

# London Borough of Harrow Pension Fund

Annual Report and Financial Statements for the  
year ended 31 March 2016



## CONTENTS

|     |                                                              |    |
|-----|--------------------------------------------------------------|----|
| 1.  | Introduction.....                                            | 3  |
| 2.  | Independent Auditor's Statement.....                         | 4  |
| 3.  | Scheme Management and Advisers.....                          | 5  |
| 4.  | Scheme Overview.....                                         | 6  |
| 5.  | Governance Arrangements.....                                 | 9  |
| 6.  | Investment Policy and Performance.....                       | 10 |
| 7.  | Statements and Publications.....                             | 13 |
| 8.  | Risk Management.....                                         | 14 |
| 9.  | Contacts.....                                                | 16 |
| 10. | Statement of Responsibilities for the Financial Statements.. | 17 |
| 11. | Harrow Pension Fund Account and Net Assets Statement...      | 18 |
| 12. | Notes to Harrow Pension Fund Accounts.....                   | 20 |
| 13. | Pension Fund Accounts Reporting Requirement.....             | 45 |

### Appendices

- Appendix 1 Governance Compliance Statement**
- Appendix 2 Communications Policy Statement**
- Appendix 3 A Brief Guide to the Local Government Pension Scheme**
- Appendix 4 Statement of Investment Principles**
- Appendix 5 Funding Strategy Statement**

## 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 2016. This Report also explains the administration and management of the Fund and its 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 Note 15 and in the Statement of the Consulting Actuary on page 45.

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

During 2015-16, most major asset classes, particularly UK equities, performed poorly with only overseas bonds and property realising significant growth. The Fund's investments reflected this disappointing performance producing an investment return of -1.9%.

The net assets of the Fund as at 31 March 2016 were £661.0m compared to £674.8m as at 31 March 2015. Whilst the Fund was ranked in the 89<sup>th</sup> percentile in the local authority annual league table of investment returns for the year, over the latest three years' it was ranked in the top third of funds.



**Dawn Calvert - CPFA**

Director of Finance

28<sup>th</sup> September 2016

# **Independent auditor's report to the members of the London Borough of Harrow on the pension fund financial statements published with the Pension Fund Annual Report**

We have examined the pension fund financial statements for the year ended 31 March 2016 on pages 18 to 44.

## **Respective responsibilities of the *Director of Finance* and the auditor**

As explained more fully in the Statement of the Director of Finance Responsibilities the Director of Finance is responsible for the preparation of the pension fund financial statements in accordance with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

Our responsibility is to report to you our opinion on the consistency of the pension fund financial statements included in the Pension Fund Annual Report with the pension fund financial statements included in the annual published statement of accounts of the London Borough of Harrow, and their compliance with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

In addition, we read the information given in the Pension Fund Annual Report to identify material inconsistencies with the pension fund financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Our report on the administering authority's annual published 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 pension fund financial statements included in the annual published statement of accounts of the London Borough of Harrow for the year ended 31 March 2016 and comply with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

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

The Code of Audit Practice requires us to report to you if:

- the information given in the Pension Fund Annual Report for the financial year for which the financial statements are prepared is not consistent with the financial statements; or
- any matters relating to the pension fund have been reported in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of, the audit.

We have nothing to report in respect of these matters.

**Andrew Sayers**

**For and on behalf of KPMG LLP, Statutory Auditor**

*Chartered Accountants*

15 Canada Square

Canary Wharf

London

E14 5GL

28 September 2016

## SCHEME MANAGEMENT AND ADVISORS

|                         |                                                                                                                                                                                                                                                                                                    |
|-------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Administering Authority | London Borough of Harrow                                                                                                                                                                                                                                                                           |
| Pension Fund Committee  | Councillor Adam Swersky (Chairman)<br>Councillor Bharat Thakker (Vice Chairman)<br>Councillor Keith Ferry<br>Councillor Norman Stevenson                                                                                                                                                           |
| Independent Advisers    | Colin Robertson<br>Richard Romain                                                                                                                                                                                                                                                                  |
| Co-optee                | Howard Bluston                                                                                                                                                                                                                                                                                     |
| Trade Union Observers   | John Royle - UNISON<br>Pamela Belgrave - GMB                                                                                                                                                                                                                                                       |
| Officer                 | Dawn Calvert, Director of Finance                                                                                                                                                                                                                                                                  |
| Actuary                 | Hymans Robertson LLP                                                                                                                                                                                                                                                                               |
| Investment Consultant   | Aon Hewitt Limited                                                                                                                                                                                                                                                                                 |
| Investment Managers     | Aviva Investors Global Services Limited<br>BlackRock Investment Management (UK) Limited<br>GMO LLC<br>Insight Investment<br>Longview Partners<br>Oldfield Partners<br>Pantheon Ventures<br>Record Currency Management Limited<br>Standard Life Investments<br>State Street Global Advisors Limited |
| AVC Providers           | Clerical Medical<br>Equitable Life Assurance Society<br>Prudential Assurance                                                                                                                                                                                                                       |
| Custodian               | JP Morgan                                                                                                                                                                                                                                                                                          |
| Auditor                 | KPMG LLP                                                                                                                                                                                                                                                                                           |
| Performance Measurement | State Street Global Services                                                                                                                                                                                                                                                                       |
| Bankers                 | The Royal Bank of Scotland                                                                                                                                                                                                                                                                         |

## SCHEME OVERVIEW

The Harrow Pension Fund ('the Fund') is part of the Local Government Pension Scheme ("LGPS") and is administered by the London Borough of Harrow. The Council is the reporting entity for the Fund.

### a) General

The Scheme is governed by the Public Service Pensions Act 2013.

The Fund is administered in accordance with the following secondary legislation:

- The Local Government Pension Scheme Regulations 2013 (as amended)
- The Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 (as amended)
- The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

It is a contributory defined benefit pension scheme designed to provide pensions and other benefits for pensionable employees of the Council and a range of other scheduled and admitted bodies. Teachers, police officers and firefighters are not included as they come within other national pension schemes.

The Fund is overseen by the Harrow Pension Fund Committee, which is a committee of the Council.

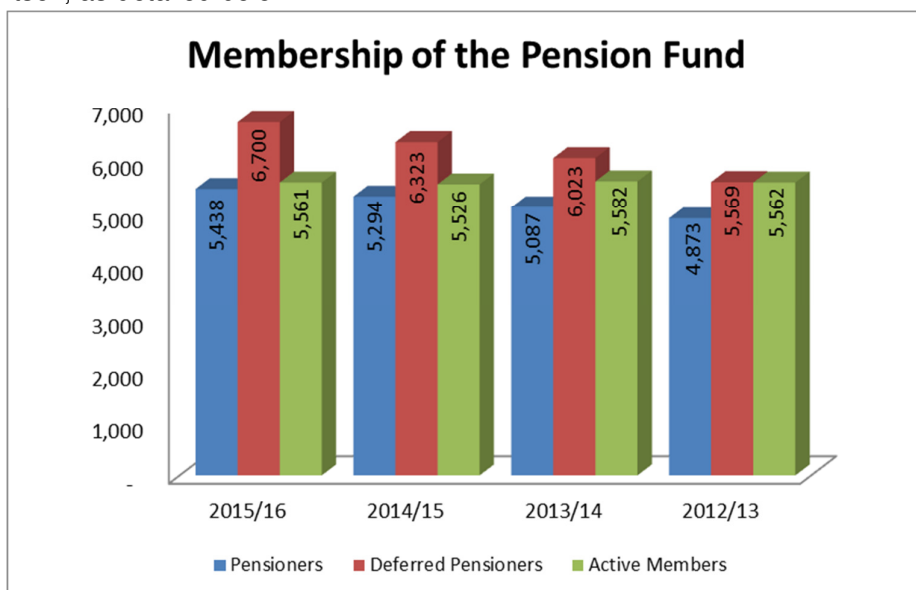
### b) Memberships

Membership of the LGPS is voluntary and employees are free to choose whether to join the Scheme, remain in the Scheme or make their own personal arrangements outside the Scheme.

Organisations participating in the Fund are:

- **Scheduled Employer:** These are statutorily defined bodies listed within the LGPS Regulations and have a statutory obligation to participate in the LGPS (e.g. a local authority, a further or higher education establishment).
- **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 which will have taken on staff from a local authority as a result of an outsourcing of services.

There are 30 employer organisations within the Harrow Pension Fund including the Council itself, as detailed below.



| Employer                  | Status                    | Actives      | Deferred     | Pensioners   | Total         | %             |
|---------------------------|---------------------------|--------------|--------------|--------------|---------------|---------------|
| Harrow Council            | Scheduled Body            | 4,086        | 5,660        | 5,087        | 14,833        | 83.80         |
| Alexandra School          | Scheduled Body            | 23           | 3            | 1            | 27            | 0.15          |
| Avanti Free School        | Scheduled Body            | 28           | 4            | 0            | 32            | 0.18          |
| Aylward Primary School    | Scheduled Body            | 77           | 6            | 0            | 83            | 0.47          |
| Bentley Wood School       | Scheduled Body            | 61           | 60           | 7            | 128           | 0.72          |
| Canons High School        | Scheduled Body            | 101          | 37           | 7            | 145           | 0.82          |
| Harrow College            | Scheduled Body            | 142          | 271          | 142          | 555           | 3.13          |
| Harrow High School        | Scheduled Body            | 63           | 45           | 6            | 114           | 0.64          |
| Hatch End School          | Scheduled Body            | 86           | 117          | 11           | 214           | 1.21          |
| Heathland and Whitefriars | Scheduled Body            | 153          | 18           | 2            | 173           | 0.98          |
| Krishna Avanti Primary    | Scheduled Body            | 22           | 7            | 0            | 29            | 0.16          |
| Nower Hill High School    | Scheduled Body            | 124          | 99           | 7            | 230           | 1.30          |
| Park High School          | Scheduled Body            | 88           | 50           | 4            | 142           | 0.80          |
| Pinner High Academy       | Scheduled Body            | 1            | 0            | 0            | 1             | 0.01          |
| Rooks Heath College       | Scheduled Body            | 107          | 40           | 7            | 154           | 0.87          |
| Salvatorian College       | Scheduled Body            | 42           | 44           | 6            | 92            | 0.52          |
| St Bernadettes            | Scheduled Body            | 30           | 0            | 0            | 30            | 0.17          |
| St Dominics College       | Scheduled Body            | 53           | 27           | 33           | 113           | 0.64          |
| Stanmore College          | Scheduled Body            | 78           | 144          | 69           | 291           | 1.64          |
| NLCS                      | Community Admission Body  | 77           | 34           | 28           | 139           | 0.79          |
| Birkin                    | Transferee Admission Body | 10           | 0            | 0            | 10            | 0.06          |
| Carillion Services        | Transferee Admission Body | 55           | 19           | 18           | 92            | 0.52          |
| Chartwells                | Transferee Admission Body | 16           | 2            | 1            | 19            | 0.11          |
| Engie (Cofely)            | Transferee Admission Body | 2            | 0            | 0            | 2             | 0.01          |
| Govindas                  | Transferee Admission Body | 5            | 0            | 0            | 5             | 0.03          |
| Granary Kids              | Transferee Admission Body | 1            | 1            | 1            | 3             | 0.02          |
| Jubilee Academy           | Transferee Admission Body | 14           | 11           | 0            | 25            | 0.14          |
| Linbrook                  | Transferee Admission Body | 4            | 1            | 0            | 5             | 0.03          |
| Sopria Steria             | Transferee Admission Body | 9            | 0            | 1            | 10            | 0.06          |
| Taylor Shaw               | Transferee Admission Body | 3            | 0            | 0            | 3             | 0.02          |
| <b>Total</b>              |                           | <b>5,561</b> | <b>6,700</b> | <b>5,438</b> | <b>17,699</b> | <b>100.00</b> |

### c) Funding

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.

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Fund in accordance with the LGPS Regulations 2013 and range from 5.5% to 12.5% of pensionable pay. Employee contributions are matched by employers' contributions which are set based on triennial actuarial funding valuations. Currently almost all, employer contribution rates fall within the range 15% to 28% of pensionable pay with most of the largest employers paying 20.85%.

### d) Benefits

Prior to 1 April 2014, pension benefits under the LGPS were based on final pensionable pay and length of pensionable service, summarised below.

|                 | Service pre 1 April 2008                                                                                                                                                                  | Service post 31 March 2008                                                                                                                                        |
|-----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Pension</b>  | Each year worked is worth 1/80 x final pensionable salary                                                                                                                                 | Each year worked is worth 1/60 x final pensionable salary                                                                                                         |
| <b>Lump Sum</b> | Automatic lump sum of 3 x salary. In addition, part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up | No automatic lump sum. Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up |

From 1 April 2014, the Scheme became a career average scheme, whereby members accrue benefits based on their pensionable pay in each year at an accrual rate of 1/49th. Accrued pension is updated annually in line with the Consumer Prices Index.

There are a range of other benefits provided under the Scheme including early retirement, disability pensions and death benefits. For more details, please refer to the 'Brief Guide to the Local Government Pension Scheme' attached as Appendix 3.

## GOVERNANCE ARRANGEMENTS

The Council has delegated to the Pension Fund Committee various powers and duties in respect of its administration of the Fund. The Committee met five times during the year. It comprises four Councillors with full voting rights. Representatives from the trade unions are able to participate as observers of the Committee but do not have voting rights.

The Pension Fund Committee has the following terms of reference:

- 1) 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;
- 2) the determination of applications under the Local Government Superannuation Regulations and the Teachers' Superannuation Regulations;
- 3) to administer all matters concerning the Council's pension investments in accordance with the law and Council policy;
- 4) to establish a strategy for the disposition of the pension investment portfolio;
- 5) to appoint and determine the investment managers' delegation of powers of management of the fund;
- 6) 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;
- 7) to apply the arrangements set out in (6) above 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;

The Committee is advised by two independent advisers, a co-optee and an investment consultant.

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>

The Local Pension Board assists the Council and the Pension Fund Committee in the administration of the Fund. In particular it oversees:

- a) the effectiveness of the decision making process
- b) the direction of the Fund and its overall objectives
- c) the level of transparency in the conduct of the Fund's activities
- d) the administration of benefits and contributions

## **INVESTMENT POLICY AND PERFORMANCE**

### **Investment Market Commentary (provided by State Street Global Services Performance Services, 2016)**

All equity markets, with the exception of North America, produced negative returns over the year. In spite of a surprise outright majority being returned in May's general election, domestic equities lost ground in the early part of the period. After rebounding to some extent in the December quarter, they ended the period down 4%, reflecting the high exposure to oil majors and commodities, which continued to suffer as oil prices fell.

In sterling terms, North America was the strongest performing of the major overseas markets returning 3%. In contrast, the poorest performing areas were the emerging and lesser Asia Pacific markets which gave up between 7 and 8%. Elsewhere, Europe lost 3% and Japan 4%. Currency had a major influence on international equity returns with the weakness of Sterling insulating UK investors against much lower base currency returns.

After the double-digit returns of the previous year, bond performance was much more subdued with an aggregate return in low single figures. Yields fell at the outset of the year and by Christmas, returns were looking quite negative. Central Government comments and risk aversion generally in the closing quarter, however saw yields pick up. Long dated bonds produced the best of the returns whilst corporate issues were marginally down over the period. Index-Linked gilts returned 2% and overseas bonds 4%.

Alternative investments in aggregate enjoyed a good year, however fortune was mixed. Private equity returned 14%, whilst hedge fund performance was flat. Pooled multi-asset (diversified growth) investments had a disappointing year, returning -3%. Property continued its strong run, returning 11%.

### **Investment Policy**

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 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 and sub-underwriting contracts.

To support the Fund's objective of achieving a return that is sufficient to meet the cost of benefits within acceptable risk parameters the Committee, in conjunction with the Fund's investment advisor, set the strategic asset allocation on 6 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.

The following table compares the actual asset allocation as at 31 March 2016 to the agreed allocation

| Investment assets                | Actual<br>Percentage<br>of Fund | Agreed<br>Allocation |
|----------------------------------|---------------------------------|----------------------|
|                                  | %                               | %                    |
| Fixed interest securities        | 11                              | 10                   |
| Index-linked securities          | 3                               | 3                    |
| Developed world equities-active  | 22                              | 21                   |
| Emerging markets equities-active | 11                              | 10                   |
| Global equities-passive          | 33                              | 31                   |
| Pooled property                  | 8                               | 10                   |
| Private equity                   | 3                               | 5                    |
| Diversified growth funds         | 8                               | 10                   |
| Forward currency contracts       | (1)                             | 0                    |
| Cash                             | 2                               | 0                    |
| <b>Total</b>                     | <b>100</b>                      | <b>100</b>           |

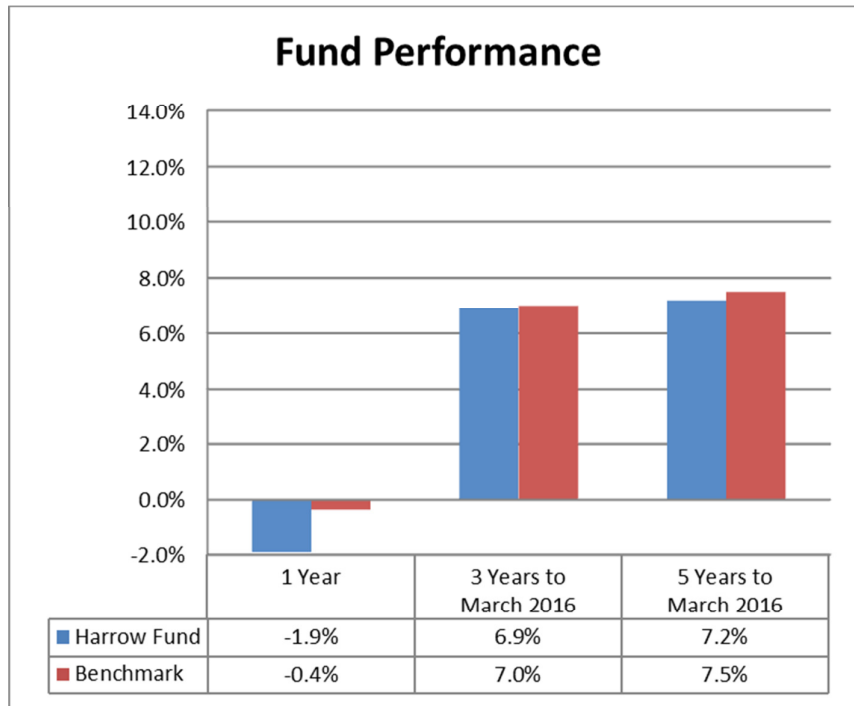
The Committee believes in appointing Fund managers with clear performance benchmarks that place maximum accountability for performance against that benchmark with the investment manager. Fund managers are set risk parameters to provide them with some flexibility in achieving the asset allocation to allow 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. 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

| Market value<br>31 March 2015 | Percentage<br>of Fund | Manager       | Investment assets                | Market value<br>31 March 2016 | Percentage<br>of Fund |
|-------------------------------|-----------------------|---------------|----------------------------------|-------------------------------|-----------------------|
| £'000                         | %                     |               |                                  | £'000                         | %                     |
| 69,247                        | 10                    | BlackRock     | Fixed interest securities        | 69,401                        | 11                    |
| 17,130                        | 3                     | BlackRock     | Index-linked securities          | 17,577                        | 3                     |
| 76,541                        | 11                    | GMO           | Emerging markets equities-active | 71,463                        | 11                    |
| 75,561                        | 11                    | Longview      | Developed world equities-active  | 75,499                        | 11                    |
| 77,276                        | 11                    | Oldfields     | Developed world equities-active  | 70,701                        | 11                    |
| 220,601                       | 33                    | State Street  | Global equities-passive          | 219,424                       | 33                    |
| 0                             | 0                     | London CIV    | UK equities-passive              | 150                           | 0                     |
| 50,562                        | 8                     | Aviva         | Pooled property                  | 53,481                        | 8                     |
| 22,954                        | 3                     | Pantheon      | Private equity                   | 20,571                        | 3                     |
| 28,857                        | 4                     | Insight       | Diversified growth fund          | 27,071                        | 4                     |
| 30,678                        | 5                     | Standard Life | Diversified growth fund          | 29,216                        | 4                     |
| (2,649)                       | 0                     | Record        | Forward currency contracts       | (6,388)                       | (1)                   |
| 865                           | 0                     | BlackRock     | Cash with investment managers    | 44                            | 0                     |
| 272                           | 0                     | JP Morgan     | Cash with investment managers    | 0                             | 0                     |
| 5,793                         | 1                     |               | Cash deposits                    | 11,485                        | 2                     |
| <b>673,688</b>                | <b>100</b>            |               | <b>Total</b>                     | <b>659,695</b>                | <b>100</b>            |

## Fund performance

The Committee uses State Street Global Services as its independent investment performance measurer. Investment returns over 1, 3 and 5 years are shown below.



Source: State Street Global Services

The Fund's return of -1.9% during 2015-16 was due to the relatively poor performance of equities generally and the UK in particular and the disappointing performance of some of the fund managers. Returns over the longer time periods were broadly in line with the expected performance benchmarks.

The average local authority fund (as measured by State Street Global Services Performance Services) returned 0.2% on its assets during the year. The Council's Fund was ranked in the 89<sup>th</sup> percentile (2014-15: 14<sup>th</sup>) in the local authority annual league table of investment returns for the year.

The under performance of 2.1% against the average local authority fund was due mainly to the performance of the diversified growth funds and stock selection by equity fund managers.

## **STATEMENTS AND PUBLICATIONS**

### **Governance Compliance Statement**

The Local Government Pension Scheme (Administration) Regulations 2008 Regulation 31 require 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; and
- 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; and
- 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.

## **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 risks 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:

### **Governance and Regulatory Risk**

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:

- Decisions are taken by the Pension Fund Committee in the light of advice from the Investment Adviser and officers;
- 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; and.
- Establishment of the Pension Board.

### **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 some of the Admitted employers.

### **Investment Risk**

The Fund is invested in a range of asset classes as detailed in Note 12. 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:

#### Pricing Risk

The valuation of investments is constantly changing, impacting on the potential realisation proceeds and income. For example, the value of the Fund's investments decreased by 3% in 2015-16 compared to increasing by 14% in the previous year. Most of the price changes relate to the value of global 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 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 and one passive manager and diversified growth funds by two managers to reduce the risk of underperformance against benchmarks. The Investment Adviser provides quarterly reports on the performance and skills of each manager to the Pension Fund Committee; and
- 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 11% of Harrow's Fund is in illiquid assets. This is deemed appropriate for a fund 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 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.

#### **Actuarial Risk**

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 benefits structure have reduced some of these risks. All are monitored through the actuarial valuation process and additional contributions required from employers should deficits arise.

#### **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 manager together with annual assessments of the control environment including reviews of internal controls reports certified by reporting auditors.

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

## CONTACTS

|                          |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|--------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Registered Address       | London Borough of Harrow<br>HR Operations - Pensions,<br>3rd Floor South Wing,<br>Civic Centre,<br>Harrow,<br>HA1 2XF                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| Administration Enquiries | Email address: Pension@harrow.gov.uk<br>Telephone Number: 020 8424 1186<br>Website: <a href="http://www.harrowpensionfund.org">www.harrowpensionfund.org</a>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| Complaints and Advice    | The Pensions Advisory Service<br>11 Belgrave Road<br>London<br>SW1V 1RB<br><br>Telephone Number: 0300 123 1047<br>Website: <a href="http://www.pensionsadvisoryservice.org.uk">www.pensionsadvisoryservice.org.uk</a><br><br>The Pensions Regulator<br>Napier House<br>Trafalgar Place<br>Brighton<br>BN1 4DW<br><br>Telephone Number: 0345 6000707<br>Website: <a href="http://www.thepensionsregulator.gov.uk">www.thepensionsregulator.gov.uk</a><br><br>The Pensions Ombudsman<br>11 Belgrave Road<br>London<br>SW1V 1RB<br><br>Telephone Number: 0207 630 2200<br>Fax Number: 0207 821 0065<br><br>Email: <a href="mailto:enquiries@pensions-ombudsman.org.uk">enquiries@pensions-ombudsman.org.uk</a><br>Website: <a href="http://www.pensions-ombudsman.org.uk">www.pensions-ombudsman.org.uk</a> |
| Tracing Service          | The Pension Tracing Service<br>Tyneview Park<br>Whitley Road<br>Newcastle Upon Tyne<br>NE98 1BA<br><br>Telephone Number: 0800 122 3170<br>Website: <a href="http://www.gov.uk/find-lost-pension">www.gov.uk/find-lost-pension</a>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |

## **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;
- 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's Responsibilities**

The Director of Finance 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 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; and
- 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 2016 and its income and expenditure for the year then ended.



**Dawn Calvert – CPFA**  
Director of Finance  
28<sup>th</sup> September 2016

# Harrow Pension Fund Account for the year ended 31 March 2016

| 2014/15          |                                                                                         | Notes | 2015/16          |
|------------------|-----------------------------------------------------------------------------------------|-------|------------------|
| £'000            |                                                                                         |       | £'000            |
|                  | <b>Dealings with members, employers and others directly involved in the fund</b>        |       |                  |
| (28,013)         | Contributions receivable                                                                | 6     | (28,333)         |
| (1,267)          | Transfers in from other pension funds                                                   | 7     | (5,839)          |
| (35)             | Other income                                                                            |       | (261)            |
| <b>(29,315)</b>  |                                                                                         |       | <b>(34,433)</b>  |
| 32,008           | Benefits payable                                                                        | 8     | 31,265           |
| 2,266            | Payments to and on account of leavers                                                   | 9     | 3,239            |
| <b>34,274</b>    |                                                                                         |       | <b>34,504</b>    |
| <b>4,959</b>     | <b>Net additions/reductions from dealings with members</b>                              |       | <b>71</b>        |
| 3,958            | Management expenses                                                                     | 10    | 4,630            |
|                  | <b>Return on investments</b>                                                            |       |                  |
| (10,863)         | Investment income                                                                       | 11    | (10,425)         |
| (82,082)         | Profit/losses on disposal of investments and changes in the market value of investments | 12A   | 19,568           |
| <b>(92,945)</b>  | <b>Net return on investments</b>                                                        |       | <b>9,143</b>     |
| (84,028)         | Net (increase)/decrease in the net assets available for benefits during the year        |       | 13,844           |
| (590,817)        | Net Assets at start of year                                                             |       | (674,845)        |
| <b>(674,845)</b> | <b>Net Assets at end of year</b>                                                        |       | <b>(661,001)</b> |

# Net Assets Statement as at 31 March 2016

| 2014/15        |                                                                        | Notes | 2015/16        |
|----------------|------------------------------------------------------------------------|-------|----------------|
| £'000          |                                                                        |       | £'000          |
|                | <b>Investment assets</b>                                               |       |                |
| 669,407        | Investments                                                            | 12    | 654,554        |
| 1,459          | Derivative contracts                                                   | 12    | 878            |
| 1,137          | Cash with investment managers                                          | 12    | 44             |
| <b>672,003</b> |                                                                        |       | <b>655,476</b> |
| 5,793          | Cash deposits                                                          | 12    | 11,485         |
| <b>677,796</b> |                                                                        |       | <b>666,961</b> |
|                | <b>Investment liabilities</b>                                          |       |                |
| (4,108)        | Derivative contracts                                                   | 12    | (7,266)        |
| <b>673,688</b> |                                                                        |       | <b>659,695</b> |
| 2,051          | Current assets                                                         | 17    | 2,069          |
| (894)          | Current liabilities                                                    | 18    | (763)          |
| <b>674,845</b> | <b>Net assets of fund available to fund benefits at the period end</b> |       | <b>661,001</b> |

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 45 and 46 and these Financial Statements should be read in conjunction with it.

*D. Calvert*

**Dawn Calvert – CPFA**  
Director of Finance  
28<sup>th</sup> September 2016

# Notes to the Harrow Pension Fund

## Accounts for the year ended

### 31 March 2016

#### **NOTE 1: BASIS OF PREPARATION**

The Statement of Accounts summarises the Fund's transactions for the 2015/16 financial year and its position as at 31 March 2016. The Accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 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.

#### **NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### **Fund account – Revenue Recognition**

###### **a) Contributions income**

Normal contributions, both from the members and from employers, are accounted for on an accruals basis at the percentage rate recommended by the Fund actuary in the financial year to which they relate.

Employer deficit funding contributions are accounted for on the due dates on which they are payable under the schedule of contributions set by the Fund actuary or on receipt if earlier than the due date.

Employers' augmentation contributions and pensions 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 until future years, if significant, 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 during the financial year and are calculated in accordance with The Local Government Pension Scheme Regulations (see notes 7 and 9).

Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

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

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

### **c) Investment income**

- i) 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
- ii) Distributions from pooled funds are recognised at the date of issue.
- iii) Changes in the net market value of investments are recognised as income and comprise all realised and unrealised gains/losses during the year.

## **Fund account – Expense items**

### **a) 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.

### **b) 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.

### **c) Management expenses**

The Code does not require any breakdown of pension fund administrative expenses. However in the interest of greater transparency, the Council discloses its Pension Fund management expenses in accordance with the CIPFA guidance *Accounting for Local Government Pension Scheme Management Costs* (2014).

#### Administrative expenses

All administrative expenses are accounted for on an accruals basis. All staff costs of the Pension's Administration Team are recharged to the Fund. Associated management, accommodation and other overheads are apportioned to this activity and recharged as expenses to the Fund.

#### Oversight and governance costs

All oversight and governance expenses are accounted for on an accruals basis. All staff costs relating to the oversight and governance of the Fund's investments are recharged to the Fund. Associated management, accommodation and other overheads are apportioned to this activity and recharged as expenses to the Fund.

### Investment management expenses

All investment management expenses are accounted for on an accruals basis.

Fees of the external investments 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 values of these investments change

Where an investment manager's fee invoice has not been received by the balance sheet date an estimate based on the market value of their mandate as at the end of the year is used for inclusion in the Fund account in 2015/16.

## **Net Assets Statement**

### **a) 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 an asset are recognised in the Fund account.

The values of investments as shown in the Net Assets Statement have been determined as follows:

#### i) Market-quoted investments

The value of an investment for which there is a readily available market price is determined by the bid market price ruling on the final day of the accounting period.

#### ii) Fixed interest securities

Fixed interest securities are recorded at bid market price ruling on the final day of the accounting period.

#### iii) Unquoted investments

Investments in unquoted property pooled funds are valued at the net asset value as advised by the fund manager.

Investments in private equity funds and unquoted listed partnerships are valued based on the Fund's share of the net assets in the private equity fund or limited partnership using the latest financial statements published by the respective fund managers in accordance with the *International Private Equity and Venture Capital Valuation Guidelines 2012*. The Fund's private equity investments are valued by the manager at 31 December 2015 and are adjusted to take into account distributions/contributions and exchange rate movements taking place up to 31 March 2016

#### iv) Pooled investment vehicles

Pooled investment vehicles are valued at closing bid price if both bid and offer prices are published; or if single priced, at the closing price available. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income which is reinvested in the Fund, net of applicable withholding tax.

**b) Derivatives**

The Fund uses derivative financial instruments to manage its exposure to specific risks arising from its investment activities. The Fund does not hold derivatives for speculative purposes.

Derivative contract assets are fair valued at bid prices and liabilities are fair valued at offer prices. Changes in the fair value of derivative contracts are included in change in market value.

The future value of forward currency contracts is based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year end with an equal and opposite contract.

**c) Cash and cash equivalents**

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

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.

**d) 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.

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

The actuarial present value of promised retirement benefits 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 statement (Note 16).

**f) Additional Voluntary Contributions**

The Fund provides an additional voluntary contribution (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. The Fund has appointed Prudential Assurance, Clerical Medical and Equitable Life Assurance Society as its AVC providers. AVCs are paid to the AVC provider by employers and are specifically intended 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.

AVCs are not included in the accounts in accordance with section 4 (2)(b) of The Local Government Pension Scheme (Management and Investments of Funds) Regulations 2009 but are disclosed as a note only (Note 19)

## NOTE 3: CRITICAL JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

### Unquoted private equity investments

It is important to recognise the subjective nature of determining the fair value of private equity investments. They are inherently based on forward-looking estimates and judgements involving many factors. Unquoted private equities are valued by the investment managers using the *International Private Equity and Venture Capital Valuation Guidelines 2012*. The value of unquoted private equities at 31 March 2016 was £20.6m (31 March 2015 £23.0m).

### Pension Fund liability

The Pension Fund liability is calculated every three years by the appointed actuary. Annual updates in the intervening years use the methodology in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in notes 15 and 16. Valuations are subject to significant variances based on changes to the underlying assumptions.

## NOTE 4: 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 for the 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 2016 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

| Item                                                           | Uncertainties                                                                                                                                                                                                                                                                                                                                                                                      | Effect if actual results differ from assumptions                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|----------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Actuarial present value of promised retirement benefits</b> | 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 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. | <p>The effects on the net pension liability of changes in individual assumptions can be measured. For instance:</p> <ul style="list-style-type: none"> <li>• a 0.5% decrease in the discount rate assumption would result in an increase in the pension liability of £88m</li> <li>• a 0.5% increase in assumed earnings inflation would increase the value of liabilities by approximately £21m</li> <li>• a one-year increase in assumed life expectancy would increase the liability by approximately £28m</li> </ul> |

**Private equity**

Private equity 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 as such there is a degree of estimation involved in the valuation.

The total private equity investments in the financial statements are £20.6m. There is a risk that this investment may be under or overstated in the accounts.

**NOTE 5: EVENTS AFTER THE REPORTING DATE**

These are events that occur between the end of the reporting period and the date when the financial statements are authorised for issue.

The Fund is not aware of any such events.

**NOTE 6: CONTRIBUTIONS RECEIVABLE****By category**

| 2014/15         |                                       | 2015/16         |
|-----------------|---------------------------------------|-----------------|
| £'000           |                                       | £'000           |
| (6,561)         | Employees' contributions              | (6,599)         |
|                 | <b>Employers' contributions:</b>      |                 |
| (16,580)        | Normal contributions                  | (16,763)        |
| (3,934)         | Deficit recovery contributions        | (4,549)         |
| (938)           | Pension strain contributions          | (422)           |
| <b>(21,452)</b> | <b>Total employers' contributions</b> | <b>(21,734)</b> |
| <b>(28,013)</b> |                                       | <b>(28,333)</b> |

**By authority**

| 2014/15         |                             | 2015/16         |
|-----------------|-----------------------------|-----------------|
| £'000           |                             | £'000           |
| (21,243)        | Administering Authority     | (21,504)        |
| (5,410)         | Scheduled bodies            | (5,667)         |
| (504)           | Community admission body    | (519)           |
| (856)           | Transferee admission bodies | (643)           |
| <b>(28,013)</b> |                             | <b>(28,333)</b> |

## NOTE 7: TRANSFERS IN FROM OTHER PENSION FUNDS

| 2014/15 |                      | 2015/16 |
|---------|----------------------|---------|
| £'000   |                      | £'000   |
| 0       | Group transfers      | (3,304) |
| (1,267) | Individual transfers | (2,535) |
| (1,267) |                      | (5,839) |

## NOTE 8: BENEFITS PAYABLE

### By category

| 2014/15       |                                              | 2015/16       |
|---------------|----------------------------------------------|---------------|
| £'000         |                                              | £'000         |
| 25,188        | Pensions                                     | 26,454        |
| 6,068         | Commutation and lump sum retirement benefits | 4,074         |
| 752           | Lump sum death benefits                      | 737           |
| <b>32,008</b> |                                              | <b>31,265</b> |

### By authority

| 2014/15       |                             | 2015/16       |
|---------------|-----------------------------|---------------|
| £'000         |                             | £'000         |
| 30,268        | Administering Authority     | 29,070        |
| 1,398         | Scheduled bodies            | 1,508         |
| 203           | Community admission body    | 290           |
| 139           | Transferee admission bodies | 397           |
| <b>32,008</b> |                             | <b>31,265</b> |

## NOTE 9: PAYMENTS TO AND ON ACCOUNT OF LEAVERS

| 2014/15      |                                    | 2015/16      |
|--------------|------------------------------------|--------------|
| £'000        |                                    | £'000        |
| 44           | Refunds to members leaving service | 60           |
| 2,222        | Individual transfers               | 3,179        |
| <b>2,266</b> |                                    | <b>3,239</b> |

## NOTE 10: MANAGEMENT EXPENSES

| 2014/15      |                                | 2015/16      |
|--------------|--------------------------------|--------------|
| £'000        |                                | £'000        |
| 823          | Administrative costs           | 642          |
| 2,569        | Investment management expenses | 3,452        |
| 566          | Oversight and governance costs | 536          |
| <b>3,958</b> |                                | <b>4,630</b> |

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

## NOTE 11: INVESTMENT INCOME

| 2014/15         |                                                           | 2015/16         |
|-----------------|-----------------------------------------------------------|-----------------|
| £'000           |                                                           | £'000           |
| (5,723)         | Private equity net distributions                          | (6,030)         |
| (1,940)         | Pooled property investments                               | (1,708)         |
| (3,200)         | Pooled investments - units trusts and other managed funds | (2,687)         |
| <b>(10,863)</b> |                                                           | <b>(10,425)</b> |

## NOTE 12: INVESTMENTS

| Market value                  |                                        | Market value   |
|-------------------------------|----------------------------------------|----------------|
| 31 March 2015                 |                                        | 31 March 2016  |
| £'000                         |                                        | £'000          |
| <b>Investment assets</b>      |                                        |                |
| 69,247                        | Fixed interest securities              | 69,401         |
| 17,130                        | Index-linked securities                | 17,577         |
| 449,979                       | Pooled equity investments              | 437,087        |
| 0                             | Equity in London CIV                   | 150            |
| 50,562                        | Pooled property investments            | 53,481         |
| 22,954                        | Private equity                         | 20,571         |
| 59,535                        | Alternative investments                | 56,287         |
| 1,459                         | Derivative contracts: forward currency | 878            |
| 1,137                         | Cash with investment managers          | 44             |
| 5,793                         | Cash deposits                          | 11,485         |
| <b>677,796</b>                | <b>Total investment assets</b>         | <b>666,961</b> |
| <b>Investment liabilities</b> |                                        |                |
| (4,108)                       | Derivative contracts: forward currency | (7,266)        |
| <b>(4,108)</b>                | <b>Total investments liabilities</b>   | <b>(7,266)</b> |
| <b>673,688</b>                | <b>Net investment assets</b>           | <b>659,695</b> |

## NOTE 12A: RECONCILIATION OF MOVEMENTS IN INVESTMENTS AND DERIVATIVES

|                                           | Market value<br>31 March 2015 | Purchases during<br>the year and<br>derivative<br>payments | Sales during the<br>year and<br>derivative<br>receipts | Net change in<br>market value<br>during the year | Market value<br>31 March 2016 |
|-------------------------------------------|-------------------------------|------------------------------------------------------------|--------------------------------------------------------|--------------------------------------------------|-------------------------------|
|                                           | £'000                         | £'000                                                      | £'000                                                  | £'000                                            | £'000                         |
| <b>Investment assets</b>                  |                               |                                                            |                                                        |                                                  |                               |
| Fixed interest securities                 | 69,247                        | 3,130                                                      | (231)                                                  | (2,745)                                          | 69,401                        |
| Index-linked securities                   | 17,130                        | 1,032                                                      | (422)                                                  | (163)                                            | 17,577                        |
| Pooled equity investments                 | 449,979                       | 0                                                          | (1,742)                                                | (11,150)                                         | 437,087                       |
| Pooled property investments               | 50,562                        | 0                                                          | (474)                                                  | 3,393                                            | 53,481                        |
| Equity in London CIV                      | 0                             | 150                                                        | 0                                                      | 0                                                | 150                           |
| Private equity                            | 22,954                        | 0                                                          | (564)                                                  | (1,819)                                          | 20,571                        |
| Alternative investments                   | 59,535                        | 0                                                          | (365)                                                  | (2,883)                                          | 56,287                        |
| Derivative contracts:net forward currency | (2,649)                       | 3,867                                                      | (3,405)                                                | (4,201)                                          | (6,388)                       |
| Cash re Transition                        | 268                           | 0                                                          | (268)                                                  | 0                                                | 0                             |
|                                           | <b>667,026</b>                | <b>8,179</b>                                               | <b>(7,471)</b>                                         | <b>(19,568)</b>                                  | <b>648,166</b>                |
| Cash with investment managers             | 869                           |                                                            |                                                        |                                                  | 44                            |
| Cash deposits                             | 5,793                         |                                                            |                                                        |                                                  | 11,485                        |
|                                           | <b>6,662</b>                  |                                                            |                                                        |                                                  | <b>11,529</b>                 |
| <b>Total investment assets</b>            | <b>673,688</b>                |                                                            |                                                        | <b>(19,568)</b>                                  | <b>659,695</b>                |

|                                           | Market value<br>31 March 2014 | Purchases during<br>the year and<br>derivative<br>payments | Sales during the<br>year and<br>derivative<br>receipts | Net change in<br>market value<br>during the year | Market value<br>31 March 2015 |
|-------------------------------------------|-------------------------------|------------------------------------------------------------|--------------------------------------------------------|--------------------------------------------------|-------------------------------|
|                                           | £'000                         | £'000                                                      | £'000                                                  | £'000                                            | £'000                         |
| <b>Investment assets</b>                  |                               |                                                            |                                                        |                                                  |                               |
| Fixed interest securities                 | 57,567                        | 3,302                                                      | (106)                                                  | 8,484                                            | 69,247                        |
| Index-linked securities                   | 14,468                        | 683                                                        | (791)                                                  | 2,770                                            | 17,130                        |
| Pooled equity investments                 | 387,311                       | 363,811                                                    | (359,049)                                              | 57,906                                           | 449,979                       |
| Pooled property investments               | 45,051                        | 0                                                          | (433)                                                  | 5,944                                            | 50,562                        |
| Private equity                            | 24,648                        | 731                                                        | (7,002)                                                | 4,577                                            | 22,954                        |
| Alternative investments                   | 54,520                        | 27,925                                                     | (28,374)                                               | 5,464                                            | 59,535                        |
| Derivative contracts:net forward currency | 1,113                         | 1,282                                                      | (1,713)                                                | (3,331)                                          | (2,649)                       |
| Cash re Transition                        | 0                             | 0                                                          | 0                                                      | 268                                              | 268                           |
|                                           | <b>584,678</b>                | <b>397,734</b>                                             | <b>(397,468)</b>                                       | <b>82,082</b>                                    | <b>667,026</b>                |
| Cash with investment managers             | 602                           |                                                            |                                                        |                                                  | 869                           |
| Cash deposits                             | 4,271                         |                                                            |                                                        |                                                  | 5,793                         |
|                                           | <b>4,873</b>                  |                                                            |                                                        |                                                  | <b>6,662</b>                  |
| <b>Total investment assets</b>            | <b>589,551</b>                |                                                            |                                                        | <b>82,082</b>                                    | <b>673,688</b>                |

## NOTE 12B: ANALYSIS OF INVESTMENTS

| 31 March 2015                 |                                     |                           | 31 March 2016  |
|-------------------------------|-------------------------------------|---------------------------|----------------|
| £'000                         |                                     |                           | £'000          |
| <b>Pooled Investments</b>     |                                     |                           |                |
| <b>UK</b>                     |                                     |                           |                |
| 69,247                        | Fixed Interest Securities           | Corporate                 | 69,401         |
| 17,130                        | Index Linked Securities             | Public Sector             | 17,577         |
| 50,562                        | Managed Funds - Property            | Unit Trusts               | 53,481         |
| <b>Global</b>                 |                                     |                           |                |
| 220,601                       | Managed Funds - Equities            | Unitised Insurance Policy | 219,424        |
| 229,378                       | Managed Funds - Equities            | Other                     | 217,663        |
| <b>449,979</b>                |                                     |                           | <b>437,087</b> |
| 30,678                        | Managed Funds - Alternatives        | Unit Trusts               | 29,216         |
| 28,857                        | Managed Funds - Alternatives        | Other                     | 27,071         |
| <b>59,535</b>                 |                                     |                           | <b>56,287</b>  |
| 22,954                        | Managed Funds - Private Equity      | Other                     | 20,571         |
| 1,459                         | Derivatives                         |                           | 878            |
| 0                             | Equity in London CIV                |                           | 150            |
| 1,137                         | Cash with investment managers       |                           | 44             |
| 5,793                         | Cash Deposits                       |                           | 11,485         |
| <b>677,796</b>                | <b>Total Investment Assets</b>      |                           | <b>666,961</b> |
| <b>Investment Liabilities</b> |                                     |                           |                |
| (4,108)                       | Derivatives                         |                           | (7,266)        |
| <b>(4,108)</b>                | <b>Total Investment Liabilities</b> |                           | <b>(7,266)</b> |
| <b>673,688</b>                | <b>Net Investment Assets</b>        |                           | <b>659,695</b> |

### Analysis of derivatives

#### Objectives and policies for holding derivatives

Most of the holding in derivatives is to hedge liabilities or hedge exposures to reduce risk in the Fund. Derivatives may be used to gain exposure to an asset more efficiently than holding the underlying asset. The use of derivatives is managed in line with the investment management agreement agreed between the Fund and the various investment managers.

In order to maintain appropriate diversification and to take advantage of overseas investment returns, a significant proportion of the Fund's equity portfolio is in overseas stock markets. To reduce the volatility associated with fluctuating currency rates, the Fund has a passive currency programme in place managed by Record Currency Management Limited. The Fund hedges 50% of the exposure in various developed world currencies within the equities portfolio.

## Open forward currency contracts

| Settlement                                              | Currency bought | Local value | Currency sold | Local value | Asset value  | liability value |
|---------------------------------------------------------|-----------------|-------------|---------------|-------------|--------------|-----------------|
|                                                         |                 | 000         |               | 000         | £'000        | £'000           |
| Up to one month                                         | GBP             | 2,360       | AUD           | (4,967)     |              | (299)           |
| Up to one month                                         | GBP             | 3,136       | CAD           | (6,507)     |              | (365)           |
| Up to one month                                         | GBP             | 4,143       | CHF           | (6,112)     |              | (300)           |
| Up to one month                                         | GBP             | 5,100       | EUR           | (6,878)     |              | (356)           |
| Up to one month                                         | HKD             | 40,399      | GBP           | (3,651)     |              | (27)            |
| Up to one month                                         | GBP             | 3,493       | HKD           | (40,399)    |              | (132)           |
| Up to one month                                         | GBP             | 12,164      | JPY           | (2,204,400) |              | (1,486)         |
| Up to one month                                         | GBP             | 26,631      | USD           | (40,405)    |              | (1,484)         |
| One to six months                                       | GBP             | 2,634       | AUD           | (4,967)     |              | (13)            |
| One to six months                                       | GBP             | 3,469       | CAD           | (6,507)     |              | (31)            |
| One to six months                                       | GBP             | 4,416       | CHF           | (6,112)     |              | (44)            |
| One to six months                                       | GBP             | 5,037       | EUR           | (6,878)     |              | (432)           |
| One to six months                                       | GBP             | 9,885       | JPY           | (1,797,900) |              | (1,276)         |
| One to six months                                       | GBP             | 23,283      | USD           | (34,707)    |              | (860)           |
| Over six months                                         | GBP             | 5,429       | EUR           | (6,878)     |              | (55)            |
| Over six months                                         | GBP             | 11,137      | JPY           | (1,797,900) |              | (54)            |
| Over six months                                         | GBP             | 21,473      | USD           | (30,965)    |              | (52)            |
| Up to one month                                         | AUD             | 4,967       | GBP           | (2,646)     | 13           |                 |
| Up to one month                                         | CAD             | 6,507       | GBP           | (3,470)     | 31           |                 |
| Up to one month                                         | CHF             | 6,112       | GBP           | (4,400)     | 43           |                 |
| Up to one month                                         | EUR             | 6,878       | GBP           | (5,402)     | 53           |                 |
| Up to one month                                         | JPY             | 2,204,400   | GBP           | (13,320)    | 330          |                 |
| Up to one month                                         | USD             | 40,405      | GBP           | (27,791)    | 325          |                 |
| One to six months                                       | USD             | 3,742       | GBP           | (2,546)     | 57           |                 |
| One to six months                                       | GBP             | 3,651       | HKD           | (40,399)    | 26           |                 |
| <b>Open forward currency contracts at 31 March 2016</b> |                 |             |               |             | <b>878</b>   | <b>(7,266)</b>  |
| <b>Net forward currency contracts at 31 March 2016</b>  |                 |             |               |             |              | <b>(6,388)</b>  |
| <b><u>Prior year comparative</u></b>                    |                 |             |               |             |              |                 |
| <b>Open forward currency contracts at 31 March 2015</b> |                 |             |               |             | <b>1,459</b> | <b>(4,108)</b>  |
| <b>Net forward currency contracts at 31 March 2015</b>  |                 |             |               |             |              | <b>(2,649)</b>  |

**The following investments represent more than 5% of the net assets of the Fund**

| Market value 31 March 2015 | % of total fund | Investment                                                   | Market value 31 March 2016 | % of total fund |
|----------------------------|-----------------|--------------------------------------------------------------|----------------------------|-----------------|
| £'000                      |                 |                                                              | £'000                      |                 |
| 220,601                    | 33              | SSGA MPF All World Equity Index Sub-Fund                     | 219,424                    | 33              |
| 75,561                     | 11              | Longview Partners - Global Pooled Equities FD K Class        | 75,499                     | 11              |
| 76,541                     | 11              | GMO Emerging Domestic Opportunities Equity Fund              | 71,463                     | 11              |
| 77,276                     | 12              | Overstone Global Equity CCF (USD Class A1 Units)             | 70,701                     | 11              |
| 69,247                     | 10              | BlackRock Institutional Bond Fund - Corp Bond 10 yrs A Class | 69,401                     | 11              |
| 50,562                     | 8               | Aviva Investors UK Real Estate Fund of Funds                 | 53,481                     | 8               |
| <b>569,788</b>             | <b>85</b>       | <b>Total over 5% holdings</b>                                | <b>559,969</b>             | <b>85</b>       |

**NOTE 12C: STOCK LENDING**

Within the Statement of Investment Principles stock lending is permitted within pooled funds. At present, use of this facility is restricted to the State Street Global Advisors mandate.

The State Street lending programme covers equity and fixed income assets around the world and is designed to generate incremental returns for investors in a risk controlled manner.

The programme benefits from a counterparty default indemnity from State Street Bank & Trust Company pursuant to its Securities Lending Authorisation Agreement.

## NOTE 13: FINANCIAL INSTRUMENTS

### NOTE 13A: CLASSIFICATION OF FINANCIAL INSTRUMENTS

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of financial assets and liabilities (excluding cash) by category and net assets statement heading. No financial assets were reclassified during the accounting period.

| Fair value through profit and loss | Loans and receivables | Financial liabilities at amortised cost |                             | Fair value through profit and loss | Loans and receivables | Financial liabilities at amortised cost |
|------------------------------------|-----------------------|-----------------------------------------|-----------------------------|------------------------------------|-----------------------|-----------------------------------------|
|                                    | 31 March 2015         |                                         |                             |                                    | 31 March 2016         |                                         |
| £'000                              | £'000                 | £'000                                   |                             | £'000                              | £'000                 | £'000                                   |
| <b>Financial assets</b>            |                       |                                         |                             |                                    |                       |                                         |
| 69,247                             | 0                     | 0                                       | Fixed interest securities   | 69,401                             | 0                     | 0                                       |
| 17,130                             | 0                     | 0                                       | Index-linked Securities     | 17,577                             | 0                     | 0                                       |
| 449,979                            | 0                     | 0                                       | Pooled equity investments   | 437,087                            | 0                     | 0                                       |
| 0                                  | 0                     | 0                                       | Equity in London CIV        | 150                                | 0                     | 0                                       |
| 50,562                             | 0                     | 0                                       | Pooled property investments | 53,481                             | 0                     | 0                                       |
| 22,954                             | 0                     | 0                                       | Private equity              | 20,571                             | 0                     | 0                                       |
| 59,535                             | 0                     | 0                                       | Alternative investments     | 56,287                             | 0                     | 0                                       |
| 1,459                              | 0                     | 0                                       | Derivative contracts        | 878                                | 0                     | 0                                       |
| 0                                  | 8,496                 | 0                                       | Cash                        | 0                                  | 13,281                | 0                                       |
| 0                                  | 485                   | 0                                       | Debtors                     | 0                                  | 317                   | 0                                       |
| <b>670,866</b>                     | <b>8,981</b>          | <b>0</b>                                |                             | <b>655,432</b>                     | <b>13,598</b>         | <b>0</b>                                |
| <b>Financial liabilities</b>       |                       |                                         |                             |                                    |                       |                                         |
| (4,108)                            | 0                     | 0                                       | Derivative contracts        | (7,266)                            | 0                     | 0                                       |
| 0                                  | 0                     | 0                                       | Other investment balances   | 0                                  | 0                     | 0                                       |
| 0                                  | 0                     | (894)                                   | Creditors                   | 0                                  | 0                     | (763)                                   |
| <b>(4,108)</b>                     | <b>0</b>              | <b>(894)</b>                            |                             | <b>(7,266)</b>                     | <b>0</b>              | <b>(763)</b>                            |
| <b>666,758</b>                     | <b>8,981</b>          | <b>(894)</b>                            |                             | <b>648,166</b>                     | <b>13,598</b>         | <b>(763)</b>                            |

## NOTE 13B: NET GAINS AND LOSSES ON FINANCIAL INSTRUMENTS

| 31 March 2015 |                                    | 31 March 2016   |
|---------------|------------------------------------|-----------------|
| £'000         |                                    | £'000           |
|               | <b>Financial assets</b>            |                 |
| 85,145        | Fair value through profit and loss | (15,367)        |
| 268           | Loans and receivables              | 0               |
|               | <b>Financial liabilities</b>       |                 |
| (3,331)       | Fair value through profit and loss | (4,201)         |
| 0             | Loans and receivables              | 0               |
| <b>82,082</b> | <b>Total</b>                       | <b>(19,568)</b> |

The authority has not entered into any financial guarantees that are required to be accounted for as financial instruments.

## NOTE 13C: VALUATION OF FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

### Level 1

Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as Level 1 comprise quoted equities, quoted fixed interest securities, quoted index linked securities and unit trusts.

As far as they are available listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

### Level 2

Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

### Level 3

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

Such instruments would include unquoted equity investments and hedge fund of funds, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investment in private equity are based on valuations provided by the general partners to the private equity funds in which the Fund has invested.

These valuations are prepared in accordance with the *International Private Equity and Venture Capital Valuation Guidelines*, which follow the valuation principles of IFRS and US GAAP. Valuations are usually undertaken annually at the end of December. Cash flow adjustments and currency movements are used to roll forward the valuations to 31 March as appropriate.

The following tables provide 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<br>market<br>price | Using<br>observable<br>inputs | With<br>significant<br>unobservable<br>inputs |                |
|-------------------------------------------------------------|---------------------------|-------------------------------|-----------------------------------------------|----------------|
| Values at 31 March 2016                                     | Level 1                   | Level 2                       | Level 3                                       | Total          |
|                                                             | £'000                     | £'000                         | £'000                                         | £'000          |
| <b>Financial assets</b>                                     |                           |                               |                                               |                |
| Financial assets at fair value through profit and loss      | 633,983                   | 878                           | 20,571                                        | <b>655,432</b> |
| Loans and receivables                                       | 13,598                    | 0                             | 0                                             | <b>13,598</b>  |
| <b>Total financial assets</b>                               | <b>647,581</b>            | <b>878</b>                    | <b>20,571</b>                                 | <b>669,030</b> |
| <b>Financial liabilities</b>                                |                           |                               |                                               |                |
| Financial liabilities at fair value through profit and loss | 0                         | (7,266)                       | 0                                             | <b>(7,266)</b> |
| Financial liabilities at amortised cost                     | (763)                     | 0                             | 0                                             | <b>(763)</b>   |
| <b>Total financial liabilities</b>                          | <b>(763)</b>              | <b>(7,266)</b>                | <b>0</b>                                      | <b>(8,029)</b> |
| <b>Net financial assets</b>                                 | <b>646,818</b>            | <b>(6,388)</b>                | <b>20,571</b>                                 | <b>661,001</b> |

|                                                             | Quoted<br>market<br>price | Using<br>observable<br>inputs | With<br>significant<br>unobservable<br>inputs |                |
|-------------------------------------------------------------|---------------------------|-------------------------------|-----------------------------------------------|----------------|
| Values at 31 March 2015                                     | Level 1                   | Level 2                       | Level 3                                       | Total          |
|                                                             | £'000                     | £'000                         | £'000                                         | £'000          |
| <b>Financial assets</b>                                     |                           |                               |                                               |                |
| Financial assets at fair value through profit and loss      | 646,453                   | 1,459                         | 22,954                                        | <b>670,866</b> |
| Loans and receivables                                       | 8,981                     | 0                             | 0                                             | <b>8,981</b>   |
| <b>Total financial assets</b>                               | <b>655,434</b>            | <b>1,459</b>                  | <b>22,954</b>                                 | <b>679,847</b> |
| <b>Financial liabilities</b>                                |                           |                               |                                               |                |
| Financial liabilities at fair value through profit and loss | 0                         | (4,108)                       | 0                                             | <b>(4,108)</b> |
| Financial liabilities at amortised cost                     | 0                         | 0                             | (894)                                         | <b>(894)</b>   |
| <b>Total financial liabilities</b>                          | <b>0</b>                  | <b>(4,108)</b>                | <b>(894)</b>                                  | <b>(5,002)</b> |
| <b>Net financial assets</b>                                 | <b>655,434</b>            | <b>(2,649)</b>                | <b>22,060</b>                                 | <b>674,845</b> |

## **NOTE 14: 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. 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 Fund portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet its forecast cash flows. The Council manages these investment risks as part of its overall Pension Fund risk management programme.

Responsibility for the Fund's risk management strategy rests with the Pension Fund Committee. The Committee reviews the Fund's risk register on an annual basis.

#### **a) Market risk**

Market risk is the risk of loss from fluctuations in equity and commodity 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 is to identify, manage and control market risk exposure within acceptable parameters.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Council and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

#### **i) Other price risk**

Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all such instruments in the market.

The Fund's investment managers mitigate this price risk through diversification.

## ii) Other price risk – sensitivity analysis

Following analysis of historical data and expected investment return movement during the financial year, in consultation with the Fund's performance advisors, the Council has determined that the following movements in market price risk are reasonably possible.

| Assets type                              | Potential market movements (+/-) |
|------------------------------------------|----------------------------------|
| Total equities                           | 10.07%                           |
| Fixed interest & index linked securities | 9.07%                            |
| Alternative investments                  | 7.36%                            |
| Cash and equivalents                     | 0.01%                            |
| Pooled property investments              | 2.37%                            |

Potential price changes are determined based on the observed historical volatility of asset class returns. 'Riskier' assets such as equities will display greater potential volatility than bonds as an example, so the overall outcome will depend largely on the Fund's asset allocations. The potential volatilities are consistent with a one standard deviation movement in the change in value of the assets over the latest three years. This can then be applied to the period end asset mix.

Had the market price of the Fund investments increased/decreased in line with the above the change in the net assets available to pay benefits would have been as follows:

| Asset type                                 | Value as at 31 March 2016 | Percentage change | Value on increase | Value on decrease |
|--------------------------------------------|---------------------------|-------------------|-------------------|-------------------|
|                                            | £'000                     | %                 | £'000             | £'000             |
| <b>Cash and cash equivalents</b>           | 11,529                    | 0.01              | 11,530            | 11,528            |
| <b>Investment portfolio assets:</b>        |                           |                   |                   |                   |
| Total equities                             | 457,808                   | 10.07             | 503,909           | 411,707           |
| Fixed interest & index linked securities   | 86,978                    | 9.07              | 94,867            | 79,089            |
| Alternative investments                    | 56,287                    | 7.36              | 60,430            | 52,144            |
| Pooled property investments                | 53,481                    | 2.37              | 54,748            | 52,214            |
| Derivative contracts: net forward currency | (6,388)                   | 0.00              | (6,388)           | (6,388)           |
| <b>Total</b>                               | <b>659,695</b>            |                   | <b>719,096</b>    | <b>600,294</b>    |

| Asset type                                 | Value as at 31 March 2015 | Percentage change | Value on increase | Value on decrease |
|--------------------------------------------|---------------------------|-------------------|-------------------|-------------------|
|                                            | £'000                     | %                 | £'000             | £'000             |
| <b>Cash and cash equivalents</b>           | 6,930                     | 0.01              | 6,931             | 6,929             |
| <b>Investment portfolio assets:</b>        |                           |                   |                   |                   |
| Total equities                             | 472,933                   | 9.01              | 515,544           | 430,322           |
| Fixed interest & index linked securities   | 86,377                    | 8.49              | 93,710            | 79,044            |
| Alternative investments                    | 59,535                    | 6.92              | 63,655            | 55,415            |
| Pooled property investments                | 50,562                    | 2.60              | 51,877            | 49,247            |
| Derivative contracts: net forward currency | (2,649)                   | 0.00              | (2,649)           | (2,649)           |
| <b>Total</b>                               | <b>673,688</b>            |                   | <b>729,068</b>    | <b>618,308</b>    |

## b) 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 direct exposure to interest rate movements as at 31 March 2016 and 31 March 2015 is set out below.

| Asset type                | As at 31 March 2016 | As at 31 March 2015 |
|---------------------------|---------------------|---------------------|
|                           | £'000               | £'000               |
| Cash and cash equivalents | 11,529              | 6,930               |
| Fixed interest securities | 69,401              | 69,247              |
| <b>Total</b>              | <b>80,930</b>       | <b>76,177</b>       |

### Interest rate risk sensitivity analysis

The Council recognises that interest rates can vary and can affect both income to the Fund and the carrying value of Fund assets, both of which affect the value of the net assets available to pay benefits.

The impact of a 1% movement in interest rates would be as follows:

| Assets exposed to interest rate risk    | Carrying amount as at 31 March 2016 | Potential movement on 1% change in interest rates | Value on increase | Value on decrease |
|-----------------------------------------|-------------------------------------|---------------------------------------------------|-------------------|-------------------|
|                                         | £'000                               |                                                   | £'000             | £'000             |
| Cash and cash equivalents               | 11,529                              | 0                                                 | 11,529            | 11,529            |
| Fixed interest securities               | 69,401                              | 694                                               | 70,095            | 68,707            |
| <b>Total change in assets available</b> | <b>80,930</b>                       | <b>694</b>                                        | <b>81,624</b>     | <b>80,236</b>     |

| Assets exposed to interest rate risk    | Carrying amount as at 31 March 2015 | Potential movement on 1% change in interest rates | Value on increase | Value on decrease |
|-----------------------------------------|-------------------------------------|---------------------------------------------------|-------------------|-------------------|
|                                         | £'000                               |                                                   | £'000             | £'000             |
| Cash and cash equivalents               | 6,930                               | 0                                                 | 6,930             | 6,930             |
| Fixed interest securities               | 69,247                              | 692                                               | 69,939            | 68,555            |
| <b>Total change in assets available</b> | <b>76,177</b>                       | <b>692</b>                                        | <b>76,869</b>     | <b>75,485</b>     |

This analysis demonstrates that changes in interest rates do not impact on the value of cash & cash equivalents balances but do affect the fair value on fixed interest securities.

Changes in interest rates affect interest income received on cash balances but have no effect on income from fixed income securities. However since the Fund's cash balances are low, the effect of interest changes is minimal.

### c) 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 its global equities pooled fund investments, some of which are denominated in currencies other than sterling. To mitigate this risk, the Fund uses derivatives and hedges 50% of the overseas equity portfolio arising from the developed market currencies.

The table below provides the estimated total of the Fund's currency exposure as at 31 March 2016.

#### Currency risk sensitivity analysis

Following analysis of historical data in consultation with the Fund's performance advisers the Council considers the likely volatility associated with foreign exchange rate movements to be 3.77%

A 3.77% strengthening/weakening of the pound against the various currencies in which the fund holds investments would increase/decrease the net assets available as follows.

| Currency Exposure - asset type | Asset Value as at<br>31 March 2016 | Change to net assets |         |
|--------------------------------|------------------------------------|----------------------|---------|
|                                |                                    | +3.77%               | -3.77%  |
|                                | £'000                              | £'000                | £'000   |
| Overseas Equities              | 390,763                            | 405,495              | 376,031 |

| Currency Exposure - asset type | Asset Value as at<br>31 March 2015 | Change to net assets |         |
|--------------------------------|------------------------------------|----------------------|---------|
|                                |                                    | +3.62%               | -3.62%  |
|                                | £'000                              | £'000                | £'000   |
| Overseas Equities              | 398,206                            | 412,621              | 383,791 |

### d) 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.

In essence the Fund's entire investment portfolio is exposed to some form of credit risk, with the exception of the derivatives positions. However the selection of high quality counterparties, brokers and financial institutions by Fund managers should minimise the credit risk that may occur.

Cash deposits are not made with banks and financial institutions unless they are rated independently and meet the Council's Treasury Management investment criteria.

The Council believes it has managed its exposure to credit risk, and has had no experience of default or uncollectable deposits over the past five years.

The Fund's cash holding at 31 March 2016 was £11.5m (31 March 2015: £6.9m). This was held with the following institutions.

| Summary                | Balances at 31 March 2016 | Balances at 31 March 2015 |
|------------------------|---------------------------|---------------------------|
|                        | £'000                     | £'000                     |
| <b>Bank accounts</b>   |                           |                           |
| Royal Bank of Scotland | 10,048                    | 4,633                     |
| JP Morgan              | 1,437                     | 1,432                     |
| BlackRock              | 44                        | 865                       |
|                        | <b>11,529</b>             | <b>6,930</b>              |

#### **e) Liquidity risk**

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. The Council therefore takes steps to ensure that the Pension Fund has adequate cash resources to meet its commitments.

The Council has immediate access to its Pension Fund cash holdings.

The Fund considers liquid assets to be those that can be converted to cash within three months. Illiquid assets are those assets which will take longer than three months to convert in to cash. As at 31 March 2016 the value of illiquid assets was £74.1m, which represented 11% of the total Fund assets (31 March 2015: £73.5m, which represented 11% of the total Fund assets).

All financial liabilities at 31 March 2016 are due within one year.

#### **f) Refinancing risk**

The Pension Fund does not have any financial instruments that have a refinancing risk.

### **NOTE 15: FUNDING ARRANGEMENTS**

In line with The Local Government Pension Scheme Regulations 2013, 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 last such valuation took place as at 31 March 2013. The next valuation takes place as at 31 March 2016.

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 contribution rates where the administering authority considers it reasonable to do so; 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 aim is to achieve 100% solvency over a period of 20 years and to provide stability in employer contribution rates by spreading any increases in rates over a period of time. Solvency is achieved when the funds held, plus future expected investment returns and future contributions, are sufficient to meet expected future pension benefits payable.

At the 2013 actuarial valuation, the Fund was assessed as 70.3% funded (73.5% at the March 2010 valuation). This corresponded to a deficit of £234m (2010 valuation: £157m) at that time.

For most employers within the Fund, contribution increases were phased in over the 3 years' period ending 31 March 2017.

Individual employers' rates vary depending on the demographic and actuarial factors particular to each employer. Full details of the contribution rates payable can be found in the 2013 actuarial valuation report on the Fund's website.

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

## Financial assumptions

|                            | 2013 | 2010 |
|----------------------------|------|------|
|                            | %    | %    |
| Price inflation (CPI)      | 2.5  | 3.3  |
| Salary increases           | 3.8  | 4.8  |
| Pension increases          | 2.5  | 3.3  |
| Gilt based discount rate   | 3.0  | 4.5  |
| Funded basis discount rate | 4.6  | 6.1  |

## Demographic assumptions

The life expectancy assumptions are based on the Fund's Hymans Robertson's VitaCurves with improvements in line with the CMI 2010 model, assuming the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% per annum.

Future life expectancy based on the Actuary's Fund-specific mortality review is as follows:

|                                           | Male       | Female     |
|-------------------------------------------|------------|------------|
| Current pensioners                        | 22.1 years | 24.4 years |
| Future pensioners (assumed to be aged 45) | 24.5 years | 26.9 years |

## Commutation assumption

It is assumed that 50% of future retirees will elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2008 and 75% for service from 1 April 2008.

## NOTE 16: 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 IAS 19 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 contribution rates and the Fund accounts do not take account of liabilities 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 15). The actuary has also valued ill health and death benefits in line with IAS 19.

| 31 March 2015 |                                               | 31 March 2016 |
|---------------|-----------------------------------------------|---------------|
| £m            |                                               | £m            |
| (959)         | Present value of promised retirement benefits | (894)         |
| 602           | Fair value of scheme assets                   | 594           |
| <b>(357)</b>  | <b>Net Liability</b>                          | <b>(300)</b>  |

As noted above, the liabilities are calculated on an IAS 19 basis and therefore will differ from the results of the 2013 triennial funding valuation because IAS 19 stipulates a discount rate rather than a rate which reflects market rates.

## Assumptions used

|                                             | 2015/16 | 2014/15 |
|---------------------------------------------|---------|---------|
|                                             | % pa    | % pa    |
| Inflation/pensions increase rate assumption | 2.2     | 2.4     |
| Salary increase rate                        | 3.7     | 3.8     |
| Discount rate                               | 3.5     | 3.2     |

## NOTE 17: CURRENT ASSETS

| 31 March<br>2015 |                                      | 31 March<br>2016 |
|------------------|--------------------------------------|------------------|
| £'000            |                                      | £'000            |
| <b>Debtors:</b>  |                                      |                  |
| 381              | Contributions due - employers        | 297              |
| 79               | Transfer values receivable (joiners) | 0                |
| 25               | Sundry debtors                       | 20               |
| 1,566            | Cash owed to Fund                    | 1,752            |
| <b>2,051</b>     |                                      | <b>2,069</b>     |

### Analysis of debtors

| 31 March<br>2015 |                                | 31 March<br>2016 |
|------------------|--------------------------------|------------------|
| £'000            |                                | £'000            |
| 1,645            | Other local authorities        | 1,752            |
| 4                | NHS bodies                     | 4                |
| 381              | Scheduled/Admitted bodies      | 297              |
| 21               | Other entities and individuals | 16               |
| <b>2,051</b>     |                                | <b>2,069</b>     |

## NOTE 18: CURRENT LIABILITIES

| 31 March<br>2015 |                                   | 31 March<br>2016 |
|------------------|-----------------------------------|------------------|
| £'000            |                                   | £'000            |
| (355)            | Sundry creditors                  | (167)            |
| (212)            | Transfer values payable (leavers) | (430)            |
| (327)            | Benefits payable                  | (166)            |
| <b>(894)</b>     |                                   | <b>(763)</b>     |

### Analysis of creditors

| 31 March<br>2015 |                                | 31 March<br>2016 |
|------------------|--------------------------------|------------------|
| £'000            |                                | £'000            |
| (4)              | Central government bodies      | (15)             |
| (212)            | Other local authorities        | (431)            |
| (678)            | Other entities and individuals | (317)            |
| <b>(894)</b>     |                                | <b>(763)</b>     |

## NOTE 19: ADDITIONAL VOLUNTARY CONTRIBUTIONS

AVC contributions of £0.31m were paid directly to the providers during the year (2014/15: £0.36m)

| Market value<br>31 March 2015 |                                  | Market value<br>31 March 2016 |
|-------------------------------|----------------------------------|-------------------------------|
| £'000                         |                                  | £'000                         |
| 1,208                         | Prudential Assurance             | 1,233                         |
| 812                           | Clerical Medical                 | 741                           |
| 266                           | Equitable Life Assurance Society | 237                           |
| <b>2,286</b>                  |                                  | <b>2,211</b>                  |

## NOTE 20: RELATED PARTY TRANSACTIONS

### Harrow Council

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.

| 31 March 2015 |                                              | 31 March 2016 |
|---------------|----------------------------------------------|---------------|
| £'000         |                                              | £'000         |
| (16,162)      | Employer's Pension Contributions to the Fund | (16,351)      |
| 1,061         | Administration expenses paid to the Council  | 853           |
| 1,566         | Cash held by the Council                     | 1,752         |

## Governance

Each member of the Pension Fund Committee is required to declare their interests at each meeting.

### Key management personnel

Paragraph 3.9.4.3 of the Code exempts local authorities from the key management personnel disclosure requirements of IAS 24, on the basis that the disclosure requirements for officer remuneration and members' allowances detailed in section 3.4 of the Code (which are derived from the requirements of Regulation 7(2)–(4) of The Accounts and Audit (England) Regulations 2011 and Regulation 7A of The Accounts and Audit (Wales) Regulations 2005) satisfy the key management personnel disclosure requirements of paragraph 16 of IAS 24. This applies in equal measure to the accounts of the Harrow Pension Fund.

The disclosures required by Regulation 7(2)–(4) of The Accounts and Audit (England) Regulations can be found in the main accounts of Harrow Council.

## **NOTE 21: CONTINGENT LIABILITIES AND CONTRACTUAL COMMITMENTS**

Outstanding capital commitments at 31 March 2016 totalled £2.9m (31 March 2015: £4.5m).

These commitments relate to outstanding call payments due on unquoted limited partnership funds held by Pantheon Ventures in the private equity part of the portfolio.

## **NOTE 22: CONTINGENT ASSETS**

Three admitted body employers in the Fund hold insurance bonds or guarantees to guard against the possibility of being unable to meet their pension obligations. These bonds are drawn in favour of the Fund and payment will only be triggered in the event of employer default.

## Pension Fund Accounts Reporting Requirement

### Introduction

CIPFA's Code of Practice on Local Authority Accounting 2015/16 requires Administering Authorities of LGPS funds that prepare pension fund accounts to disclose what IAS26 refers to as the actuarial present value of promised retirement benefits.

The actuarial present value of promised retirement benefits is to be calculated similarly to the defined benefit obligation under IAS19. There are three options for its disclosure in pension fund accounts:

- showing the figure in the Net Assets Statement, in which case it requires the statement to disclose the resulting surplus or deficit;
- as a note to the accounts; or
- by reference to this information in an accompanying actuarial report.

If an actuarial valuation has not been prepared at the date of the financial statements, IAS26 requires the most recent valuation to be used as a base and the date of the valuation disclosed. The valuation should be carried out using assumptions in line with IAS19 and not the Pension Fund's funding assumptions.

I have been instructed by the Administering Authority to provide the necessary information for the London Borough of Harrow Pension Fund, which is in the remainder of this note.

### Present value of Promised Retirement Benefits

| Present value of Promised Retirement Benefits (£m) | Year ended    |               |
|----------------------------------------------------|---------------|---------------|
|                                                    | 31 March 2016 | 31 March 2015 |
| Active members                                     | 496           | 502           |
| Deferred pensioners                                | 169           | 192           |
| Pensioners                                         | 351           | 388           |
| Total                                              | 1,016         | 1,082         |

Liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2013. The approximation involved in the roll forward model means that the split of scheme liabilities between the three classes of member may not be reliable. However, I am satisfied the aggregate liability is a reasonable estimate of the actuarial present value of benefit promises. I have not made any allowance for unfunded benefits.

The above figures include both vested and non-vested benefits, although the latter is assumed to have a negligible value.

It should be noted the above figures are appropriate for the Administering Authority only for preparation of the accounts of the Pension Fund. They should not be used for any other purpose (i.e. comparing against liability measures on a funding basis or a cessation basis).

### Assumptions

The assumptions used are suitable for IAS19 purposes as required by the Code of Practice. They are given below. I estimate that the impact of the change of assumptions to 31 March 2016 is to decrease the actuarial present value by £96m.

### Financial assumptions

My recommended financial assumptions are summarised below:

| Year ended                       | 31 March 2016<br>% p.a. | 31 March 2015<br>% p.a. |
|----------------------------------|-------------------------|-------------------------|
| Inflation/pensions increase rate | 2.2%                    | 2.4%                    |
| Salary increase rate             | 3.7%                    | 3.8%                    |
| Discount rate                    | 3.5%                    | 3.2%                    |

### Longevity assumptions

As discussed in the accompanying report, the life expectancy assumption is based on the Fund's VitaCurves with improvements in line with the CMI 2010 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:

| Average future life expectancies at age 65 (years) | Males | Females |
|----------------------------------------------------|-------|---------|
| Current pensioners                                 | 22.1  | 24.4    |
| Future pensioners*                                 | 24.5  | 26.9    |

\* Future pensioners are assumed to be aged 45 at the most recent formal valuation as at 31 March 2013.

Please note that the assumptions are identical to last year's IAS26 disclosure for the Fund.

### Commutation assumption

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2008 service and 75% of the maximum tax-free cash for post-April 2008 service.

### Sensitivity Analysis

CIPFA guidance requires the disclosure of the sensitivity of the results to the methods and assumptions used. The sensitivities regarding the principal assumptions used to measure the liabilities are set out below:

| Change in assumptions for the year ended<br>31 March 2016 | Approximate %<br>increase to liabilities | Approximate monetary<br>amount (£m) |
|-----------------------------------------------------------|------------------------------------------|-------------------------------------|
| 0.5% decrease in discount rate                            | 10%                                      | 102                                 |
| 1 year increase in member life expectancy                 | 3%                                       | 30                                  |
| 0.5% increase in salary increase rate                     | 3%                                       | 30                                  |
| 0.5% increase in pensions increase rate                   | 7%                                       | 70                                  |

### Professional notes

This paper accompanies my covering report titled 'Actuarial Valuation as at 31 March 2016 for accounting purposes'. The covering report identifies the appropriate reliances and limitations for the use of the figures in this paper, together with further details regarding the professional requirements and assumptions.

Prepared by:-

Gemma Sefton FFA  
For and on behalf of Hymans Robertson LLP  
9 May 2016