London Borough of Harrow Pension Fund

Annual Report and Financial Statements for the year ended 31 March 2014

CONTENTS

Appendices

1. Introduction

The main purpose of the Pension Fund Annual Report is to account for the income, expenditure and net assets of the London Borough of Harrow Pension Fund ('the Fund') for the financial year to 31 March 2014. This report also explains the administration and management of the Fund, the investment and funding policy objectives and asset allocation, as well as highlighting market and Fund performance.

Information about the economic resources controlled by the Fund is provided by the net assets statement. The actuarial funding level is reported in paragraph 12.14 and in the Statement of the Consulting Actuary.

The Pension Fund Committee is responsible for overseeing the management, administration and strategic direction of the Fund. The Committee continuously reviews the Fund's investment strategy to improve returns within acceptable risk parameters. This in turn minimises the amount the Council and other employers will need to make in contributions to the scheme to meet future liabilities.

During 2013-14, overall, equity markets continued to perform strongly with most developed markets producing returns approaching 20% in local currency, though some of this return was eroded for UK investors in the US and Japan by the relative strength of Sterling against the Dollar and the Yen. UK equities were below the overseas average but still returned 11% for the year. UK bonds realised only their third year of negative results in the last twenty years whilst, on the other hand, property returned 11% for the year.

The market value of the Fund as at 31 March 2014 was £590.8m compared to £552.2m as at 31 March 2013. The Fund was ranked 19th in the local authority annual league table of investment returns for the year.

Simon George BA (HONS) ACMA ACMT

Director of Finance and Assurance
September 2014

2. Audit Opinion and Certificate

INDEPENDENT AUDITOR'S STATEMENT TO THE MEMBERS OF LONDON BOROUGH OF HARROW ON THE PENSION FUND FINANCIAL STATEMENTS

We have examined the pension fund financial statements for the year ended 31 March 2014, which comprise the Fund Account, the Net Assets Statement and the related notes 12.1 to 12.15.

This report is made solely to the members of London Borough of Harrow, as a body, in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by the Audit Commission. Our audit work has been undertaken so that we might state to the Authority those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Director of Finance and Assurance and the auditor
As explained more fully in the Statement of the Director of Finance and Assurance's Responsibilities, the Director of Finance and Assurance is responsible for the preparation of the pension fund's financial statements in accordance with applicable United Kingdom law.

Our responsibility is to report to you our opinion on the consistency of the pension fund financial statements within the pension fund annual report with the pension fund financial statements in the statement of accounts of London Borough of Harrow, and its compliance with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

We also read the other information contained in the pension fund annual report as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the pension fund financial statements.

We conducted our work in accordance with Bulletin 2008/3 issued by the Auditing Practices Board. Our report on the administering authority's full annual statement of accounts describes the basis of our opinion on those financial statements.

Opinion
In our opinion, the pension fund financial statements are consistent with the full annual statement of accounts of London Borough of Harrow for the year ended 31 March 2014 and comply with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

Paul Schofield (Engagement Lead)
For and on behalf of Deloitte LLP
Appointed Auditor
St Albans, UK

September 2014

3. Scheme Management and Advisors

Administering Authority	London Borough of Harrow
Pension Fund Committee	Councillor Richard Romain (Chairman) Councillor Keith Ferry (Vice Chairman) Councillor Sachin Shah Councillor Tony Ferrari
Co-optees	Howard Bluston Stephen Compton – UNISON Pamela Belgrave - GMB
Officer	Simon George, Director of Finance and Assurance
Actuary	Hymans Robertson LLP
Investment Consultant	Aon Hewitt
Investment Managers	Aviva Investors Global Services Limited Baring Asset Management BlackRock Investment Management (UK) Limited Fidelity Worldwide Investments Longview Partners Pantheon Ventures Record Currency Management Limited Standard Life Investments State Street Global Advisors Limited Wellington Management Company.
AVC Providers	Clerical and Medical Equitable Life Assurance Society Prudential Assurance
Custodian	JP Morgan and Bank of New York Mellon
Auditor	Deloitte LLP
Performance Measurement	WM Company
Bankers	The Royal Bank of Scotland

4. Scheme Overview

The London Borough of Harrow Pension Fund is part of the Local Government Pension Scheme (LGPS) which is governed by various regulations. Its benefits are therefore defined and guaranteed in law. The LGPS is contracted out of the State Second Pension (S2P) and must, in general, provide benefits at least as good as most members would have received had they been members of S2P.

The London Borough of Harrow Pension Fund is a funded pension scheme which means that contributions into the Fund are made by employers and employees which are then used to make investments upon which a return is anticipated. Benefits are paid using the Fund's cash flow.

The purpose of the Fund is to provide pensions to all the Council's employees with the exception of teaching staff. Also included are certain employees of admitted and scheduled bodies who have gained admittance to the Fund in accordance with the Fund's admittance criteria.

Scheduled Employer: This is a statutorily defined body listed within Local Government Pension Scheme (LGPS) Regulations and has a statutory obligation to participate in the LGPS (e.g. a local authority, a further or higher education establishment).

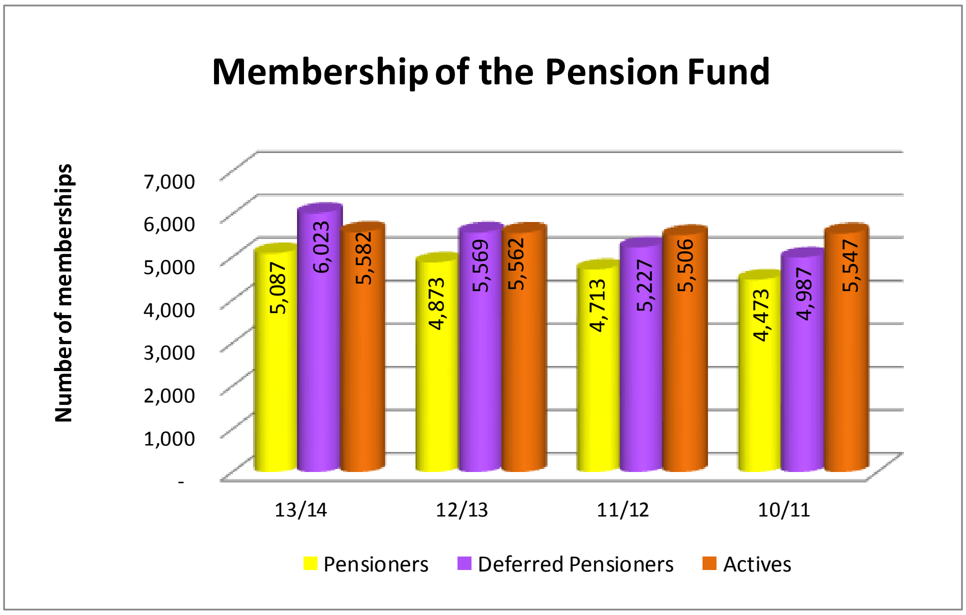
Admitted Employer: There are two types of admission body:
Community Admission Body – These are typically charities or other not-for-profit public sector bodies providing a public service which has sufficient links with the administering employer to be regarded as having a community of interest.

Transferee Admission Body – These are typically private sector companies or charities who will have taken on staff from a local authority as a result of an outsourcing of services.

Membership of the Fund is voluntary. Full-time, part-time and casual employees, where there is a mutuality of obligation and who have a contract of more than three months, are brought into the Fund automatically but have the right to "opt out" if they so wish. Casual employees with no mutuality of obligation are not eligible for membership.

Employee contribution rates are set by regulations and are dependent upon each member's full time equivalent salary. Employee contributions attract tax relief at the time they are deducted from pay and the employee also pays lower National Insurance contributions between the Lower and Upper Earnings Limits, unless the employee has opted to pay the married woman's reduced rate.

Employers participating in the Fund pay different rates of contributions depending on their history, their staff profile and any deficit recovery period agreed with the Fund. Employer contribution rates are reviewed as part of the triennial actuarial valuation. The last valuation took place as at 31 March 2013 and showed that the fund was 70% funded. The deficit is to be funded by additional employer contributions over the course of 20 years.



Employer	Status	Actives	Deferred	Pensioners	Total	%
Harrow Council	Scheduled	4,272	5,297	4,804	14,373	86.12
Alexandra School	Scheduled	32	1	0	33	0.20
Avanti Free School	Scheduled	15	1	0	16	0.10
Bentley Wood School	Scheduled	53	35	6	94	0.56
Canons High School	Scheduled	86	23	5	114	0.68
Harrow College	Scheduled	176	235	128	539	3.23
Harrow High School	Scheduled	91	19	3	113	0.68
Hatch End High School	Scheduled	81	110	6	197	1.18
Jubilee Academy	Scheduled	16	2	0	18	0.11
Krishna Avanti Primary School	Scheduled	19	0	0	19	0.11
North London Collegiate School	Scheduled	71	19	26	116	0.69
Nower Hill High School	Scheduled	145	57	2	204	1.22
Park High School	Scheduled	67	26	2	95	0.57
Rooks Heath College	Scheduled	113	21	2	136	0.81
St Dominics 6th Form College	Scheduled	50	20	30	100	0.60
Salvatorian College	Scheduled	57	26	3	86	0.51
Stanmore College	Scheduled	102	116	60	278	1.67
Capita Business Services Ltd	Admitted	11	4	5	20	0.12
Carillion Services	Admitted	87	4	4	95	0.57
Family Action	Admitted	2	0	0	2	0.01
Granary Kids	Admitted	2	1	0	3	0.02
Govindas	Admitted	5	0	0	5	0.03
Harrisons Catering	Admitted	22	3	0	25	0.15
Julius Rutherfoord & Co	Admitted	1	2	1	4	0.02
Linbrook Services Ltd	Admitted	4	1	0	5	0.03
Temco Facilities Services Ltd	Admitted	2	0	0	2	0.01
	Total	**5,582**	**6,023**	**5,087**	**16,692**	**100**

From April 2008 the payment of a pension is calculated at 1/60th of the final year's pay multiplied by the number of years of service, with an option to exchange part of the pension into a tax free lump sum. The calculation of benefits in respect of pre April 2008 pensionable service is based on the accrual rate of 1/80th of the final year's pay for each year of membership plus a lump sum of three times the pension. Actual membership may be enhanced in cases of ill health retirement. Employers may choose to augment the active member's number of years of service (other than on ill health grounds). In all cases, it is possible to exchange part of the pension for a tax free lump sum.

New LGPS regulations are due to come into force from 1 April 2014. The changes are summarised below:

- Basis of pension to become career average revalued earnings rather than final salary
- Accrual rate (rate at which pension is earned) to be changed to 1/49th from 1/60th
- Revaluation rate to be based on Consumer Prices Index (CPI) rather than final salary
- Pensionable pay now to include non-contractual overtime and additional hours for part time staff
- Members can now pay 50% contributions for 50% of pension benefit
- Normal pension age to be equal to the individual member's state pension age rather than the age of 65
- Death in service survivor benefits and ill health provision to reflect the change in normal pension age

The investment objective of the Pension Fund is to ensure that the Fund has sufficient assets to pay pensions and other benefits by maximising investment returns within acceptable risk tolerances.

5. Governance Arrangements

The London Borough of Harrow is the Administering Authority for the Pension Fund. Council has delegated to the Pension Fund Committee various powers and duties in respect of its administration of the Fund. The Committee convenes approximately six times a year and contains four Councillors with full voting rights. Representatives from the trade unions are able to participate as members of the Committee but do not have voting rights.

The Pension Fund Committee has the following terms of reference:

- to exercise on behalf of the Council, all the powers and duties of the Council in relation to its functions as Administering Authority of the LB Harrow Pension Fund (the Fund), save for those matters delegated to other Committees of the Council or to an Officer;
- the determination of applications under the Local Government Superannuation Regulations and the Teachers' Superannuation Regulations;
- to administer all matters concerning the Council's pension investments in accordance with the law and Council policy;
- to establish a strategy for the disposition of the pension investment portfolio;
- to appoint and determine the investment managers' delegation of powers of management of the Fund;
- to determine cases that satisfy the Early Retirement provision under Regulation 26 of the Local Government Pension Scheme Regulations 1997 (as amended), and to exercise discretion under Regulation 8 of the Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2000 (as amended), subject to the conditions now agreed in respect of all staff, excluding Chief Officers;
- to apply the arrangements to Chief Officers where the application has been recommended by the Chief Executive, either on the grounds of redundancy, or in the interests of the efficiency of the service, and where the application was instigated by the Chief Executive in consultation with the leaders of the political groups;
- to approve any severance packages for officers of £100,000 or over irrespective of the grade of officer. The definition of severance package is in accordance with the DCLG supplementary statutory guidance 'Openness and accountability in local pay: Guidance under section 40 of the Localism Act 2011' issued in February 2013; and
- to report back to Council for information purposes on all such approved severance packages.

The dates of the Pension Fund Committee meetings, along with meeting agendas, reports and minutes are available on the Harrow Council website:
http://www.harrow.gov.uk/www2/mgCommitteeDetails.aspx?ID=1297

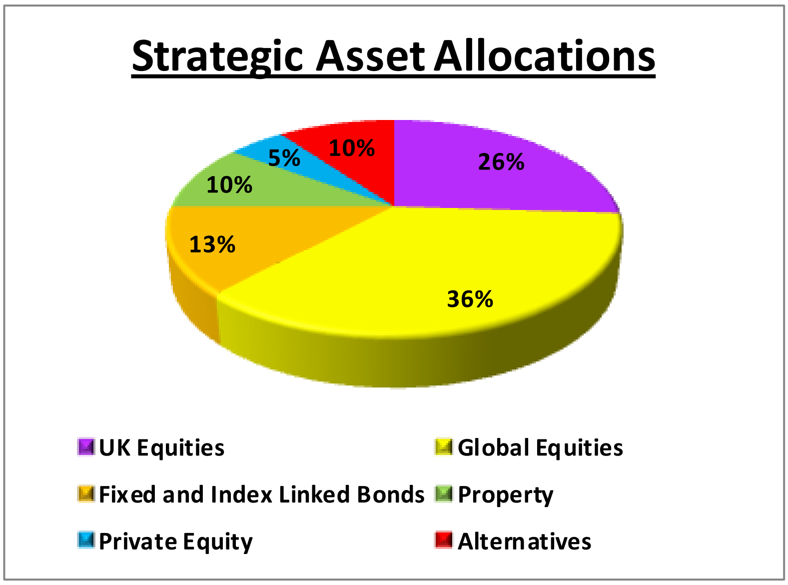
6. Investment Policy and Performance

The investment objective of the Fund is to achieve a return that is sufficient to meet the primary funding objective of minimising the level of employer contribution in order to meet the cost of pension fund benefits as required by statute, subject to an appropriate level of risk (implicit in the target) and liquidity.

The Council has delegated the management of the Fund's investments to professional investment managers, appointed in accordance with the LGPS regulations, whose activities are specified in detailed investment management agreements and regularly monitored.

The Fund Statement of Investment Principles specifies that the Fund may invest in accordance with the Regulations in equities, fixed interest and other bonds and property, in the UK and overseas markets. The Regulations specify other investment instruments that may be used, for example, financial futures, traded options, insurance contracts, stock lending, sub-underwriting contracts.

To support the Fund's objective of achieving a return that is sufficient to meet the cost of benefits and achieving this within acceptable risk parameters the Committee, in conjunction with the Fund's investment advisor, set the following strategic asset allocation in March 2013:



The Committee aims to achieve its investment objective by maintaining a high allocation to growth assets, mainly equities, reflecting the security of the sponsor's covenant, the funding level, the long time horizon of the Fund and the projected asset class returns and volatility. Diversifying investments reduces the risk of a sharp fall in one particular market having a substantial impact on the whole Fund.

Following the strategy review concluded in March 2013 cash balances and realisations from listed equities managed by Fidelity were used to invest 10% of the Fund in two multi- asset class mandates managed by Barings and Standard Life.

The following table compares the actual asset allocation as at 31 March 2014 to the benchmark:

Asset (%)	Actual	Target
UK Equities	26	26
Global Equities	39	36
Fixed and Index Linked Bonds	12	13
Property	8	10
Private Equity	4	5
Alternatives	10	10
Cash	1	0
Total	**100**	**100**

The Committee believes in appointing fund managers with clear performance benchmarks that place maximum accountability for performance against that benchmark with the investment manager. Fund managers are set risk parameters to provide them with some flexibility in achieving the asset allocation to allow them to make the most of market conditions. They must seek approval for any positions that go beyond the agreed risk parameters set for their strategies. Following the manager changes discussed above, the Fund has ten investment managers to give diversification of investment style and spread of risk. The Committee will continue to monitor the ability of the investment managers to achieve their target returns.

Investments held by Fund Managers

	2013-14 £000	2013-14 %	**2012-13 £000**	2012-13 %	
Aviva	**45,051**	**8**	41,905	8	UK Property
State Street	**155,512**	**27**	142,591	27	UK Equities Passive
BlackRock	72035	12	72059	14	Corporate and Index-linked bonds
Fidelity	**68,381**	**12**	98,872	18	Global Equities
Longview	**49,507**	**8**	40,109	7	Global Equities
Wellington	**113,911**	**19**	109,156	21	Global Equities
Barings	**26,630**	**5**	0	0	Alternatives
Standard Life	**27,890**	**5**	0	0	Alternatives
Pantheon	**24,648**	**4**	26,328	5	Private Equity
Record	**1,113**	**0**	-2,274	0	Passive currency
Total Fund	**584,678**	**100**	528,746	100	

Market commentary

The Federal Reserve (Fed) continued its open-ended quantitative easing (QE) programme to support the US economy. However, investors became anxious in May as Fed Chairman Bernanke signalled a reduction in QE sooner than expected, possibly in September. In the event, the Fed actually initiated its withdrawal of QE in December. As the Fed continued to wind down its asset purchases, Bernanke's successor Janet Yellen emphasised her commitment to maintain accommodative monetary policy in order to support continuing economic growth.

Both Janet Yellen and Bank of England Governor Mark Carney changed course on their respective forward guidance policies, playing down dependence on the unemployment rate, which had been falling faster than anticipated in both the US and UK.

Tensions in the Ukraine surfaced in early 2014, sparking a fresh bout of volatility in equity markets, after which Russia's president Vladimir Putin calmed investors by saying that he wanted to rebuild ties with independent Ukraine.

The Eurozone emerged from recession in Q2 2013, led by stronger German growth, although many peripheral countries continued to struggle. Deflationary concerns caused the European Central Bank to lower its policy rate to 0.25%.

For many developed economies, economic data picked up over the year, with a string of strong Purchasing Managers' Index (PMI) releases globally in the second half of 2013. Growth in emerging economies slowed however, with the larger economies, such as China, particularly disappointing investors.

Equities

Markets brushed aside concerns over a reduction in QE, and despite various economic and political difficulties, global equity returns were strong over the year to 31 March 2014, and the MSCI All Country World Index returned 17.4% in local currency terms. However, sterling strength over the year eroded the majority of these returns, and the sterling return on the index was 6.7%.

Despite some encouraging economic data and having the fastest developed market GDP growth, UK equity market returns over the past 12 months were overshadowed by other developed markets. The UK equity market returned 8.8%.

Over the past 12 months, US equities provided the highest return in local currency terms (22.2%) whilst returning 11.3% in sterling terms due to sterling strength. Despite investors having to adjust to the prospect of a return to normal monetary policy, equities were able to sustain gains over the period.

Continental European equities returned 21.2% in local currency terms, which equated to 17.3% in sterling terms, higher than in any other region.

Japanese equities performed exceptionally well in 2013 as new government and central bank leadership led to an aggressive stimulus package in an attempt to jumpstart growth and end years of deflation. However, Japanese equities lost their momentum at the start of 2014 as investors became worried about the implications of a weaker Chinese economy on Japanese exports and the stalling progress of reforms. Japanese equities returned 18.4% in yen terms, but the combination of sterling strength and yen weakness meant that the return to sterling investors was -1.6%.

Emerging Markets lagged developed markets and were the worst performers in both local currency (3.8%) and sterling (-9.9%) terms. This poor performance was due to a slowdown in emerging market growth and weaker commodity prices. Investors also grew concerned about the impact of Fed monetary policy on the region.

<u>Gilts</u>

UK fixed interest gilts provided negative return over the year as better economic data and speculation over an end to QE in the US put upward pressure on UK bond yields.

UK corporate bonds returned 1.6% over the year as the narrowing of credit spreads offset the rise in gilt yields.

<u>UK Property</u>

UK property returns were positive, with the IPD Monthly Index rising 14.0% over the period, its highest 12-month return since December 2010.

<u>Currencies and interest rates</u>

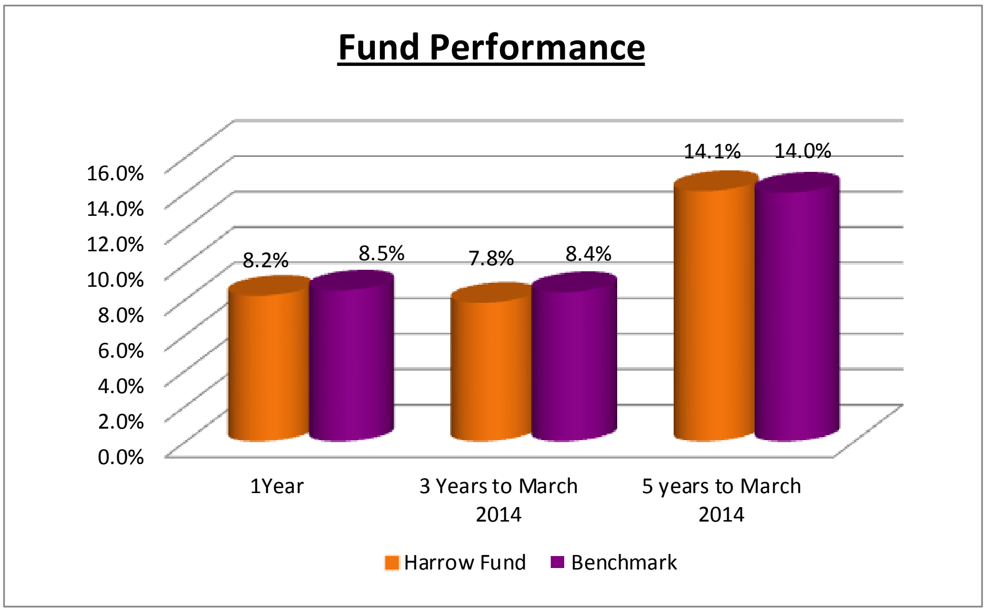
Bank of England (BoE) policy rates remained at 0.5%, unchanged since March 2009. New BoE Governor Mark Carney, who started in July, issued forward guidance that interest rates would stay low until unemployment falls. After falling faster than anticipated, the unemployment rate was dropped as the main trigger for allowing interest rates to rise. Improving UK economic data caused sterling to appreciate against most major currencies over the year. Sterling ended the year up 7.2% on a trade-weighted basis.

The Federal Funds rate remained between 0% and 0.25%. QE3 continued throughout the year with $85bn a month of asset purchases. However, in December, the Fed started to wind down its asset purchases, which now stand at $55bn per month. The US dollar appreciated on a trade-weighted basis by 1.8%, though this was largely a result of the hefty devaluation of the Japanese yen. The US dollar depreciated by 8.9% against sterling.

The ECB cut rates by 25 basis points to 0.5% in May 2013, after which weak inflation data and a reduction in growth forecasts prompted the ECB to further cut their policy rate to 0.25% in November. The euro depreciated by 2.2% against sterling over the year.

The Bank of Japan (BoJ) left rates at between 0 and 0.1%, unchanged since December 2008. In April the new BoJ Governor announced a massive escalation in monetary easing to boost growth and tackle deflation. The yen depreciated by 16.8% against sterling over the year as a result.

Fund performance
The Committee uses WM Performance Services as its independent investment performance measurer. Investment returns over 1, 3 and 5 years are shown below.



Source: WM Performance Services

The Fund's return of 8.2% during 2013-14 was due to positive returns on equities, property and private equity, this was partly offset by a negative return on bonds.
Returns over all three time periods were strong, reflecting recovery from the significantly lower returns achieved at the height of the financial crisis in 2008.
The average local authority fund (as measured by WM Performance Services) returned 6.4% on its assets during the year. The Council's Fund was ranked 19th (67th 2012-13) in the local authority annual league table of investment returns for the year. Asset allocation added 0.2% to the return relative to the local authority universe whilst the successful stock selection by some of the managers realised a relative outperformance of 1.6%.

7. Statements and Publications

Governance Compliance Statement

The Local Government Pension Scheme (Administration) Regulations 2008 Regulation 31 requires all administering authorities to produce a Governance Compliance Statement. This Statement must set out whether the Administering Authority delegates its function and if so what the terms, structure and operation of the delegation are. The Administering Authority must also state the extent to which a delegation complies with guidance given by the Secretary of State. The current Statement can be found in Appendix 1.

Communications Policy Statement

The Local Government Pension Scheme (Administration) Regulations 2008 require all administering authorities to produce a Communications Policy Statement. This statement sets out the Fund's strategy for communicating with members, members' representatives, prospective members and employing authorities, together with the promotion of the Scheme to prospective members and their employing authorities. The latest Statement can be found in Appendix 2.

Local Government Pension Scheme Guide

A brief guide to the Local Government Pension Scheme can be found in Appendix 3

Statement of Investment Principles

Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 requires administering authorities to publish a Statement of Investment Principles. This Statement provides details of the Fund's investment policies including

- The types of investment to be held
- The balance between different types of investment
- Risk measurement and management

The Statement also details the Fund's compliance with the six principles set out in the Chartered Institute of Public Finance and Accountancy's publication 'Investment Decision Making and Disclosure in the Local Government Pension Scheme 2009 – a guide to the application of the 2008 Myners Principles to the management of LGPS funds'.
The current version can be found in Appendix 4.

Funding Strategy Statement

Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 requires all administering authorities to produce a Funding Strategy Statement. The purpose of the Funding Strategy Statement is to explain the funding objectives of the Fund, in particular:

- How the costs of the benefits provided under the LGPS are met through the Fund
- The objectives in setting employer contribution rates
- The funding strategy that is adopted to meet these objectives.

The Funding Strategy Statement is reviewed every three years at the same time as the triennial actuarial valuation of the Fund. An interim review of the statement may be carried out and a revised Statement published if there has been a material change in the policy matters set out in the Statement or there has been a material change to the Statement of Investment Principles. The current full Statement can be found in Appendix 5.

8. Risk Management

The Fund's primary long term risk is that the assets will fall short of its liabilities (i.e. promised benefits payable to members). The Pension Fund Committee is responsible for managing and monitoring risks and ensuring that appropriate risk management processes are in place and operating effectively. The aim of risk management is to limit risk to those that are expected to provide opportunities to add value.

The most significant risks faced by the Fund and the procedures in place to manage these risks are described below:

a. Governance and Regulatory Risks

The failure to exercise good governance and operate in line with regulations can lead to financial as well as reputation risk. These risks are managed through:

- Regular reviews of the Statement of Investment Principles and Funding Strategy Statement that set out the high level objectives of the Fund and how these will be achieved.
- Tailored training for members.
- Reviews of the Pension Fund Committee agenda and papers by Harrow's Legal Department.

b. Sponsor Risk

The Fund is currently in deficit and achieving a fully funded status may require the continued payment of deficit contributions. The Actuary reviews the required level of contributions every three years. To protect the Fund and the Administering Employer, bonds and other forms of security are received from Admitted employers.

c. Investment Risk

The Fund is invested in a range of asset classes as detailed in paragraphs 12.7 and 12.9. This is done in line with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 which require pension funds to invest any monies not immediately required to pay benefits. These Regulations require the formulation of a Statement of Investment Principles which sets out the Fund's approach to investment including the management of risk. The predominant asset class is listed equities, which has both a greater expected return and volatility than the other main asset classes. Potential risks affecting investments include:

<u>Pricing Risk</u>
The valuation of investments is constantly changing, impacting on the potential realisation proceeds and income. For example, the value of the Fund fell by 31% in the 15 months to March 2009 before increasing by 54% in the next 21 months to December 2010. During the last year the net assets of the Fund have increased by 7%. Most of the price changes relate to the global value of equities. Changes of a similar magnitude are possible in future.
Procedures in place to manage the volatility of investments include:

- Diversification of the investments between asset classes and geographical areas to include fixed interest and index linked bonds, property, multi assets mandates and private equity. The investment strategy is reviewed regularly by the Pension Fund Committee and market conditions are reviewed to monitor performance at every meeting to determine if any strategic action is required.
- Global equities are managed by three active managers to reduce the risk of underperformance against benchmarks. The Investment Advisor provides quarterly reports on the performance and skills of each fund manager to the Pension Fund Committee.
- The benefit liabilities are all sterling based and to reduce the currency risk from non sterling investments, 50% of the overseas currency exposures are hedged to sterling.

Liquidity Risk
Investments in some asset classes e.g. private equity and property can be illiquid in that they cannot be realised at short notice. Around 12% of Harrow's fund is in illiquid assets. This is deemed appropriate for a scheme that continues to have a positive cashflow. All cash balances are managed in accordance with the Council's Treasury Management Strategy Statement and are all are currently on overnight deposit and readily accessible.

Counterparty Risk
The failure by a counterparty, including an investee company, can lead to an investment loss. This risk is mainly managed through wide diversification of counterparties and also through detailed selection of counterparties by external fund managers.

d. Actuarial risks

The value of the liability for future benefits is impacted by changes in inflation, salary levels, life expectancy and expected future investment returns. Although there are opportunities to use financial market instruments to manage some of these risks, the Pension Fund Committee does not currently believe these to be appropriate. Recent changes to the benefit structure will reduce some of these risks. All are monitored through the actuarial valuation process and additional contributions required from employers should deficits arise.

e. Operational Risk

Operational risk relates to losses (including error and fraud) from failures in internal controls relating to investment managers and internally e.g. administration systems.

Controls at external fund managers are monitored through the receipt of audited annual accounts for each investment fund together with annual assessments of the control environment including reviews of internal controls reports certified by reporting accountants.

Controls within the Administering Authority are reviewed by Harrow's Internal Audit Team

9. Communications

Registered Address	London Borough of Harrow Civic Centre Station Road Harrow HA1 2XF
Administration Enquiries	Email address: Pension@harrow.gov.uk Telephone Number: 020 8424 1186.
Complaints and Advice	The Pensions Advisory Service 11 Belgrave Road London SW1V 1RB Website: www.pensionsadvisoryservice.org.uk
The Office of the Pensions Ombudsman	The Pensions Ombudsman 11 Belgrave Road London SW1V 1RB Tel No. 0207 630 2200 Fax No. 0207 821 0065 Email: enquiries@pensions-ombudsman.org.uk Website: www.pensions-ombudsman.org.uk

10. Statement of Responsibilities for the Financial Statements

The Council's Responsibilities

The Council is required:

- To make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In Harrow, that officer is the Chief Financial Officer, i.e., the Director of Finance and Assurance;

- To manage its affairs to secure economic, efficient and effective use of resources and safeguard its assets; and

- To approve the Financial Statements.

The Director of Finance and Assurance's Responsibilities

The Director of Finance and Assurance is responsible for the preparation of the Fund's statement of accounts in accordance with proper practices set out in the CIPFA Code of Practice on Local Authority Accounting.

In preparing this statement of accounts, the Director of Finance and Assurance has:

- Selected suitable accounting policies and then applied them consistently;

- Made judgements and estimates that were reasonable and prudent;

- Complied with the Code of Practice on Local Authority Accounting;

- Kept proper accounting records which were up to date;

- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

I certify that these Financial Statements present fairly the financial position of the London Borough of Harrow Fund of the Local Government Pension Scheme as at 31 March 2014 and its income and expenditure for the year then ended.

Simon George BA (HONS) ACMA ACMT
Director of Finance and Assurance
September 2014

11. London Borough of Harrow Pension Fund Financial Statements

Pension Fund Account for the year ended 31st March 2014

2012-13 £000		Notes	2013-14 £000
	Contributions and Benefits		
-25,351	Contributions receivable	12.2	-25,458
-1,279	Individual transfers in from other schemes		-2,874
24	Other income		-306
	Less:		
26,716	Benefits payable	12.3	31,259
1,062	Payments to and on account of leavers	12.4	1,074
827	Administrative expenses	12.5	981
1,999	Net additions from dealings with members		4,676
	Returns on Investments		
-4,833	Investment income	12.6	-7,468
-60,112	Change in market value of investments	12.7	-35,562
-339	Investment management expenses	12.5	-236
-65,284	Net Returns on Investments		-43,266
-63,285	Net (Increase)/decrease in Fund during the year		-38,590
-488,942	Net assets at start of year		-552,227
-552,227	Net assets at end of year		-590,817

Net Assets Statement

2012-13 £000		Notes	2013-14 £000
	Investment Assets		
531,020	Pooled investment vehicles	12.9	583,565
865	Derivative contracts	12.10	1,351
531,885			584,916
	Investment Liabilities		
-3,139	Derivative contracts	12.10	-238
528,746			584,678
20,117	Cash deposits	12.7	4,873
548,863	Net Investment Assets		589,551
3,974	Current assets	12.12	2,000
-610	Current liabilities	12.12	-734
552,227	**Net assets of the Fund available to fund benefits at 31 March 2014**		590,817

The accounts summarise the transactions of the Fund and deal with the net assets. The Net Assets Statement does not take account of the obligations to pay pensions and benefits which fall due after the end of the Fund year. The actuarial position of the Fund, which does take account of such obligations, is dealt with in the actuarial statement included on pages 25 and 26 and these Financial Statements should be read in conjunction with it.

Simon George BA (HONS) ACMA ACMT
Director of Finance and Assurance
September 2014

12. Notes to the Pension Fund Financial Statements

12.1 Accounting Policies, Judgements and Uncertainties

Accounting Policies

The accounts have been compiled in accordance with the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom 2013-14 and following guidance in the Statement of Recommended Practice “Financial Reports of Pension Schemes” (revised May 2007).

Basis of Preparation - Except where otherwise stated, the accounts have been prepared on an accruals basis.

Investments - These are shown in the accounts at market value which has been determined as follows:

- All listed investments are quoted at the bid price at the close of business on 31 March of each financial year;
- Unlisted securities are valued having regard to latest dealings, professional valuations, asset values, currency rates and other appropriate financial information adjusted to reflect cash transactions up to 31 March 2014;
- Investments in pooled investment vehicles are stated at the bid value of the latest prices quoted by their respective managers;
- Derivatives are valued at the appropriate closing exchange rate or the bid spot or forward rates. Forward foreign exchange contracts are valued by determining the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contract at that date; and
- There are no published price quotations available to determine the value of the Fund’s private equity holdings. The value of these holdings is therefore assessed by the manager as at 31 December 2013 and adjusted for drawdowns paid and distributions received in the period 1 January 2014 to 31 March 2014.

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year. Most investments are in pooled funds where the change in market value will reflect investment income earned by the Fund and fees and expenses charged to the Fund.
Investments held in foreign currencies have been valued on the relevant basis and translated into sterling at the rate ruling on 31 March of each financial year.

Benefits, Refunds of Contributions and Transfer Values - Benefits payable and refunds of contributions are accounted for in the period in which they are payable.
Transfer values are those sums paid to, or received from, other pension schemes and relate to periods of previous pensionable employment. Transfer values have been included in the accounts on a payments and receipts basis. The transfers can take a considerable time to determine and amounts can vary depending upon the date of settlement.

Investment Income - Dividends and interest on government stocks, loans and deposits have been accounted for on an accrued basis. Foreign income has been converted into Sterling at the date of the transaction.

Investment Management and Administration - Regulations published in 1989 permit the Council to charge administration costs to the Pension Fund. A proportion of the relevant Council officers' salaries, including related on-costs, have been charged to the Fund based on estimated time spent on Fund administration and investment related business. The fees of the Fund's investment managers have been accounted for on the basis contained within their respective management agreements.

Assumptions made about the future and other major sources of estimation uncertainty
The items in the Net Assets Statement as at 31 March 2014 involving assumptions about the future and major sources of estimation uncertainty for which there is a significant risk of material adjustment to the value disclosed within the next financial year are as follows:

	Uncertainties	**Effect if actual results differ from assumptions**
Unquoted property & private equity investments	There are no publicly listed prices for the Fund's investments in property and private equity and therefore there is a degree of estimation and judgement involved in the valuations used based on recognised professional guidance.	Total property and private equity investments disclosed in the Financial Statements amount to £69.7m. A 10% change in value will result in a change in value of +/- £7 million.
Actuarial present value of promised retirement benefits	Estimation of Fund deficit depends on a number of complex judgements relating to the discount rate used, and factors such as projected salary growth and inflation, commutation rates and mortality rates. The effects of changes in individual assumptions can be measured.	A decrease of 0.5% in the discount rate assumption would increase the pension liability by approximately £76m. An increase of 0.5% in assumed salary or pension inflation would increase the pension liability by approximately £19m and £56m respectively. A one year increase in assumed life expectancy would increase the pension liability by approximately £26m.

Critical judgements in applying accounting policies
The most significant judgements in applying accounting policies are as follows:
<u>Unquoted private equity investments</u>
Private equity investments are valued based on forward looking estimates and judgements made by the general partners (i.e. those controlling the partnerships) to the funds invested in, using guidelines issued by the Private Equity Industry Guidelines Group in the USA (known as the Private Equity Valuation Guidelines) and the International Private Equity and

Venture Capital Valuation Guidelines, which have been adopted by almost all venture capital associations, including the BVCA.

Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits, as disclosed in note 12.14, is prepared by the Fund's actuary, adopting prescribed assumptions as set out in IAS19. These assumptions may differ from those used by the actuary at formal triennial valuations to determine the level of contributions payable by employers. The liability disclosed in note 12.14 is subject to significant variances depending on the assumptions adopted.

12.2 Contributions

2012-13 £000		2013-14 £000
	Employers - normal	
-15,161	London Borough of Harrow	**-15,042**
-3,330	Scheduled Bodies	**-3,756**
-494	Admitted Bodies	**-344**
	Members - normal	
-5,225	London Borough of Harrow	**-5,094**
-1,024	Scheduled Bodies	**-1,137**
-117	Admitted Bodies	**-85**
-25,351		**-25,458**

12.3 Benefits

2012-13 £000		2013-14 £000
	Pensions	
21,085	London Borough of Harrow	**22,359**
709	Scheduled Bodies	**868**
141	Admitted Bodies	**69**
21,935		**23,296**
	Commutation of Pensions and Lump Sum Retirement Benefits and Commitments	
3,840	London Borough of Harrow	**5,909**
288	Scheduled Bodies	**625**
24	Admitted Bodies	**423**
4,152		**6,957**
	Lump Sum Death Benefits	
611	London Borough of Harrow	**841**
18	Scheduled Bodies	**135**
	Admitted Bodies	**30**
629		**1,006**
26,716		**31,259**

12.4 Payments to and on Account of Leavers

2012-13 £000		2013-14 £000
2	Refunds to members	**17**
1,060	Individual transfers to other schemes	**1,057**
1,062		**1,074**

12.5 Investment Management and Administration Expenses

2012-13 £000		2013-14 £000
-339	Investment management expenses	-236
	Scheme administration	
682	London Borough of Harrow	778
145	Miscellaneous (including Actuary Fees)	203
827	**Total Administration Expenses**	**981**
488	**Total Expenses**	**745**

External audit fees of £21,000, the same as in the previous year, were charged.

12.6 Investment Income

2012-13 £000		2013-14 £000
-4,628	Income from pooled investment	-7,407
-205	Interest on cash deposits	-61
-4,833		-7,468

All investments other than cash are held in pooled investments and only the income that is distributed is included above. Income retained within pooled funds is reflected within the change in market value of investments.

12.7 Investments

	Value at 01-Apr-13 £000	Purchases at Cost & Derivative Payments £000	Sale Proceeds & Derivative Receipts £000	Change in Market Value £000	**Value at 31-Mar-14 £000**
Pooled Investment Vehicles					
Property	41,905	0	0	3,146	45,051
Other	489,115	57,804	-35,202	26,797	538,514
Derivatives	-2,274	1,508	-3,740	5,619	1,113
	528,746	**59,312**	**-38,942**	**35,562**	**584,678**
Cash Deposits	20,117				4,873
	548,863				**589,551**

The change in market value reflects higher valuations for equities partly offset by a fall in the value of the bond holdings.
Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include fees, commissions, stamp duty and other fees.
All fund managers operating the pooled investment vehicles are registered in the United Kingdom.
The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

Derivative receipts (£3.7m) are in respect of realised profits on forward foreign exchange trades settled during the period.

12.8 Investments Exceeding 5% of the Total Value of Net Assets

2012-13 £m		2013-14 £m
142.6	SSGA MPF UK Equity Index Sub-Fund	**155.5**
109.2	Wellington Global Pooled Value Equity Portfolio	**113.9**
86.8	Fidelity Institutional Select Global Pooled Equities	**61.2**
57.5	BlackRock Institutional Bond Fund-Corp Bond 10 Yrs A class	**57.6**
40.1	Longview Partners Invest - Global Pooled Equities FD K Class	**49.5**
41.9	Aviva Investors UK Real Estate Fund of Funds Open Ended	**45.1**
478.1		**482.8**

12.9 Pooled Investment Vehicles

2012-13 £000		2013-14 £000
	UNITED KINGDOM	
	Managed funds - Property	
41,905	Unit Trusts	**45,051**
	Managed funds - Other	
142,592	Unitised Insurance Policy	**155,513**
	Fixed interest securities	
57,527	Corporate	**57,566**
	Index linked securities	
14,532	Public Sector	**14,468**
	GLOBAL	
	Managed funds - Other	
149,265	Unit Trusts	**191,308**
125,199	Other	**119,659**
531,020	**TOTAL**	**583,565**

12.10 Derivatives

2012-13 £000		2013-14 £000
	Investment Assets	
865	Forward foreign exchange contracts	**1,351**
	Investment Liabilities	
-3,139	Forward foreign exchange contracts	**-238**
-2,274	**Net Derivatives**	**1,113**

Counterparty	Duration	No. of Contracts	Value at 31-Mar-14 Assets £000	Liabilities £000
Barclays Bank - London	7 days - 7 mths	5	377	-41
Deutsche Bank - London	7 days - 6 mths	4	567	-17
Northern Trust	7 days - 6 mths	6	246	-6
Royal Bank of Canada - London	7 days - 6 mths	9	48	-8
Standard Chartered	7 days - 3 mths	7	10	-11
State Street - London	3 mths - 6 mths	5	6	-42
Toronto Dominion - Toronto	7 days - 6 mths	5	49	-60
Westpac - Sydney	7 days - 6 mths	5	48	-53
		46	1,351	-238

The scheme objective in using derivatives is to reduce risk in the portfolio by entering into forward contracts to mitigate the effect of currency risk from overseas investments held in the portfolio without disturbing the underlying assets. The overseas equity portfolio is 50% hedged against the currency risk arising from developed market currencies. Exposures to currencies that have a higher bid offer spread e.g. emerging markets, are not hedged. Non sterling currency exposure hedged at the year end is £105m. The main currency exposures before hedging in sterling are US$ £55m, Yen £17m and Euro £13m.

12.11 Additional Voluntary Contributions (AVCs)

Members of the Fund are able to accrue additional benefits through the payment of AVCs, which are invested outside the Fund with insurance companies. These amounts are not included in the Pension Fund Financial Statements in accordance with section 4 (2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. However, the note below details the change in value of AVCs during the year.

2012-13		2013-14
2,099	Value of AVC Fund at 1 April	2,211
356	Employee contributions	371
107	Investment income and change in market value	86
0	Transfer values in	10
-351	Benefits paid and transfers out	-268
2,211	**Value of AVC Fund at 31 March**	2,410

12.12 Current Assets & Liabilities

2012-13 £000		2013-14 £000
	Current Liabilities	
-149	Unpaid benefits	**-154**
-461	Other unpaid liabilities	**-580**
-610		**-734**
	Current Assets	
3,778	Cash balances held by London Borough of Harrow	**1,678**
177	Contributions due from employers	**283**
19	Other current assets	**39**
3,974		**2,000**
3,364	**Net Current Assets**	**1,266**

12.13 Related Party Transactions

2012-13 £000		2013-14 £000
-15,161	Employer's pension contribution to the Fund	**-15,042**
682	Administration expenses paid to the Council	**778**
3,778	Cash held by Council	**1,678**

The Fund is required under IAS24 to disclose details of material transactions with related parties. The Council is a related party to the Pension Fund. Details of the contributions made to the Fund by the Council and expenses refunded to the Council are set out above.
The Pension Fund has operated a separate bank account since April 2011. However, due to the ease of administration and to avoid any undue cost to the Fund some transactions continue to be processed through the Council's bank account and as such these balances are settled on a monthly basis.

12.14 Actuarial Value of Retirement Benefits

Disclosure of the year end actuarial value of benefits calculated under IAS 19 assumptions is required by CIPFA's Code of Practice on Local Authority Accounting 2013/14.The IAS 19 valuation is based on prescribed assumptions that differ from those used in the triennial valuation that determines the required level of contributions.

The actuarial value of benefits and the main assumptions used by the actuary are set out below.

Rate of inflation	2.80%
Rate of increase in salaries	4.10%
Rate of increase in pensions	2.80%
Rate for discounting scheme liabilities	4.30%
Longevity at 65 for current pensioners:	
Male	22.1 years
Female	24.4 years
Longevity at 65 for future pensioners:	
Male	24.5 years
Female	26.9 years

Liabilities have been projected using a roll forward approximation from the latest formal funding valuation at 31 March 2013. The liability at 31 March 2014 (£824m) has been estimated by the actuary as comprising £314m in respect of employee members, £148m in respect of deferred pensioners and £362m in respect of pensioners. The actuary is satisfied that the aggregate liability is a reasonable estimate of the actuarial present value of benefit promises.

The value of the Fund as at 31 March 2014 represents 71.7% of the value of benefits determined under IAS19 assumptions. The deficit is expected to be addressed through a combination of investment returns in excess of the discount rate and additional deficit contributions from Employers.

12.15 Actuarial Valuation

An actuarial valuation of the Fund was carried out as at 31 March 2013. The market value of the Fund's assets at the valuation date was £552m and the total accrued liabilities of the Fund were £786m. The Fund deficit was therefore £234m, producing a funding level of 70.3% (compared to 73.5% at 31 March 2010).
To reach the funding level of 100% over a period of 20 years, the common employer's contribution rate is 34.4% of pensionable pay. Projected Unit Method is used to determine this rate. Adjustments have been made to the common rate of employer's contribution to take account of certain circumstances that are peculiar to individual employers.

The main actuarial assumptions used in the 2013 actuarial valuation are detailed below:

Assumption	
Price inflation (CPI)	2.5%
Pay increases	3.8%
Gilt based discount rate	3.0%
Funding basis discount rate	4.6%
Longevity at 65 for current pensioners:	
Male	22.1 years
Female	24.4 years
Longevity at 65 for future pensioners:	
Male	24.5 years
Female	26.9 years

13. Statement of the Consulting Actuary

This statement has been prepared in accordance with Regulation 34(1)(d) of the Local Government Pension Scheme (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2013/14.

Description of Funding Policy

The funding policy is set out in the administering authority's Funding Strategy Statement (FSS), dated March 2014. 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. For employers whose covenant was considered by the administering authority to be sufficiently strong, contributions have been stabilised below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is still a better than 50% chance that the Fund will return to full funding over 20 years.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008 was as at 31 March 2013. This valuation revealed that the Fund's assets, which at 31 March 2013 were valued at £552 million, were sufficient to meet 70% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2013 valuation was £234 million. Individual employers' contributions for the period 1 April 2014 to 31 March 2017 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 28 March 2014.

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 2013 valuation were as follows:

Financial assumptions	31 March 2013	
	% p.a Nominal	% p.a. Real
Discount rate	4.60%	2.10%
Pay increases	3.80%	1.30%
Pension increases	2.50%	-

	Males	Females
Current Pensioners	22.1 years	24.4 years
Future Pensioners*	24.5 years	26.9 years

*Currently aged 45

Copies of the 2013 valuation report and Funding Strategy Statement are available on request from London Borough of Harrow , the administering authority to the Fund.

Experience over the period since April 2013

Experience has been slightly better than expected since the last valuation (excluding the effect of any membership movements). Real bond yields have risen and asset returns have been a little better than expected meaning that funding levels are likely to have improved since the 2013 valuation.

The next actuarial valuation will be carried out as at 31 March 2016. The Funding Strategy Statement will also be reviewed at that time.

Gemma Sefton FFA

Associate of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP
23 May 2014