate Governance Responsibilities

### Statement of Investment Principles

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

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

### Pensions and Research Consultants Ltd (PIRC)

To support its ESG commitments, the Fund has engaged the Pensions and Investment Research Consultants (PIRC) to provide advice and research information on all matters pertaining to corporate governance and to act as voting agents for the Fund. Motions where PIRC have consistently lodged "oppose" votes in 2016/17 include those involving governance arrangements, executive remuneration, share buy backs and auditor rotation.

### Local Authority Pension Funds Forum

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

More information about the work of the LAPFF can be found at [www.lapfforum.org](http://www.lapfforum.org). More information about Corporate Governance matters can be found on Page 42 of this report.

### Impact Investment

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

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

The Fund is also investing in the UK economy through a £100m commitment to UK infrastructure. Thus far, investments have been made in hydro, solar and wind projects as well as various strands of social infrastructure such as student accommodation, hospitals and roads.

## Staffing Resources

The Pension Section's staffing compliment at 31/03/17 was as follows:-

### Senior Officers

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

### Administration Officers

	No. of Males	No. of Females
Pension Officers	1	1
Pension Support Officer	0	1.6
Trainee Pension Officer	0	1
Pension Assistants	2	4
Clerical Assistant	0	0.5

### Investment and Accounting Officers

	No. of Males	No. of Females
Fund Accountant	0	1
Accounting Assistant	0	0.4

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

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

## Director's Report

In respect of the Fund's senior officers, no absences have been recorded. No personal data incidents or other material absences were recorded during 2016/17.

There is no need for the Pension Fund to produce a remuneration report, as the Fund does not directly employ any staff. All staff are employed by Falkirk Council, and their costs reimbursed to the Council by the Fund. Nonetheless, details of the remuneration of senior management can be found at Note 26a of the Accounts.



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

21/9/17

.....  
**Date**



.....  
**Chief Executive**

21/9/17

.....  
**Date**



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

21/9/17

.....  
**Date**

# The Local Government Pension Scheme

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

This document is the Annual Report of the Falkirk Council Pension Fund for 2016/17.

## The Local Government Pension Scheme (LGPS)

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



# Governance

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## Overview

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

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

Falkirk Council has delegated its pensions function to the Pensions Committee, with certain operational activities being delegated to the Chief Finance Officer. Pension Fund activities are overseen by a Pension Board that has been set up to comply with the requirements of the Public Service Pensions Act 2013. The Committee is required to meet on not less than a quarterly basis. During 2016/17, the Committee held four meetings, all of which were joint meetings with the Pension Board.

## Annual Governance Statement

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

The Annual Governance Statement in respect of 2016/17 is set out in full on page 89.

## Governance Compliance Statement

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

The Fund's Governance Compliance Statement is set out in full on page 94.

## Pensions Committee

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

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

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

Following the May, 2017 local government elections, Councillors C Campbell, S Carleschi and both Councillors C Martin have left the Committee. Councillors W Buchanan, A Drummond, A McCue and P Reid have been appointed in their place.

The Committee's key responsibilities are:-

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

(Councillors Blackwood, Carleschi, Dr CR Martin and Mr Douglas were active members of the Scheme during 2016/17. Councillor Patrick and Mr McLean are pensioner members).

The Committee is supported at its meetings by officers and professional advisers. External Auditors were also in regular attendance at the 2016/17 meetings.

As noted on Page 15, the implementation of investment strategy has been delegated to the Chief Finance Officer from April, 2017.

## Pension Board

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

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

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

Board Members during 2016/17 were as follows:

Mrs Susan Crook (Chair)	-	Union Representative
Mr Sandy Harrower	-	Union Representative
Mr Tommy Murphy	-	Union Representative
Mr Gordon Irvine	-	Union Representative
Councillor Donald Balsillie	-	Employer Rep. (Clackmannanshire Council)
Mr Simon Hunt	-	Employer Rep. (Scottish Autism)
Mr Ed Morrison	-	Employer Rep. (SCRA)
Mrs Jennifer Welsh	-	Employer Rep. (SEPA)

Councillor Balsillie left the Board following the May 2017 Local Government Elections and has been replaced by Councillor Margaret Brisley from Stirling Council.

## Training for those with Governance Responsibilities

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

Various seminars, conferences and in-house training events have been made available for Committee and Board members to attend. During 2016/17, these have included:

14/04/2016 – Annual Conference, Callendar House, Falkirk

24/10/2016 – ESG Training, Lesser Town Hall, Falkirk

12/12/2016 – National LGPS Training, COSLA Offices, Edinburgh

10/03/2017 - ESG and Asset Allocation Training, Council Offices, Falkirk

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

Training arrangements for 2017/18 will continue to be broadly based in order to support member decision making.

### **Conflict of interests**

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

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

### **Freedom of Information, Accountability and Transparency**

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

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

During 2016/17, the Fund responded to 27 Freedom of Information requests, the majority of which related to the composition of the Fund's assets.

### **Data Security**

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

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

- We aim to have Data Sharing Agreements in place with our constituent employers within the next two years

## Communications

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

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

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

## More Information

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

# Scheme Administration

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## Outline

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

The Section consists of 13.5 full-time equivalent staff and is headed by the Pensions Manager, who reports directly to the Chief Finance Officer. In addition to benefits administration, some staff members undertake governance, accounting, and investment related activities.

The Section is made up as follows:

Role	Nos.	Average Years of Pensions Service	Pensions/Financial Qualification
Pensions Manager	1	34 years	Yes
Fund Accountant	1	2 years	Yes
Pensions Officers	2	31 years	Yes (1)
Pensions Support Officer	1.6	13 years	Yes
Accountancy Assistant	0.4	13 years	No
Trainee Pensions Officer	1	3 years	Yes
Pensions Assistants	6	9 years	No
Clerical Assistant	0.5	3 years	No
Total	13.5		

The principal activities of the Pensions Section are:

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

## Service Planning

The Section's operations fall within the terms of the Service Plan for Corporate and Housing Services.

## Professional Development

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

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

The Council holds Investors in People accreditation.

## Equality and Diversity

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

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

## Systems

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

System	Database	Purpose
Pensions Administration System (Altair)	Web Based	Pensions Administration and Pensioner Payroll
Integra	Oracle	Financial Information System
Passport (Northern Trust)	Web Based	Custodian Information
Clydesdale Bank	Web Based	Fund Banking Information

During 2016/17, pensioner payroll records were migrated from the Council's Payroll system to the payroll module of the Altair Pensions Administration System. This should improve the Section's efficiency as all key pensions administration data will now be residing in the same database.

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

## Pension Section Budget

A summary of the Pension Section's administrative expenditure for 2016/17, together with the approved budget for 2017/18, is shown in the table below.

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

Pension Fund	Budget 16/17	Actuals 16/17	Variance 16/17	Budget 17/18
<b>Benefits Administration</b>				
Employee Expenses	325,460	329,561	4,101	435,710
IT Costs	277,650	157,827	(119,823)	261,830
Other	50,020	95,026	45,006	102,460
<b>Total</b>	<b>653,130</b>	<b>582,414</b>	<b>(70,716)</b>	<b>800,000</b>
<b>Oversight and Governance Costs</b>				
Employee Expenses	106,730	105,722	(1,008)	130,420
Manager Monitoring	130,000	148,445	18,445	168,000
Actuarial Fees	80,000	85,250	5,250	100,000
Tax Advice and Legal Fees	113,150	107,314	(5,836)	113,150
Investment Advisory	90,000	62,585	(27,415)	70,000
Performance Measurement	18,000	17,140	(860)	20,000
Other	20,950	31,182	10,232	54,190
<b>Total</b>	<b>558,830</b>	<b>557,638</b>	<b>(1,192)</b>	<b>655,760</b>
<b>Investment Management</b>				
Managers Fees	5,655,000	4,492,808	(1,162,192)	6,069,000
Custodian Costs	120,000	145,314	25,314	140,000
Aborted Deal Costs	150,000	13,977	(136,023)	150,000
Other	0	7,264	7,264	5,000
<b>Total</b>	<b>5,925,000</b>	<b>4,659,363</b>	<b>(1,265,637)</b>	<b>6,364,000</b>
<b>Pension Fund Total</b>	<b>7,136,960</b>	<b>5,799,415</b>	<b>(1,337,545)</b>	<b>7,819,760</b>

The main variance between budgeted and actual amounts related to:

- Underspend from delayed roll out of IT modules (i.e. i-connect, workflow)
- Underspend from lower than expected investment advisory fees
- Higher than expected custody fees
- Underspend from fee savings (i.e. arising from discounts negotiated with manager)
- Underspend from lower than expected legal costs relating to unsuccessful asset bids

Increases have been made in the 2017/18 budget to cover:

- cost of resourcing of three new posts
- higher actuarial fees because of 2017/18 fund valuation work
- manager fees (i.e. these are generally percentage based and rise in line with assets under management)

## Review of 2016/17 Administration

### Scheme Structure

Pensions administration in 2016/17 continued to be impacted by the important changes made to the Scheme on 1 April, 2015. These included:

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

To ensure compliance with the new benefit structure, a replacement pensions administration system was procured during 2014/15. The new system was bedded in successfully during 2015/16 with further development undertaken in 2016/17, the latter including contribution postings and the production of benefit statements.

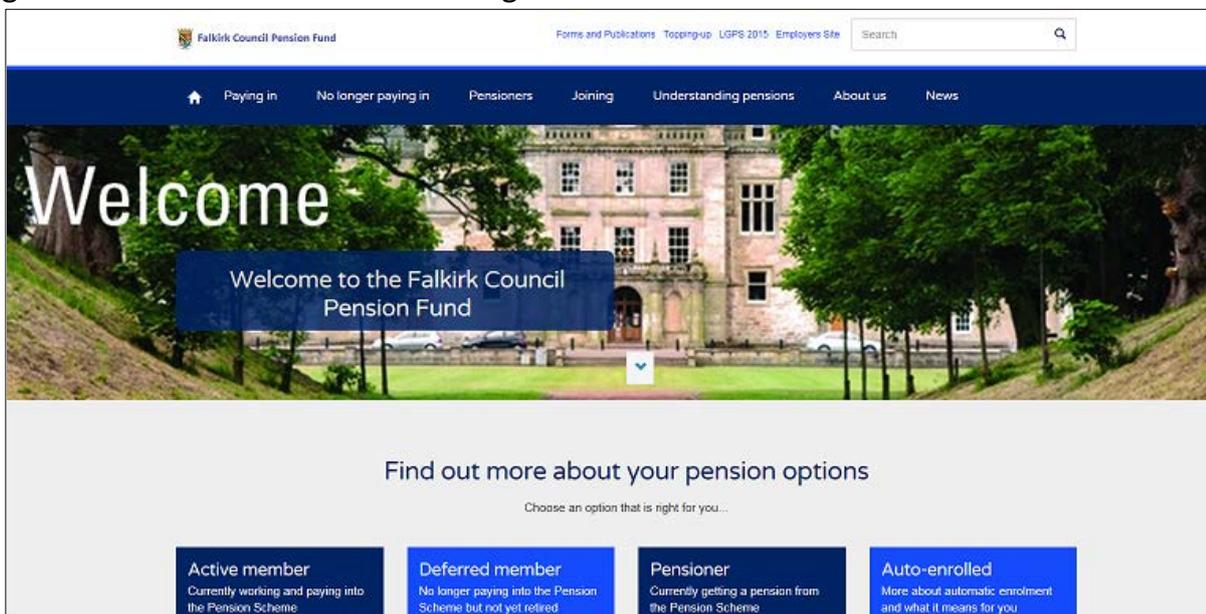
### Other Miscellaneous

Two material developments took place during 2016/17

- the Supreme Court deciding that entitlement to an unmarried partner's pension should not depend on whether a written nomination had been made in favour of the partner by the deceased; and
- Scottish LGPS funds being given authorisation by the Scottish Government to release AVC funds to members who had obtained age 55.

### Online services

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



## Analysis of Membership

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

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

Recent membership movements show that:

- Active membership showed a modest increase during 2016/17, however this was outweighed by the rise in deferred and pensioner numbers reflecting the challenging financial environment facing local authorities and the persistence of early retirement initiatives across fund employers.
- The influx of new active members remains steady with employers contractually enrolling all new entrants. This combined with the increase in pensioner members has led to a marginal but relatively insignificant maturing of the Fund's membership profile.

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

	2012/13	2013/14	2014/15	2015/16	2016/17
<b>Active</b>	<b>12,880</b>	<b>14,690</b>	<b>14,589</b>	<b>14,595</b>	<b>14,847</b>
<b>Deferred</b>	<b>5,204</b>	<b>5,320</b>	<b>5,405</b>	<b>5,430</b>	<b>5,577</b>
<b>Pensioner</b>	<b>8,372</b>	<b>8,693</b>	<b>8,995</b>	<b>9,374</b>	<b>9,834</b>
<b>Total</b>	<b>26,456</b>	<b>28,703</b>	<b>28,989</b>	<b>29,399</b>	<b>30,258</b>

<b>Maturity Level</b> (% of Deferred & Pensioner Members to Total Members)	<b>48.82%</b>	<b>49.67%</b>	<b>50.36%</b>	<b>50.93%</b>
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### Split of Membership between Scheduled and Admission Bodies

	2012/13	2013/14	2014/15	2015/16	2016/17
<b>Scheduled</b>	<b>24,045</b>	<b>26,055</b>	<b>26,160</b>	<b>26,311</b>	<b>26,933</b>
<b>Admission</b>	<b>2,411</b>	<b>2,648</b>	<b>2,829</b>	<b>3,088</b>	<b>3,325</b>
<b>Total</b>	<b>26,456</b>	<b>28,703</b>	<b>28,989</b>	<b>29,399</b>	<b>30,258</b>

# Risk Management

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## Overview

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

- the Pension Fund Risk Register
- the Fund's Statement of Investment Principles
- the Corporate and Housing (Finance) Business Continuity Plan

## Risk Register

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

The Pension Fund Risk Register is a standing item at the quarterly meetings of the Pensions Committee and Pension Board. Individual risks and proposed mitigations are identified by the Chief Finance Officer and Pensions Manager with the support of fund advisers. The areas of greatest risk identified were as follows:

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

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

Climate change has been identified by the Fund as a particular risk to asset valuations. The Fund manages this by engaging with its investment managers to ensure they are challenging investee companies on their climate change strategies. Ultimately, if companies do not demonstrate a robust approach to managing this risk, the Fund reserves the right to disinvest.

## Investment Risk

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

Decisions taken during 2016/17, including a reduction in the strategic allocation to equities, a commitment to private debt and an increased commitment to infrastructure are designed reduce investment risk and the Fund's exposure to more volatile assets.

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

Details of the control reports (or equivalent) obtained in 2016/17 are as follows:

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

Investment risk is referred to in the Notes to the Financial Statements. As a consequence, Committee and Board are alerted to risk issues at least twice annually when considering the unaudited and audited accounts. This information can be found in Note 19.

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

# Investment Policy and Performance

## Investment Overview

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

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

During 2016-17, the following investment managers managed the Fund's assets:

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

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

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

## Investment Strategy

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

The current investment strategy has its origins in 2012 when it was agreed that the Fund should diversify its traditional asset base of equities, property and bonds to include alternative assets such as infrastructure.

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

A more recent review of investment strategy concluded that the Fund should have a longer term aspiration of balancing its growth and defensive assets with a view to gradually reducing the Fund's exposure to more volatile asset classes. The review took cognisance of actuarial evidence which indicated that the Fund could reduce its exposure to riskier asset classes without compromising its prospects of reaching fully funded status in the medium to long term.

As a result, the Committee has agreed to:

- to reduce exposure to equities
- to run down the private equity allocation
- to increase the private debt allocation
- to increase the infrastructure allocation
- to invest in a factor based passive vehicle (i.e. "smart beta")

A comparison of the strategic allocation of Fund Assets as at 31 March 2017 and the longer term aspirational allocation is set out below:

Asset Class	Strategic Allocation at 31/3/2017	Projected Long Term Strategic Allocation
<b>Equities</b>	55%	25%
<b>Bonds</b>	10%	20%
<b>Property</b>	10%	15%
<b>Diversified Growth</b>	10%	10%
<b>Private Debt/Equity</b>	5%	5%
<b>Alternatives (incl Infrastructure)</b>	9%	9%
<b>Social/Affordable Housing</b>	1%	1%
<b>Other Real Income Assets</b>	-	15%
<b>Totals</b>	<b>100%</b>	<b>100%</b>

In relation to infrastructure, during 2016/17, the Fund has continued to build out its portfolio, investing in a number of projects in collaboration with the Lothian Pension Fund and increasing its commitment to £100m. The majority of the projects are structured to deliver an inflation linked income stream for the Fund over an extended period (e.g. 25 years). The investments are therefore highly suitable as matching assets for the type of inflation linked liabilities that the Fund incurs.

## Current Positioning

In spite of the significant allocation to alternatives, the sustained bull run in equity markets coupled with sterling's depreciation against major overseas currencies has led to the Fund continuing to be significantly overweight to equities. The table below shows the actual asset allocation at 31 March 2017 against the strategic allocation.

Asset Class	Actual Allocation at 31/3/2017	Strategic Allocation at 31/3/2017	Overweight / Underweight Position
<b>Equities – Active</b>	43%	33%	+10%
<b>Equities – Passive</b>	22%	22%	-
<b>Bonds</b>	8%	10%	-2%
<b>Property</b>	7%	10%	-3%
<b>Diversified Growth</b>	10%	10%	-
<b>Private Debt/Equity</b>	3%	5%	-2%
<b>Alternatives (incl Infrastructure)</b>	5%	9%	-4%
<b>Social/Affordable Housing</b>	1%	1%	-
<b>Cash</b>	1%	-	1%
<b>Totals</b>	<b>100%</b>	<b>100%</b>	-

Since 31 March 2017, the overweight position has been partially reduced by taking back £60m from one of the equity managers. This will be used in the coming months to fund further infrastructure deals and to re-invest into property.

The Fund will generally hold a minimum of 1% of assets as liquid cash in anticipation of private equity and infrastructure capital calls and higher than expected benefit payments. However, the “locking in” of £60m from the equity outperformance recently means that cash holdings in the short term will be higher than normal.

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

## Investment Monitoring

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

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

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

## Investment Performance

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

	2016/17 %	3 years % per annum	5 years % per Annum	Inception % per annum
<b>Fund Return</b>	20.0%	11.4%	11.4%	8.0%
<b>Benchmark Return</b>	18.4%	10.0%	9.5%	7.5%
<b>Excess</b>	1.6%	1.4%	1.9%	0.5%

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

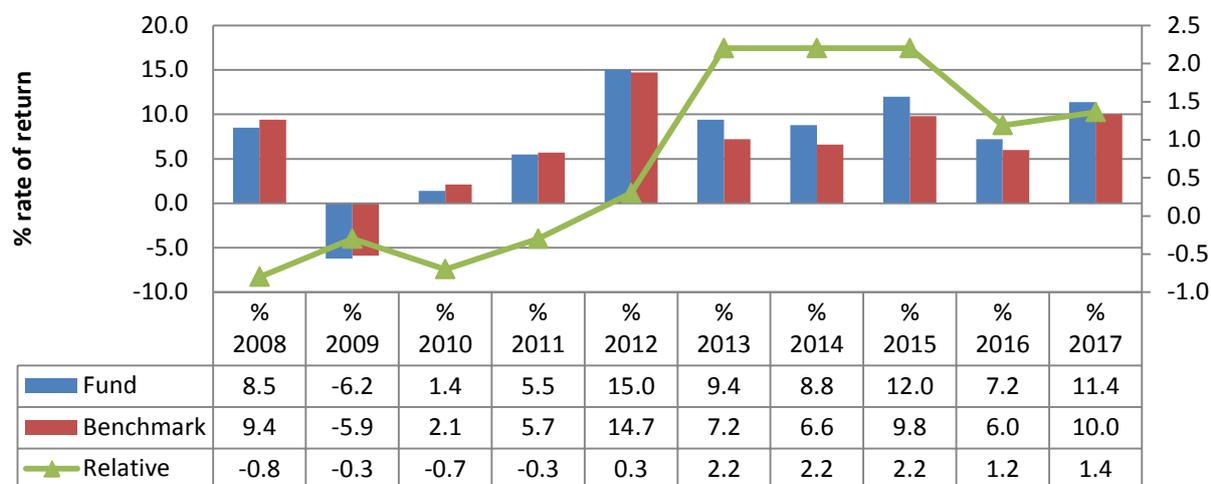
The Fund's performance remains ahead of benchmark across all time periods. The table below compares Fund returns with an indicator of inflation.

	2016/17 %	3 years % per annum	5 years % per annum	Inception % per annum
<b>Fund Return</b>	20.0%	11.4%	11.4%	8.0%
<b>Retail Price Index</b>	3.1%	1.9%	2.4%	3.5%
<b>Consumer Price Index</b>	2.3%	0.9%	1.5%	2.5%
<b>National Average Earnings</b>	2.4%	2.9%	1.9%	2.9%

\* Inception date 30/09/2001

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

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



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

	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
	%	%	%	%	%	%	%	%	%	%
<b>Fund</b>	8.5	-6.2	1.4	5.5	15.0	9.4	8.8	12.0	7.2	11.4
<b>Benchmark</b>	9.4	-5.9	2.1	5.7	14.7	7.2	6.6	9.8	6.0	10.0
<b>Relative</b>	-0.8	-0.3	-0.7	-0.3	0.3	2.2	2.2	2.2	1.2	1.4

## Manager Returns

The Fund's investment managers had the following performance against benchmark over 2016/17:

Fund Manager	Mandate	1 Year %	Benchmark %	Excess %
Aberdeen Asset Management	Global Equities – Active	29.4	33.0	-3.6
Baillie Gifford	Fixed Interest	11.8	11.1	+0.7
Baillie Gifford	Diversified Growth	10.9	0.5	+10.4
Hearthstone	Affordable Housing	-3.2	5.1	-8.3
Legal & General	Global Equities – Passive	29.6	29.3	+0.3
Newton Inv. Management Ltd	Global Equities – Active	22.2	32.2	-10.0
Schroder Inv. Management Ltd	UK Equities – Active	24.3	22.0	+2.3
Schroder Inv. Management Ltd	Property	3.0	3.7	-0.7
Alternatives	Private Equity/Infrastructure	13.9	5.1	+8.8

n.b. (i) The Legal and General Fundamental Weighting mandate has been running less than a year and is therefore not listed above  
(ii) Alternatives include UK and Global Infrastructure and Private Equity

## Comments on 2016/17 Manager Performance

- The overall Fund return of 20% in 2016/17 was underpinned by strong absolute performances from the equity managers and creditable performances from the Bond, Diversified Growth and Alternatives mandates, albeit not all equity managers matched their target benchmarks. Returns from the property related mandates were muted.
- Most managers benefited from buoyant markets driven upwards by the combination of the continued low interest rate environment, the depreciation in sterling following the Brexit vote, and the prospects of a reflationary stimulus to the US economy following the election of President Trump.
- One year is a very short period over which to measure manager performance. When reviewing mandates the Committee will always consider longer term performance (e.g. over a complete an economic cycle).
- **Aberdeen** delivered an improved performance in 2016/17 with a return of almost 30%. Benchmark performance was affected by the manager being underweight to North America and the Financials and Energy Sectors as well as being overweight in Consumer Staples and Healthcare. Historically, returns over 3 and 5 years have been around 10%, however, this has fallen short of the benchmark by 5%. Mindful of the costs of transitioning assets to a new manager and the dangers of being a forced seller, the Committee has retained Aberdeen thus far. Nonetheless, the Fund will be maintaining a close watch on performance in 2017/18 and on developments following Aberdeen's merger with Standard Life. Aberdeen remains committed to its philosophy of sourcing investments in strong cash generative companies undervalued by markets.
- **Baillie Gifford's** fixed interest mandate generated a 11.8% return for the Fund outperforming the benchmark by 0.7%. Returns over 3 and 5 years have been close to the benchmark with the 5 year return being around 8%. The mandate seeks to exploit market inefficiencies in areas of stock selection as well as interest rate and currency strategies. The Fund holds fixed interest securities for their defensive characteristics.
- The Fund also invests in **Baillie Gifford's** Diversified Growth Fund, whose objective is to achieve equity-like returns but with lower-than-equity levels of volatility. The mandate returned over 10% during the year significantly ahead of the UK base rate benchmark. It also achieved its volatility target, albeit that the mandate does appear to have a high correlation with equity markets.
- The **Hearthstone** affordable housing mandate was significantly behind its benchmark. The fund, however, is still in the early years of its 10 year lifespan. The poor returns have mainly been the result of the transactions costs arising from the initial purchase of properties. Notwithstanding the ongoing flow of rental income, returns will be only truly measurable at the end of the fund's life when properties are sold. It is hoped that the new management team at Hearthstone will accelerate deployment of the remaining capital.

- Returns from **Legal and General** were in line with their benchmark.
- Although **Newton** delivered a strong absolute performance of 22%, it lagged its benchmark by 10%. However, returns over both 3 and 5 years are 17% and 15% respectively and ahead of benchmark. The manager seeks to identify long term global themes (e.g. technology, ageing populations) to inform its stock selections. Benchmark performance was hit by the manager being underweight in Financials and Energy and overweight in Consumer Staples and Healthcare. The manager continues to have concerns about the levels of global debt and holds a significant level of cash as a defensive measure.
- The **Schroder** UK Equities mandate, which pursues a value based investment style, achieved a 24% return in 2016/17, comfortably ahead of benchmark. Returns across all time periods have exceeded benchmark (e.g. 13.5% p.a. absolute return v 9.5% benchmark over 5 years) emphasizing the consistency of the manager. The Schroder team has also been vocal recently in expressing concern about the proposed Tesco / Booker merger as to whether it would be in the long term interests of shareholders.
- The **Schroder** property mandate returned 3%, being slightly behind benchmark. Exposure to non-UK European property was a detractor to performance together with the selling down of funds expected to be poorer performers going forward. The Committee continues to explore options for building out the Fund's property holdings.
- The Fund's **alternatives** programme continues to mature as an increasing number of underlying private equity funds are reaching the "harvesting" stage of their life cycle and delivering cash returns as underlying assets are realised. A number of new investments have been made in the UK infrastructure space with a view to minimising fees, delivering long term inflation linked returns and achieving alignment with fund objectives.

## Investment Holdings

The Fund's 10 largest equity holdings at 31/03/2017 are as listed below:

Name of Stock	Market Value as at 31/03/2017	Sector
CENTRICA	£19,493,781	Utilities
HSBC	£17,159,826	Financials
BP	£15,959,788	Energy
ROYAL BANK OF SCOTLAND	£15,817,616	Financials
ROYAL DUTCH SHELL	£15,676,606	Energy
GLAXOSMITHKLINE	£15,019,105	Health Care
JAPAN TOBACCO	£14,975,474	Consumer Staples
BARCLAYS	£14,657,836	Financials
AVIVA	£13,989,435	Financials
NOVARTIS	£13,937,886	Health Care

The scheme rules specify that the maximum holding a fund may have in a single asset is 5% of the total fund value. The Falkirk Fund's largest single holding - in Centrica - is approximately 0.88% of fund value, which is well within the statutory ceiling.

A full list of Fund holdings can be found on the Fund website under Forms and Publications at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org).

# Investment Market Review

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## 2016/17 Review

UK economic growth moderated further in 2016, slowing from 2.2% in 2015 to 1.8% in 2016, with political events dominating the news over the year.

Towards the end of June, the UK voted to leave the European Union, a result which was largely unanticipated by most investors. Global equity markets fell for two days before steadying and recovering most of their ground by the end of the month. However, the pound weakened sharply following the result, declining by almost 15% against the dollar, contributing to an increase in expected inflation over the next year. UK bond markets rose on fears of weaker economic growth.

Anticipating a potential slowdown in the economy, the Bank of England cut interest rates in August to a historic low of 0.25%. Subsequent economic news pointed to the UK economy faring better than expected, with the Bank revising its 2017 growth forecasts upwards from 1.4% in November 2016 to 2.0% in February 2017.

Following the EU referendum, investor attention focused on the November US Presidential election. Having fallen prior to the election, equity markets then recovered strongly following another unexpected result, confounding those that had predicted market turmoil accompanying a Trump victory.

Signalling its confidence in the state of the US economy, the US Federal Reserve raised interest rates during December 2016 and then again in March 2017. While indicating that further rate rises would be likely over the remainder of 2017, the chair of the Federal Reserve Bank also noted that the outlook remained uncertain.

In December, the European Central Bank (ECB) voted to extend its quantitative easing programme by a further nine months to the end of 2017, as estimates suggested inflation would remain below its 2% target in 2019. The Bank of Japan left its bank rate unchanged over the year and maintained its own ongoing quantitative easing programme.

For the 12 months to 31 March 2017, equity market returns for sterling-based investors were boosted by the immediate drop in the currency after the referendum, and then further weakness as investors priced in the likelihood of an unpleasant Brexit in economic terms. Index-linked bonds delivered strong returns over the year, as bond investors also priced in the likelihood of weaker UK economic growth. The weaker UK outlook also contributed to subdued returns from UK property, with rental income offsetting a small decline in capital values.

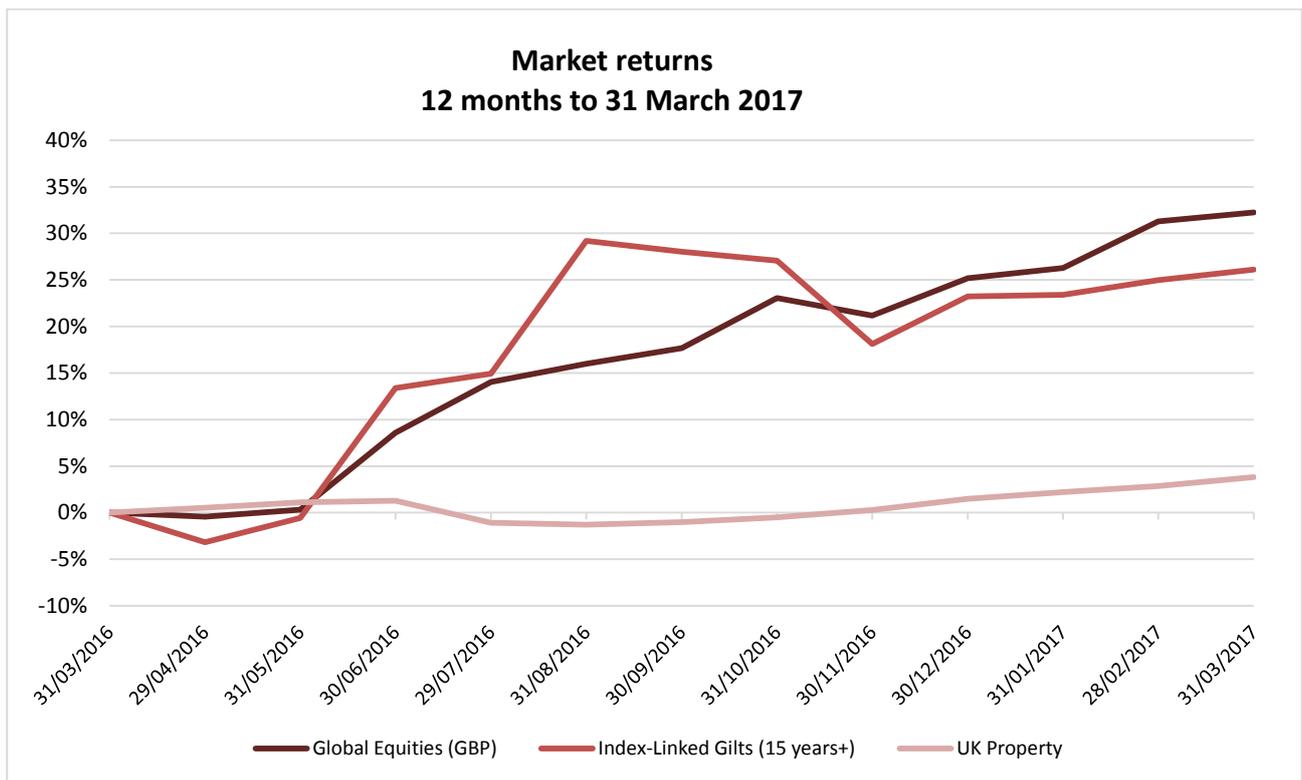
## Outlook

The outlook for the global economy – steady developed market growth and mixed conditions across emerging markets – has remained broadly constant over the past year. Recent divergence in central bank monetary policy suggests the US is ahead of the rest of the world in its economic cycle. President Trump’s pre-election promises of higher infrastructure spending and tax reform has been positive for equities but negative for US bonds.

However, the prospect of the US turning inwards to support its domestic economy also looms, which would be negative for global growth and raise the risk of a global recession.

The year ahead also sees potential for further surprises on the political front, most notably in Europe, where elections in France, the UK, and Germany take place.

The chart below compares the returns from Global Equities, UK Index Linked Gilts and UK Property over 2016/17.



# Corporate Governance

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## Overview

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

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

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

## Local Authority Pension Funds Forum

During 2016/17, LAPFF engaged with major companies on a diverse range of issues, including tax transparency, climate change, executive pay, bankers' bonuses, gender balance, accounting standards and working conditions in emerging markets. Engagement is invariably at a personal level between LAPFF office bearers and company chairs and senior executives.

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

## Voting

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

During 2016/17, PIRC voted at 130 company meetings on 1,892 resolutions with 1,175 votes being cast in favour of resolutions, 536 opposed, 181 being mainly abstentions or withheld votes. The breakdown of votes by geography and category is set out overleaf.

<b>Number of meetings voted by geographical location</b>	<b>Q2 2016</b>	<b>Q3 2016</b>	<b>Q4 2016</b>	<b>Q1 2017</b>	<b>Total</b>
UK & British Overseas	29	11	2	3	45
Europe & Global EU	13	1	0	2	16
USA & Canada	30	1	6	8	45
Rest of the world	14	2	4	4	24
	<b>86</b>	<b>15</b>	<b>12</b>	<b>17</b>	<b>130</b>

<b>Number of Resolutions by Vote Categories</b>	<b>Q2 2016</b>	<b>Q3 2016</b>	<b>Q4 2016</b>	<b>Q1 2017</b>	<b>Total</b>
For	858	137	77	103	1,175
Abstain	56	12	4	20	92
Oppose	405	33	37	61	536
Non-Voting	22	0	1	0	23
Withhold	47	0	7	6	60
US Frequency Vote on Pay	0	0	0	6	6
	<b>1,388</b>	<b>182</b>	<b>126</b>	<b>196</b>	<b>1,892</b>

## Voting Themes

Areas where “oppose” votes were regularly cast included remuneration policies and executive pay, share buybacks, governance, and auditor independence.

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

## Stewardship Code

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

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

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

**Falkirk Council Pension Fund  
Audited Statement of  
Accounts  
2016/17**

# Statement of Responsibilities

## Administering Authority's Responsibilities

The Authority is required to:

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

I confirm that these Annual Accounts were approved for signature by the Falkirk Council Pension Fund Committee at its meeting on 21 September 2017.



**Councillor Tom Coleman**  
**Convener of Falkirk Council Pensions Committee**

## Chief Finance Officer Responsibilities

The Chief Finance Officer is responsible for the:

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

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

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

The Chief Finance Officer has also:-

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

## Certificate by the Chief Finance Officer

I certify that the financial statements give a true and fair view of the financial position of the Pension Fund as at 31 March 2017 and the transactions of the Pension Fund for year ended 31 March 2017.

A handwritten signature in blue ink, appearing to read 'Bryan Smail', with a horizontal line underneath.

**Bryan Smail, CPFA MBA**  
**Chief Finance Officer**  
**21 September 2017**

# Independent Auditor's Report

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

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice approved by the Accounts Commission, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

### **Report on the audit of the financial statements**

#### **Opinion on financial statements**

We certify that we have audited the financial statements in the annual accounts of Falkirk Council Pension Fund for the year ended 31 March 2017 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Fund Account, the Net Assets Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the 2016/17 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the financial transactions of the fund during the year ended 31 March 2017 and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

#### **Basis of opinion**

We conducted our audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standards for Auditors, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## **Responsibilities of the Chief Finance Officer for the financial statements**

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Chief Finance Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## **Auditor's responsibilities for the audit of the financial statements**

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require us to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the fund and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Finance Officer; and the overall presentation of the financial statements.

Our objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

## **Other information in the annual accounts**

The Chief Finance Officer is responsible for the other information in the annual accounts. The other information comprises the information other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission to the extent explicitly stated later in this report.

In connection with our audit of the financial statements in accordance with ISAs (UK&I), our responsibility is to read all the financial and non-financial information in the annual accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

## **Report on other requirements**

### **Opinions on other prescribed matters**

We are required by the Accounts Commission to express an opinion on the following matters.

In our opinion, based on the work undertaken in the course of the audit

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003;
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016); and
- the information given in the Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2014.

### **Matters on which we are required to report by exception**

- We are required by the Accounts Commission to report to you if, in our opinion:
- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

CAREEN L GRAY

Careen Gray,

for and on behalf of Ernst & Young LLP, Appointed Auditor

5 George Square, Glasgow G2 1DY

21 September 2017

## PENSION FUND ACCOUNT

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

<b>2015/16 £'000</b>	<b>Dealings with members, employers and others directly involved in the fund</b>	<b>2016/17 £'000</b>	<b>Note</b>
(80,163)	Contributions	(82,190)	8
(1,730)	Transfers from other pension funds	(5,211)	9
(81,893)		(87,401)	
63,169	Benefits	66,098	10
2,203	Payments to and on account of leavers	2,893	11
65,372		68,991	
<b>(16,521)</b>	<b>Net (additions)/withdrawals from dealing with members</b>	<b>(18,410)</b>	
10,773	Management expenses	10,931	12
<b>(5,748)</b>	<b>Net (additions)/withdrawals including fund management expenses</b>	<b>(7,479)</b>	
	<b>Returns on investments</b>		
(30,306)	Investment income	(32,103)	13
1,835	Taxes on income	1,915	14a
(3,386)	Profit and losses on disposal of investments and changes in market value of investments	(343,707)	15a
<b>(31,857)</b>	<b>Net return on investments</b>	<b>(373,895)</b>	
<b>(37,605)</b>	<b>Net (increase)/decrease in the net assets available for benefits during the year</b>	<b>(381,374)</b>	
<b>1,799,846</b>	<b>Opening Net Assets as at 1 April 2016</b>	<b>1,837,451</b>	
<b>1,837,451</b>	<b>Closing Net Assets as at 31 March 2017</b>	<b>2,218,825</b>	

## PENSION FUND NET ASSETS STATEMENT

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

2015/16 £'000		2016/17 £'000	Note
1,832,638	Investment assets	2,249,480	15
(1,324)	Investment liabilities	(38,666)	15
1,831,314	<b>Total net investments</b>	2,210,814	
75	Non-current assets	37	22
10,667	Current assets	10,914	23
(4,605)	Current liabilities	(2,940)	24
<b>1,837,451</b>	<b>Net Assets of the fund available to fund benefits at the period end</b>	<b>2,218,825</b>	

The Fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end. The actuarial present value of promised retirement benefits is disclosed in Note 21.

The unaudited accounts were issued on 29 June 2017 and the audited accounts were authorised for issue on 21 September 2017. The Statements of Accounts present a true and fair view of the financial position of the Pension Fund as at 31 March 2017 and their income and expenditure for the year ended 31 March 2017.



**Bryan Smail, CPFA MBA**  
**Chief Finance Officer**  
**21 September 2017**

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

### **Introduction**

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

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

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

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

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

Administration of the Falkirk Council Pension Fund is undertaken by an in-house team who oversee the benefits of contributors, deferred members and pensioners on behalf of Clackmannanshire, Falkirk and Stirling Councils, as well as around 30 other employers. Teachers, Police and Firefighters do not come within the scope of the LGPS as they have their own national pension arrangements. A full list of employers who participate in the Falkirk Council Pension Fund is included in this report in Appendix 2.

## Membership

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

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

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

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

Full details of membership numbers are contained on Page 29 of the Annual Report.

## Benefits

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

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

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

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

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

## Funding

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

Employer contributions are based on the results of a three yearly actuarial funding valuation. The last completed valuation was at 31 March, 2014. For the majority of fund employers, contribution rates are in the range 17% – 22% of pensionable pay. A copy of the 2014 Valuation Report can be found at [www.falkirkpensionfund.org](http://www.falkirkpensionfund.org) in the Forms and Publications Section. A Fund valuation as at 31 March 2017 is currently being conducted.

## 2. Prior Year Adjustment

During the year, the Fund has changed its accounting policy in relation to the treatment of indirect fees deducted from investment capital. As such, a restatement of the 2015/16 results is required.

Last year, indirect fees deducted from capital were included in the reported management fees. Following revised guidance from CIPFA (i.e. "Accounting for Local Government Pension Scheme Management Expenses") issued in June 2016, the Fund now only recognises in the accounts expenses directly invoiced by investment managers and fees payable to fund managers that are deducted from fund assets. Indirect fees occurring from fund of funds structures are disclosed in the notes to the accounts.

As a result of the restatement, reported 2015/16 management fees have been reduced by £1.9m. The Fund's Profit and Loss on disposal of investment and changes in market values of investments have also been reduced by £1.9m. The restated values are shown in Notes: 12, 12A and 15A.

	<b>2015/16 Balance as previously reported £'000</b>	<b>Adjustment £'000</b>	<b>Reclassification of withholding tax from management expenses to Note 14a £'000</b>	<b>2015/16 Restated Balance £'000</b>
Profit and losses on disposal of investments and changes in market value of investments	5,336	1,950	-	3,386
Management expenses	12,930	(1,950)	(207)	10,773

### 3. Basis of Preparation

The Statement of Accounts summarises the Fund's transactions for the 2016/17 financial year and its position at year-end as at 31 March 2017.

The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Fund and report on the net assets available to pay pension benefits.

The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year.

### 4. Summary of Significant Accounting Policies

#### Fund account - revenue recognition

##### a) Contribution income

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

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

Employers' pension strain contributions are accounted for in the period in which the liability arises. Any amount due in year but unpaid will be classed as a current financial asset. Amounts not due to be paid until future years are classed as long-term financial assets.

##### b) Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund and are calculated in accordance with the Local Government Pension Scheme regulations and guidance from the Government Actuary. Individual transfers in/out are accounted for when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers In.

**c) Investment income**

i) *Interest income*

Interest income is recognised in the Fund Account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii) *Dividend income*

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iii) *Distributions from pooled funds*

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iv) *Property related income*

Property-related income consists primarily of rental income.

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

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

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

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

**Fund account - expense items**

**d) Benefits payable**

Pensions and lump sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

**e) Taxation**

The Fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a Fund expense as it arises.

**f) Management Expenses**

The Code does not require any breakdown of pension fund administrative expenses. However, in the interest of greater transparency, the fund discloses its pension fund management expenses in accordance with CIPFA's "Accounting for Local Government Pension Scheme Management Expenses (2016)".

*Administrative Expenses*

All administration expenses are accounted for on an accruals basis. All staff costs of the pensions administration team are charged direct to the fund. Associated management, accommodation and other overheads are apportioned to this activity and charged as expenses to the fund.

*Oversight and Governance Costs*

All oversight and governance expenses are accounted for on an accruals basis. All staff costs associated with governance and oversight are charged direct to the fund. Associated management, accommodation and other overheads are apportioned to the activity and charged as expenses to the fund.

*Investment Management Expenses*

All investment management expenses are accounted for on an accruals basis

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly these are based on the market value of the investments under their management and therefore increase or reduce as the value of the investments change.

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

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

## Net assets statement

### g) Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the fund becomes party to the contractual acquisition of the asset.

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

The values of investments as shown in the net assets statement have been determined at fair value in accordance with the requirements of the Code and IFRS 13. For the purpose of disclosing levels of fair value hierarchy, the fund has adopted the classification guidelines recommended in “Practical Guidance on Investment Disclosures” (PRAG/Investments Association, 2016) (see Note 17).

### h) Freehold and leasehold properties

The Fund’s direct property holding was valued at 31 March 2017 in accordance with the requirements of the RICS Valuation Standards 2014 UK Edition (the “Red Book”). The CIPFA code prescribes that investment properties are to be valued at Fair Value, but also at “highest and best use” following the specification in IFRS13. The valuation took this into account.

### i) Foreign currency transactions and balances

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of transaction. End-of-year spot market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchases and sales outstanding at the end of the reporting period.

### j) Derivatives

Some of the Fund’s external managers use derivative financial instruments to manage the Fund’s exposure to specific risks arising from their investment activities. None of the derivatives are held for speculative purposes (see Note 16).

### k) Cash and cash equivalents

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

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

**l) Financial liabilities**

The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net assets statement on the date the Fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised by the Fund.

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

The actuarial present value of promised retirement benefits of the Fund is assessed on an annual basis by the Fund Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under the Code, the Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statements (Note 21).

**n) Additional voluntary contributions**

The Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. The Fund has appointed Standard Life and Prudential to act as joint AVC providers. AVCs are paid to the AVC Provider by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

In accordance with regulation 4(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, AVCs are not included in the pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed in Note 25.

**o) Contingent assets and contingent liabilities**

A contingent liability arises where an event has taken place prior to the year-end giving rise to a possible financial obligation whose existence will only be confirmed or otherwise by the occurrence of future events. Contingent liabilities can also arise in circumstances where a provision would be made, except that it is not possible at the balance sheet date to measure the value of the financial obligation reliably.

A contingent asset arises where an event has taken place giving rise to a possible asset whose existence will only be confirmed or otherwise by the occurrence of future events.

Contingent assets and liabilities are not recognised in the net assets statement but are disclosed by way of narrative in the notes.

## 5. Critical Judgement in Applying Accounting Policies

### Pension Fund Liability

The net pension fund liability is recalculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines.

The estimate is subject to significant variances based on changes to the underlying assumptions which are agreed with the actuary and have been summarised in Note 20.

These actuarial revaluations are used to set future contributions rate and underpin the fund's most significant investment management policies, for example in terms of the balance struck between longer term investment growth and short term return.

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

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

The items in the net assets statement at 31 March 2017 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

### **(i) Actuarial present value of promised retirement benefits (Note 21)**

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in inflation, retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied.

The table below highlights the approximate impact that a small change in the assumptions used would have on the liability of the Fund.

Change in assumptions at 31 March 2017	Approximate % increase in liabilities	Approximate monetary amount (£m)
0.5% decrease in Real Discount Rate	11%	381
0.5% increase in the Salary Increase Rate	3%	112
0.5% increase in the Pension Increase Rate	8%	258

**(ii) Private equity/infrastructure investments (Note 17)**

Private equity and infrastructure investments are valued at fair value in accordance with “International Private Equity and Venture Capital Valuation Guidelines (2012)”. These investments are not publicly listed and such there is a degree of estimation involved in the valuation.

Private equity and infrastructure investments are valued at in the financial statements at £185m. There is a risk that these investments may be under or overstated in the accounts by £27.6m.

**(iii) Freehold and leasehold property, pooled property funds (Note 17)**

Valuation techniques are used to determine the carrying amount of pooled property funds and directly held freehold and leasehold property. Where possible these valuation techniques are based on observable data, but where this is not possible management uses the best available data. Changes in the valuation assumptions used, together with significant changes in rental growth, vacancy levels or discount rate could affect the fair value of property.

The effect of variations in the factors supporting the valuation would be an increase or decrease in the value of directly held property by £0.2m on a fair value of £2.5m.

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

The unaudited Statement of Accounts were issued by the Chief Finance Officer on 29 June 2017 and the audited Statement of Accounts were authorised for issue on 21 September 2017. Events taking place after this date are not reflected in the financial statements or notes. There have been no material events since the date of the Net Asset Statement which have required the figures in the financial statements and notes to be adjusted.

## 8. Contributions Receivable

### By Category

2015/16 £'000		2016/17 £'000
17,888	Employees' normal contributions	17,944
60,304	Employers' normal contributions (incl. strain)	62,032
1,971	Employers' deficit recovery contributions	2,214
<b>80,163</b>	<b>Total</b>	<b>82,190</b>

### By Authority

2015/16 £'000		2016/17 £'000
27,550	Administering authority	27,840
43,770	Other scheduled bodies	45,227
8,634	Admission bodies	8,927
209	Transferee admission body	196
<b>80,163</b>	<b>Total</b>	<b>82,190</b>

## 9. Transfers from Other Pension Funds

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

2015/16 £'000		2016/17 £'000
1,730	Individual transfers	5,211

## 10. Benefits Payable

### By Category

2015/16 £'000		2016/17 £'000
47,414	Pensions	49,685
14,438	Commutation and lump sum retirement benefits	15,286
1,317	Lump sum death benefits	1,127
<b>63,169</b>	<b>Total</b>	<b>66,098</b>

## By Authority

2015/16 £'000		2016/17 £'000
23,858	Administering authority	21,898
36,193	Other scheduled bodies	40,813
3,106	Admission bodies	3,359
12	Transferee admission body	28
<b>63,169</b>	<b>Total</b>	<b>66,098</b>

## 11. Payments to and on account of leavers

2015/16 £'000		2016/17 £'000
469	Refunds to members leaving service	310
1,734	Individual transfers	2,583
<b>2,203</b>	<b>Total</b>	<b>2,893</b>

## 12. Management Expenses

2015/16 £'000		2016/17 £'000
855	Administrative costs	582
9,394	Investment management expenses	9,791
524	Oversight and Governance Costs	558
<b>10,773</b>	<b>Total</b>	<b>10,931</b>

Due to changes in accounting policy, the 2015/16 expenses were restated (Note 2).

## 12a. Investment Management Expenses

2015/16 £'000		2016/17 £'000
4,840	Management fees invoiced	4,398
3,311	Management fees deducted from capital	3,867
871	Transaction costs	956
255	Performance related fees	404
117	Custody fees	145
-	Other	21
<b>9,394</b>	<b>Total</b>	<b>9,791</b>

In addition to fees disclosed in this note, the Fund also incurred indirect management fees resulting from investments in fund of funds structures. The estimated value of these fees in 2016/17 is £3.7m (£1.9m in 2015/16).

## 13. Investment Income

2015/16 £'000		2016/17 £'000
22,404	Income from equities	23,664
-	Income from bonds	(118)
1,880	Private equity income	989
5,238	Pooled property investments	5,392
220	Pooled investments – unit trusts and other managed funds	143
190	UK Property	182
49	Infrastructure	1,585
325	Cash & other income	266
<b>30,306</b>	<b>Total</b>	<b>32,103</b>

The negative balance shown under “income from bonds” relates to income that is due to the previous owner of the bonds.

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

## 14. Other Fund Account Disclosures

### 14a. Taxes on Income

2015/16 £'000		2016/17 £'000
(1,494)	Withholding tax-equities	(1,577)
(134)	Withholding tax-pooled property investments	(141)
(207)	Withholding tax-private equity	(197)
<b>(1,835)</b>	<b>Total</b>	<b>(1,915)</b>

### 14b. External Audit Costs

2015/16 £'000		2016/17 £'000
23	Payable in respect of external audit	20

## 15. Investments

Market Value 31/03/16 £'000	Investment Assets	Market Value 31/03/17 £'000
	<b>Investment Assets</b>	
0	Bonds	1,552
690,588	Equities	818,939
767,046	Pooled investments	905,873
139,207	Managed property funds	142,819
137,582	Private equity/infrastructure	187,695
2,300	Property (West Mains)	2,500
126	Derivatives – Options	76
	<b>Cash Deposits</b>	
13,396	Other balances	27,142
77,157	Deposits	80,613
	<b>Other Investment Balances</b>	
3,728	Debtors – investment income due	3,359
1,508	– due from broker	78,912
<b>1,832,638</b>	<b>Total Investment Assets</b>	<b>2,249,480</b>
	<b>Investment Liabilities</b>	
(1)	Derivatives – forward foreign exchange	(123)
(1,323)	Creditor – due to broker	(38,543)
(1,324)	<b>Total Investment Liabilities</b>	(38,666)
<b>1,831,314</b>	<b>Net Investment Assets</b>	<b>2,210,814</b>

During 2016/17, the value of the Fund's holdings in pooled investments increased significantly due to an allocation being made to a factor based pooled fund with Legal and General. In addition, the Fund's Fixed Income and Diversified Growth Holdings, held as throughout 2016/17 pooled investments were transferred on a pound for pound basis from Life Policies with Baillie Gifford Life Ltd to holdings in Open Ended Investment Company Funds with Baillie Gifford.

## 15a. Reconciliation of movements in investments and derivatives

Period 2016/17 Investment Assets	Market Value 01/04/16 £'000	Purchases at Cost £'000	Sale Proceeds £'000	Change in Market Value £'000	Market Value 31/03/17 £'000
Bonds	0	3,480	0	(1,928)	1,552
Equities	690,588	221,831	(254,207)	160,727	818,939
Pooled investments	767,046	1,063,510	(1,076,205)	151,522	905,873
Managed property funds	139,207	12,400	(9,941)	1,153	142,819
Private equity/infrastructure	137,582	63,969	(39,746)	25,890	187,695
Property (West Mains)	2,300	-	-	200	2,500
Derivatives					
- Exchange traded futures	-	471	0	(395)	76
- Forward foreign exchange	125	1,149	(2,536)	1,139	(123)
	<u>1,736,848</u>	<u>1,366,810</u>	<u>(1,382,634)</u>	338,308	2,059,331
Deposits	77,157			5,263	80,613
Other balances	13,396			136	27,142
Broker balance	185			-	40,369
Investment income due	3,728			-	3,359
<b>Net Investment Assets</b>	<b><u>1,831,314</u></b>			<b><u>343,707</u></b>	<b><u>2,210,814</u></b>

## Reconciliation of movements in investments and derivatives

Period 2015/16 Investment Assets	Market Value 01/04/15 £'000	Purchases at Cost £'000	Sale Proceeds £'000	Change in Market Value £'000	Market Value 31/03/16 £'000
Equities	686,664	257,333	(234,385)	(19,024)	690,588
Pooled investments	768,796	4,857	(5,512)	(1,095)	767,046
Managed property funds	124,536	4,878	(326)	10,119	139,207
Private equity/infrastructure	127,202	30,695	(32,497)	12,182	137,582
Property (West Mains)	2,300	-	-	-	2,300
Derivatives					
- Exchange Traded Futures	-	--	-	-	-
- Forward foreign exchange	(1)	246	(583)	463	125
	<u>1,709,497</u>	<u>298,009</u>	<u>(273,303)</u>	2,645	<u>1,736,848</u>
Deposits	62,133			741	77,157
Other Balances	18,860			-	13,396
Broker balance	(2,295)			-	185
Investment income due	2,806			-	3,728
<b>Net Investment Assets</b>	<b><u>1,791,001</u></b>			<b><u>3,386</u></b>	<b><u>1,831,314</u></b>

The reconciliation of movements in investments and derivatives for the period 2015/16 has been restated to reflect 2016/17 changes in accounting policies in relation to management costs. Indirect costs incurred through funds of funds investments have been removed from the purchases resulting in a reduction in the reported change in market value during the year (See Note 2).

## 15b. Analysis of Investments

31/03/16 £'000		31/03/17 £'000
0	<b><u>UK Corporate Bonds</u></b>	1,552
	<b><u>Quoted Equities</u></b>	
271,743	UK	329,553
418,845	Overseas	489,386
<b>690,588</b>		<b>818,939</b>
	<b><u>Pooled funds</u></b>	
141,768	Equities – UK	144,348
241,703	– Overseas	335,228
142,934	Bonds – UK	124,158
13,278	– Overseas	50,466
204,213	Diversified growth	226,372
23,150	Social & affordable housing	25,301
<b>767,046</b>		<b>905,873</b>
	<b><u>Property</u></b>	
134,988	Pooled Property Funds – UK	139,724
4,219	– Overseas	3,095
2,300	Direct UK (West Mains)	2,500
<b>141,507</b>		<b>145,319</b>
	<b><u>Private Equity</u></b>	
66,321	Pooled UK and Overseas Funds	68,709
<b>66,321</b>		<b>68,709</b>
	<b><u>Private Debt</u></b>	
10,190	Pooled UK Funds	4,782
<b>10,190</b>		<b>4,782</b>
	<b><u>Infrastructure</u></b>	
15,739	Pooled Infrastructure Funds – UK	53,528
45,333	– Overseas	60,676
<b>61,072</b>		<b>114,204</b>
126	<b><u>Derivatives</u></b>	76
90,552	<b><u>Cash deposits &amp; other balances</u></b>	107,755
3,728	<b><u>Investment income due</u></b>	3,359
1,508	<b><u>Amounts due from broker</u></b>	78,912
<b>1,832,638</b>	<b>Total investment assets</b>	<b>2,249,480</b>
	<b><u>Investment liabilities</u></b>	
(1)	Derivatives	(123)
(1,323)	Amounts due to broker	(38,543)
<b>(1,324)</b>	<b>Total investment liabilities</b>	<b>(38,666)</b>
<b>1,831,314</b>	<b>Net investment assets</b>	<b>2,210,814</b>

## 15c. Investments Analysed By Fund Manager

MARKET VALUE 31 March 2016			MARKET VALUE 31 March 2017	
£'m	(%)		£'m	(%)
223	12.3	Aberdeen Asset Management	289	13.1
156	8.6	Baillie Gifford & Co Ltd – Bonds	175	7.9
204	11.2	Baillie Gifford & Co Ltd – Diversified Growth	226	10.3
371	20.4	L&G Investment Management Ltd – Passive	371	16.8
-	-	L&G Investment Management - Fundamental Weighting	109	5.0
300	16.5	Newton Investment Management Ltd	365	16.6
229	12.6	Schroder Investment Management Ltd	285	13.0
141	7.8	Schroder Investment Management Ltd (Property)	147	6.7
36	2.0	SL Capital Partners LLP	37	1.7
30	1.7	Wilshire Private Markets Group	32	1.5
10	0.6	M&G UK Companies	5	0.2
23	1.3	Hearthstone	25	1.2
45	2.5	Grosvenor Capital	61	2.8
10	0.6	Ancala Partners	25	1.2
3	0.1	Dalmore	11	0.5
-	-	Equitix Investment Management	12	0.5
3	0.1	FIM Harburnhead LP	3	0.1
-	-	UBS/Greensands	6	0.3
33	1.7	In House Cash	13	0.6
<b>1,817</b>	<b>100.0</b>	<b>Total</b>	<b>2,197</b>	<b>100.0</b>

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

	31 March 2016		31 March 2017	
	£'000	%	£'000	%
Baillie Gifford Diversified Growth	204,213	11.2	226,372	10.3
L&G UK Equity Index (OFC)	132,357	7.3	134,546	6.1
L&G N America Equity Index (OFC)	129,162	7.1	125,186	5.7
*Baillie Gifford Sterling Aggregate Bonds	94,327	5.2	-	-

\* Reclassified during 2016/17 within Baillie Gifford & Co Ltd – Bonds.

Regulation 14 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) 2010 (SSI 2010/233) sets the maximum level of investment the fund is allowed to have in a single holding or in unlisted securities.

## 15d. Securities Lending

The Fund did not participate in any stock lending programmes.

## 15e. Property Holdings

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

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

<b>2015/16</b>		<b>2016/17</b>
<b>£'000</b>		<b>£'000</b>
140	Within one year	199
479	Between one and five years	703
303	Later than five years	225
<b>922</b>	<b>Total</b>	<b>1,127</b>

## 16. Analysis of Derivatives

The Fund's approach to derivatives is to allow individual managers to decide to participate in derivative contracts subject to any limits set out in their investment management agreements. At present, only Newton chooses to do so, with derivatives making up 0.01% of their portfolio's value.

<b>Settlement</b>	<b>Currency bought</b>	<b>Local Value</b>	<b>Currency Sold</b>	<b>Local Value</b>	<b>Asset Value</b>	<b>Liability Value</b>
		<b>000</b>		<b>000</b>	<b>£'000</b>	<b>£'000</b>
One to six months	NOK	4,162	USD	(4,285)	0	(123)
<b>Open forward currency contracts at 31 March 2017</b>					<b>0</b>	<b>(123)</b>
<b>Net forward currency contracts at 31 March 2017</b>						<b>(123)</b>

Prior year comparative

<b>Open forward currency contracts at 31 March 2016</b>	<b>126</b>	<b>(1)</b>
<b>Net forward currency contracts at 31 March 2016</b>	<b>125</b>	

## Options

Investment	Expires	Put/call	Notional Holding	Market value at 31 March 2017
				£'000
S&P 500 INDEX	One to three months	Put	389	76

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

## 17. Fair Value – Basis of Valuation

The basis of the valuation of each class of investment asset is set out below. There has been no change in the valuation techniques used during the year. All assets have been valued using fair value techniques which represent the highest and best price available at the reporting date.

Description of asset	Valuation hierarchy	Basis of Valuation	Observable and Unobservable inputs	Key sensitivities affecting the valuations provided
Market quoted investments	Level 1	Published bid market price ruling on the final day of the accounting period	Not required	Not required
Equity derivatives - options	Level 1	Closing bid value on published exchanges	Not required	Not required
Pooled investments – equities, fixed income and property funds	Level 2	Closing bid price where bid and offer price are published  Closing single price where single price published	NAV – based pricing set on a forward pricing basis	Not required
Forward foreign exchange derivatives	Level 2	Market forward exchange rates at the year end	Exchange rate risk	Not required

Directly held property/Social and Affordable Housing	Level 3	Valued at year end in accordance with the RICS Valuation Standards by RICS registered valuer of Falkirk Council (Directly held property) and independent valuer Graham and Sibbald (Social and Affordable Housing)	Existing lease terms and rentals Independent market research Covenant strength for existing tenants	Significant changes in the rental growth, vacancy levels, general changes in the market conditions
Private Equity/Infrastructure	Level 3	Valuation in accordance with the International Private Equity and Venture Capital Valuation Guidelines	Discount rate Projected future cash flow Recent market transactions for similar assets in comparable markets	Changes to the cash flows, differences between audited and unaudited accounts, material events occurring between the date of financial statements provided and the pension fund's own reporting date

### Sensitivity of assets valued at level 3

Having considered historical data and current market trends, and consulted with independent advisors, the fund has determined that the valuation methods described above are likely to be accurate within the following ranges, and has set out below the consequent potential impact on the closing value of investments held at 31 March 2017.

	Assessed valuation range (+/-)	Value at 31 March 2017 in £'000	Value on increase in £'000	Value on decrease in £'000
Infrastructure	15%	114,204	131,335	97,073
Private Debt	11%	4,782	5,308	4,256
Private Equity	15%	68,710	79,017	58,404
Social and Affordable Housing	10%	25,301	27,831	22,771
Property	8%	2,500	2,700	2,300
		<b>215,497</b>	<b>246,191</b>	<b>184,804</b>

## 17a. Fair Value Hierarchy

Assets and liabilities valuations have been classified into three levels, according to the quality and reliability of information used to determine fair values. Transfers between levels are recognised in the year in which they occur.

### Level 1

Assets and liabilities at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as Level 1 comprise quoted equities and an exchange traded derivative.

### Level 2

Assets and liabilities at Level 2 are those where quoted market prices are not available, for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value.

### Level 3

Assets and liabilities at Level 3 are those where at least one input that could have a significant effect on the instruments' valuation is not based on observable market data.

The following table provides an analysis of the financial assets and liabilities of the Fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Total
Values at 31 March 2017	£'000	£'000	£'000	£'000
Financial assets at fair value through profit & loss	819,014	1,027,230	210,710	2,056,954
Non-financial assets at fair value through profit and loss	-	-	2,500	2,500
Financial liabilities at fair value through profit and loss	-	(123)	-	(123)
<b>Net investment assets</b>	<b>819,014</b>	<b>1,027,107</b>	<b>213,210</b>	<b>2,059,331</b>

	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Total
Values at 31 March 2016	£'000	£'000	£'000	£'000
Financial assets at fair value through profit & loss	690,714	883,103	160,732	1,734,549
Non-financial assets at fair value through profit and loss	-	-	2,300	2,300
Financial liabilities at fair value through profit and loss	-	(1)	-	(1)
<b>Net investment assets</b>	<b>690,714</b>	<b>883,103</b>	<b>163,032</b>	<b>1,736,848</b>

The Pension Research Accountants Group (PRAG) published practical guidance for investment disclosures during 2016 in response to FRS 102 amendments of the fair value hierarchy disclosure alignment with IFRS. Consequently £578,681,000 has been reclassified from level 1 to level 2 investments. Additionally investments in directly held property have been amended as a result of changes in the Code.

### 17c. Reconciliation of fair value measurements within Level 3

	Market Value 1 April 2016	Transfers into Level 3	Purchases during the Year	Sales during the year	Unrealised gains/ (losses)	Realised Gains/ (losses)	Market Value 31 March 2017
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Infrastructure	61,072	-	58,907	(17,609)	3,440	6,108	111,917
Private Debt	10,190	-	-	(5,860)	452	-	4,782
Private Equity	66,320	-	5,238	(16,277)	4,657	8,772	68,710
Social & Affordable Housing	23,150	-	3,311	(311)	(849)	-	25,301
Property	-	2,500	-	-	-	-	2,500
	<b>160,732</b>	<b>2,500</b>	<b>67,456</b>	<b>(40,057)</b>	<b>7,700</b>	<b>14,880</b>	<b>213,210</b>

## 18. Financial Instruments

### 18a. Classification of Financial Instruments

The following table analyses the fair value amounts of financial instruments by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 March 2016			31 March 2017		
Fair value through profit & loss £'000	Loans and receivables £'000	Financial liabilities at amortised cost £'000	Fair value through profit & loss £'000	Loans and receivables £'000	Financial liabilities at amortised cost £'000
			<b>Financial Assets</b>		
0			1,552		
690,588			818,939		
767,046			905,873		
139,207			142,819		
137,582			187,695		
126			76		
	94,337			111,484	
	5,236			82,271	
	6,958			7,222	
<b>1,734,549</b>	<b>106,531</b>		<b>2,056,954</b>	<b>200,977</b>	
			<b>Financial Liabilities</b>		
(1)			(123)		
(1,323)			(38,543)		
		(4,605)			(2,940)
<b>(1,324)</b>		<b>(4,605)</b>	<b>(38,666)</b>	<b>-</b>	<b>(2,940)</b>
<b>1,733,225</b>	<b>106,531</b>	<b>(4,605)</b>	<b>2,018,288</b>	<b>200,977</b>	<b>(2,940)</b>
			<b>Total net financial instruments</b>		
			<b>1,835,151</b>	<b>2,216,325</b>	
			<u>2,300</u>	<u>2,500</u>	
			<b>1,837,451</b>	<b>2,218,825</b>	
			<b>Total net assets</b>		

## 18b. Net Gains and Losses on Financial Instruments

31 March 2016 £'000		31 March 2017 £'000
	<b>Financial assets</b>	
2,646	Fair value through profit and loss	336,968
740	Loans and receivables	5,399
	<b>Financial liabilities</b>	
-	Fair value through profit and loss	1,140
-	Financial Liabilities at amortised cost	200
<b>3,386</b>	<b>Total</b>	<b>343,707</b>

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

### Risk and Risk Management

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

### Types of Investment Risk

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

#### (i) Market Risk

Market risk is the risk of loss from fluctuations in equity and other asset prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix.

The objective of the Fund's risk management strategy as it relates to investments is to identify, manage and control market risk exposure within acceptable parameters,

whilst optimising the return on assets. Investment risk is considered further in the Fund's **Statement of Investment Principles**.

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

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

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

(ii) **Interest Rate Risk**

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is recognised by the Administering Authority and its investment advisors. The Fund monitors the interest rate risk faced and will adjust its strategy in accordance with its **Statement of Investment Principles**. The Fund's direct exposure to interest rate movement as at the 31 March 2017 is estimated to be around £479.4m (31 March 2016: £388.6m).

(iii) **Currency Risk**

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Fund (£GBP). The Fund holds both monetary and non-monetary assets denominated in currencies other than £GBP.

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

The Fund's currency exposure as at the 31 March 2017 is estimated to be around £643m (31 March 2016:£551m).

(iv) **Credit Risk**

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's assets and liabilities (as outlined in Market Risk above).

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

The main area where risk is not reflected in a market price is cash deposits which at 31 March 2017 accounted for 5.1% of fund assets (31 March 2016: 4.4%).

<b>Balances at 31 March 2016 £'000</b>		<b>Moody's Credit Rating</b>	<b>Balances at 31 March 2017 £'000</b>
	<b>Held for investment purposes</b>		
36,363	Northern Trust Global Investment Limited – Liquidity Funds	Aaa-mf	68,261
5,002	Standard Life Investment Sterling Liquidity Fund	AAA-mf	5,000
29,686	Northern Trust Company – Cash Deposits	Aaa-mf	28,433
2,010	Santander UK PLC	Aa3	2,016
4,045	Bank of Scotland PLC	A1	4,045
<b>77,106</b>	<b>Total investment cash</b>		<b>107,755</b>
	<b>Held for other purposes</b>		
4,091	Clydesdale Bank	Baa2	4,866
<b>81,197</b>	<b>Total cash</b>		<b>112,621</b>

As part of its approach to managing credit risk, the Fund formalised its Treasury operations during 2016/17 through the implementation of a Cash Management Strategy. These details:

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

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

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

(v) **Liquidity Risk**

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

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

(vi) **Refinancing Risk**

Refinancing risk is the risk that the Fund will be bound to replenish a significant proportion of its Pension Fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments. In any event, the Fund does not have any financial instruments that have a refinancing risk as part of its Pension Fund management and investment strategies.

## **Sensitivity Analysis**

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

Management has sought to address the sensitivity disclosure requirements by considering risk on an aggregated basis. This approach does not provide the extent or detail of disclosures recommended in the Code, however management feels to obtain this information would be disproportionately expensive.

Management considers that the undernoted risk metrics are an appropriate and proportionate basis on which to measure and assess the range of investment risks faced by the Fund.

<b>Asset Type</b>	<b>Potential price movement (+ or -)</b>
Equities – Developed Markets	20.5%
Equities – Emerging Markets	30.0%
Private Equity	30.0%
Commodities	30.0%
Property	13.0%
Infrastructure	18.0%
Corporate Bonds	5.5%
Diversified Credit	11.0%
Fixed Interest Gilts	6.6%
Index-Linked Gilts	10.9%
Cash	1.1%

This sensitivity analysis incorporates volatility from market, interest rate, foreign exchange, credit and all other sources of risk, and more importantly, makes allowance for how these risks may offset each other.

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

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

**Position as at 31 March 2017**

<b>Asset Type</b>	<b>Asset Value (£'m)</b>	<b>Asset Weight</b>	<b>Volatility</b>	<b>Potential Change +/- (£'m)</b>	<b>Value on increase (£'m)</b>	<b>Value on decrease (£'m)</b>
Equities - Developed Markets	1,250.1	56.6%	20.5%	256.3	1,506.5	993.9
Equities - Emerging Markets	89.8	4.1%	30.0%	26.9	116.8	62.9
Private Equity	71.7	3.2%	30.0%	21.5	93.1	50.2
Commodities	1.8	0.1%	30.0%	0.5	2.4	1.3
Property –						
Balanced	186.5	8.4%	13.0%	24.2	210.7	162.3
Infrastructure	131.4	5.9%	18.0%	23.7	155.1	107.7
Corporate Bonds	78.4	3.5%	5.5%	4.3	82.7	74.1
Diversified Credit	88.3	4.0%	11.0%	9.7	98.0	78.6
Fixed Interest Gilts	88.6	4.0%	6.6%	5.9	94.5	82.7
Index-Linked Gilts	34.8	1.6%	10.9%	3.8	38.5	31.0
Cash	189.4	8.6%	1.1%	2.1	191.5	187.3
<b>Total Assets (without correlations)</b>	<b>2,210.8</b>	<b>100.0%</b>	<b>17.1%</b>	<b>378.9</b>	<b>2,589.8</b>	<b>1,832.0</b>
<b>Total Assets (including correlations)</b>	<b>2,210.8</b>		<b>14.8%</b>	<b>326.5</b>	<b>2,537.3</b>	<b>1,884.4</b>
<b>Assets Relative to Liabilities (including correlation)</b>	<b>2,210.8</b>		<b>14.8%</b>	<b>327.8</b>	<b>2,538.7</b>	<b>N/A</b>

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

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

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

The corresponding details as at 31 March 2016 are set out in the table overleaf.

## Position as at 31 March 2016

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

## 20. Funding arrangements

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

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

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

- To use reasonable measure to reduce the risk to other employers and ultimately to the tax payer from an employer defaulting on its pension obligations

The aim is to achieve a funding level of 100% over a period of 20 years; to minimise the downside risk of a poor funding outcome; and to provide stability in employer contributions by spreading any increase in rates over a period of time, normally three years. A deficit recovery plan was built into the contribution rates set by the actuary at the 2014 valuation. More recently, during 2016/17, employers have been made aware of their respective funding positions.

At the 2014 valuation, the Fund was assessed as 85% funded implying a deficit of £283m. A number of employers were identified as being in a deficit situation and a recovery plan was been built into their contribution rates for the period from 1 April 2015 to 31 March 2018 with contribution increases being phased in over a three year period. The common contribution rate (i.e. the rate applicable to the Fund as a whole) was assessed as 23.4% of pay.

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

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

### Financial Assumptions

Assumption	March 2014
Discount Rate	5.1%
Inflation RPI	3.5%
Inflation CPI	2.7%
Pension Increases	2.7%
Pay increases	4.0%

### Longevity Assumptions

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

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

### Commutation Assumption

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

### 50:50 Option

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

### More Information

The Actuary has provided a statement describing the funding arrangements of the Fund during 2016/17. This can be found at Appendix 1 of this report.

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

## 21. Actuarial Present Value of Promised Retirement Benefits

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

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Note 20). The actuary has also valued ill health and death benefits in line with IAS19.

	<b>31 March 2016</b> <b>£'m</b>	<b>31 March 2017</b> <b>£'m</b>
Present value of promised retirement benefits	2,584	3,407
Fair Value of Scheme Assets	1,837	2,219
Net Liability	747	1,188

As noted above, the liabilities are calculated on an IAS19 basis and will therefore differ from the results of the 2014 triennial funding valuation (see Note 20) because IAS19 requires liabilities to be valued according to a specific discount rate rather than a rate which reflects the market rates.

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

<b>IAS19 Assumptions</b>	<b>31 March 2016 % p.a.</b>	<b>31 March 2017 %p.a.</b>
Discount rate	3.5	2.6
Pay increase	3.7	3.9
Price inflation/Pensions increases	2.2	2.4

## 22. Non Current Assets

### Long Term Debtors

**31 March 2016**

**£'000**

75

Strain on Fund Contributions (Due in over 1 year)

**31 March 2017**

**£'000**

37

## 23. Current Assets

**31 March 2016**

**£'000**

4,736

1,446

673

-

28

3,784

**10,667**

### Debtors

Contributions due – employers

Contributions due – members

Strain on fund contribution (due within 1 year)

Transfer values receivable (joiners)

Sundry debtors

**Cash balances**

**Total**

**31 March 2017**

**£'000**

4,823

1,457

696

136

73

3,729

**10,914**

### Analysis of Debtors

**31 March 2016**

**£'000**

1,551

4,349

-

983

**6,883**

Central government bodies

Other local authorities

Public corporations and trading funds

Other entities and individuals

**Total**

**31 March 2017**

**£'000**

1,217

4,904

20

1,044

**7,185**

## 24. Current Liabilities

31 March 2016		31 March 2017
£'000		£'000
(3,086)	Benefits payable	(904)
-	Transfer Values Payable (leavers)	(101)
(1,519)	Miscellaneous creditors and accrued expenses	(1,935)
<b>(4,605)</b>	<b>Total</b>	<b>(2,940)</b>

### Analysis of Creditors

31 March 2016		31 March 2017
£'000		£'000
(8)	Central government bodies	(180)
(10)	Other local authorities	(51)
(1,335)	Public corporations and trading funds	(1,720)
(3,252)	Other entities and individuals	(989)
<b>(4,605)</b>	<b>Total</b>	<b>(2,940)</b>

## 25. Additional Voluntary Contributions

Market Value 31 March 2016		Market Value 31 March 2017
£'000		£'000
2,892	Standard Life	3,138
834	Prudential	2,006
<b>3,726</b>	<b>Total</b>	<b>5,144</b>

AVC contributions of £310k were paid directly to Standard Life (£297k in 2015/16) and £1,252k to Prudential during the year (£698k in 2015/16).

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

## 26. Related Party Transactions

### Falkirk Council

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

The Council incurred costs of £626k (2015/16: £603k) in relation to the administration of the Fund and was subsequently reimbursed by the Fund for these expenses. The Council is also the single largest employer of members of the Pension Fund and contributed £21.9m to the fund in 2016/17 (2015/16: £21.6m).

Transactions between the Council and the Fund are closely monitored with the aim of any balances being settled as soon as reasonably practicable. At 31 March 2017 the Fund owed the Council £1.1m (£307k in 2015-16). This was in respect of invoices processed through the Council's financial system at the end of March 2017 and paid in the new financial year. The balance was settled at the beginning of April 2017.

### Governance

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

## 26a. Key Management Personnel

The key management personnel of the Fund are the Section 95 Officer and Pensions Manager. Total remuneration payable to key management personnel is set out below:

2015/16 £'000		2016/17 £'000
85	Short-term benefits	87
541	Post-employment benefits	603
<b>626</b>	<b>Total</b>	<b>690</b>

## 27. Contingent Liabilities and Contractual Commitments

Outstanding capital commitments (investments) at 31 March 2017 totalled £118m (31 March 2016: £89m).

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

At 31 March 2017 Falkirk Council Pension Fund is exposed to a contingent liability of £11.5k (31 March 2016: £13k) related to abort costs in respect of the co-investment projects with the Lothian Pension Fund. Contingent liabilities are not recognised in the net assets statement.

## 28. Contingent Assets

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

### **Introduction**

Falkirk Council Pension Fund operates within the terms of the Local Government Pension Scheme.

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

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

### **Pension Fund Governance Framework**

The LGPS regulations require Funds to publicise their governance arrangements in a Governance Compliance Statement. The current governance model is set out in full at Page 20 of the 2016/17 Fund Annual Report and Accounts. The Pensions Committee has also agreed that a revised governance model should apply from the start of 2017/18. Reference to the new model is made in the foreword to this year's Annual Report. The changes will be incorporated within a revised governance compliance statement in early Autumn, 2017.

### **Scope of Responsibility**

Under the Scheme of Delegation, the Pensions Committee is responsible for Fund business including regulatory compliance and monitoring the implementation of audit recommendations.

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

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

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

- *adequacy of funding* is assessed through the triennial valuation process, with regular funding updates being provided to the Pensions Committee;

- records of *investment transactions* are maintained by the Fund's external investment managers and global custodian and reconciled by the Pensions team on a regular basis;
- *pension payments* and other financial transactions are initially processed by Pensions Assistants and authorised independently by senior officers; the Fund also subscribes to a specialist technical resource to help resolve complex pensions questions;
- the Council's Information Governance framework exists to enable *data to be securely managed*.

### **Control Environment**

Given the role of the external investment managers, it is essential that the Fund obtains assurances on the adequacy of the internal financial control systems operated by them. The main source of this assurance is the annual audit report produced by each of the managers' independent service auditors and the global custodian, the latter being responsible for the safekeeping and servicing of the Fund's assets. Fund officers review these reports and, on an exceptions basis, report any concerns to the Pensions Committee. Details of the reports obtained are listed on Page 31 of the Annual Report. Separately, officers of the Pension Fund (and seconded colleagues from the Lothian Pension Fund) meet at least annually with fund managers to gain assurance around the safeguarding of assets and resilience of systems.

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

In order to ensure compliance with scheme rules and reduce the risk of incorrect payments being made, the Fund operates a pensions administration system maintained by a specialist software vendor. The system is used by all other Scottish local authorities.

To support its overall framework of control, the Council has a Code of Conduct for Members and Officers, with all Members being required to apply the Standards Commission Scotland's Councillors' Code of Conduct. Contract Standing Orders and Financial Regulations which regulate financial and transactional activity have been reviewed and updated within the last two years to take account of evolving systems and emerging risks.

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

The Fund's approach to risk management continues to develop and mature, with internal and external risks being considered as part of the cyclical business of the Fund. A review and refresh of the Risk Register took place in 2016 and material risks continue to be reported to the Pensions Committee on a quarterly basis.

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

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

The Fund's governance arrangements are formally monitored via:

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

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

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

This section deals with the systems of internal financial control of Falkirk Council as administering body of the Pension Fund for the year to 31 March 2017. The Chief Finance Officer is responsible for ensuring the operation and maintenance of an effective system of internal financial control.

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

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

The Internal Audit Manager has established a Quality Assurance and Improvement Programme for the Section, including annual self-assessment and periodic external assessment of compliance with the Public Sector Internal Audit Standards. The most recent self-assessment, carried out in March 2017, confirmed that operations were broadly in line with the Standards. An independent External Quality Assessment is due to be undertaken by South Ayrshire Council's Audit Services Manager during 2017/18, and the outcomes of that review will be reported to the Council's Audit Committee in due course.

All Internal Audit reports are issued to the relevant managers, and include recommendations and agreed action plans. It is then management's responsibility to ensure that appropriate action is taken to address these recommendations. Significant matters arising are brought to the attention of the Pensions Committee. During 2016/17, there were no matters which required to be brought to the attention of the Committee.

In addition, to internal audit activity which focused on the Council's wider control environment, during 2016/17 Internal Audit undertook a review of Investment Manager controls; a review of the Council's Voluntary Severance arrangements and sample transactional testing around key pensions administration activities. The transactional testing was to determine if:

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

As a result of the work undertaken in 2016/17, Internal Audit were able to provide Substantial Assurance in relation to the adequacy of arrangements and found that the processes were working effectively. This was reported to the Pensions Committee and Pension Board at their joint meeting of 16 March 2017.

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

Falkirk Council is committed to ensuring robust and proportionate governance. That said, the ever changing environment within which the Council operates means that there will always be scope for improvement.

An example of this is the decision to adopt a new governance model with the Lothian Pension Fund from 2017/18, with the benefits being to:

- improve collaboration between two Scottish LGPS Funds
- improve resilience within the Falkirk Fund Pensions Team
- reduce key man risk within the Falkirk Fund Pensions Team
- deliver better investment outcomes
- deliver efficiency savings through joint procurement with the Lothian Pension Fund

Once underway, the new arrangement will be reviewed by Internal Audit as part of their future programme for the Fund. Other areas for improvement that will be addressed over the coming year include:

- formalising a register of interests for the Committee and Board
- formalising a conflicts of interest policy for the Committee and Board
- induction training for Committee and Board

### **Certification**

This Annual Governance Statement summarises, openly and transparently, arrangements established by Falkirk Council Pension Fund for 2016/17 and the period to date. It highlights areas for improvement, and is consistent with the Council's own improvement agenda.



**Councillor Tom Coleman**  
**Convener of the Pensions Committee**



**Mary Pitcaithly**  
**Chief Executive**

# **Falkirk Council Pension Fund**

**Local Government Pension Scheme**

## **Governance Compliance Statement**

**June, 2015**

## Part 2 – Governance Compliance Statement

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

### Principle A – Structure

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



Requirements	Level of Compliance	Arrangements in Place
(iii) Where appropriate, independent professional observers; and	<b>Not Compliant</b>	<p>There are no independent professional observers of Committee or Board business.</p> <p>It is considered that:</p> <ul style="list-style-type: none"> <li>▪ the diversity of representation; (employers, pensioner and Unions)</li> <li>▪ the training arrangements;</li> <li>▪ the annual audit process; and</li> <li>▪ attendance of professional advisors</li> </ul> <p>provide robust and adequate scrutiny of pension fund business.</p>
(iv) Expert advisors (on an ad-hoc basis).	<b>Full Compliance</b>	<p>Support for the Pensions Committee and Pension Board is provided by the undernoted advisors:</p> <ul style="list-style-type: none"> <li>• actuary and investments, Hymans Robertson</li> <li>• corporate governance, PIRC Ltd</li> <li>• investment managers and custodian, as required.</li> </ul>
(b) That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	<b>Full Compliance</b>	<p>The three co-opted members who sit on the Pensions Committee and the Pension Board members all have equality of access to papers, meetings and training. The co-opted members also have full opportunity to contribute to the decision making process, including the right to vote.</p>

## Principle C – Selection and role of lay members

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

## Principle D – Voting

Requirement		Level of Compliance	Arrangements in Place
(a)	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	<b>Full Compliance</b>	All members of the Pensions Committee including co-opted members will have voting rights on the basis that they have executive responsibility for Pension Fund decision making.

## Principle E – Training / Facility Time / Expenses

	<b>Requirement</b>	<b>Level of Compliance</b>	<b>Arrangements in Place</b>
(a)	That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	<b>Full Compliance</b>	<p>The administering authority's approach to training is set out in its training policy for the Pensions Committee and Pension Board members.</p> <p>Training is delivered in large part by addressing specific items at Committee and Board meetings and complemented by visits to Fund Managers, bespoke training events and attendance at industry seminars and conferences.</p> <p>Expenses incurred by Committee and Board members are met either by the Fund or the Falkirk Council scheme for payment of members expenses.</p>
(b)	That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	<b>Full Compliance</b>	The Training Policy for the Pensions Committee and Pension Board applies uniformly to all members.
(c)	That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	<b>Full Compliance</b>	The Training Policy for the Pensions Committee and Pensions Board includes the requirement for members to undergo training needs analysis and the development of commensurate training plans. A register of training undertaken will be maintained.

## Principle F – Meetings (Frequency/Quorum)

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

## Principle G – Access

Requirement		Level of Compliance	Arrangements in Place
(a)	That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	<b>Full Compliance</b>	Members of Pensions Committee and Pension Board have equal access to any committee papers, documents and advice that falls to be considered at meetings of the Pensions Committee.

## Principle H – Scope

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

## Principle I – Publicity

Requirement		Level of Compliance	Arrangements in Place
(a)	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	<b>Full Compliance</b>	Employers, Unions and Pensioners have been consulted regarding the governance arrangements and invited to participate.  Full details of the Governance arrangements are published on the Fund's website.

Chief Finance Officer  
Falkirk Council  
28 May 2015

## ACTUARIAL STATEMENT FOR 2016/17

### Falkirk Council Pension Fund (“the Fund”) Actuarial Statement for 2016/17

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

#### Description of Funding Policy

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

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

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

#### Funding Position as at the last formal funding valuation

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

Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

### Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 31 March 2015.

#### Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

#### Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2014 valuation were as follows:

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

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

	Male	Females
Current	22.1 years	23.8 years
Pensioners	24.3 years	26.3 years

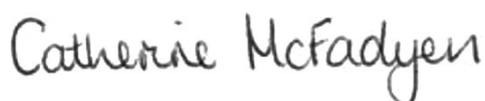
\*Future pensioners are assumed to be aged 45 at the 2014 valuation.

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

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

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

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



Catherine McFadyen FFA

Fellow of the Institute and

Faculty of Actuaries For and on

behalf of Hymans Robertson

LLP 19 May 2017

<b>SCHEDULED AND ADMISSION BODIES AS AT 31 MARCH 2017</b>
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**Scheduled Bodies**

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

**Admission Bodies with Active Members**

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

**Other Admission Bodies with Pensioners + Deferred Members**

Alsorts  
 Open Secret  
 Central Scotland Council for Regional Equality  
 Stirling University  
 Waterwatch Scotland