The Highland Council Pension Fund

Annual Report and Annual Accounts
Aithris Chunntasan

2018 - 2019

Pensions Regulator Scheme Number: 10051259

Approved at Pensions Committee
8 August 2019

HIGHLAND COUNCIL PENSION FUND

ANNUAL REPORT AND ANNUAL ACCOUNTS 2018/19

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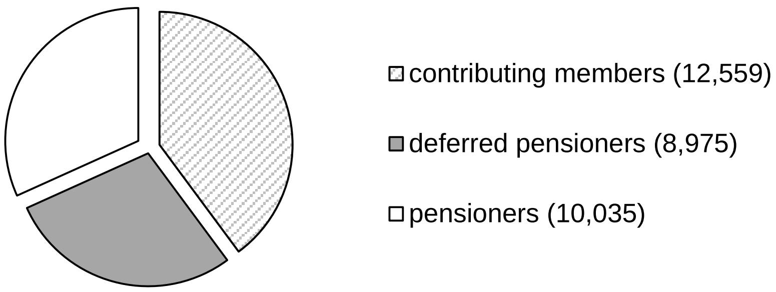
Background

Under the Local Government Pension Scheme (LGPS), The Highland Council is designated as an "Administering Authority" and is required to operate and maintain a pension fund - the Highland Council Pension Fund (HCPF) ("the Fund"). The Fund is established to provide retirement and death benefits to employees and dependents within the scheme.

The closing net assets of the Fund at 31 March 2019 are £1,999m (31 March 2018 £1,884m).

The Fund provides benefits for those employees of The Highland Council, Comhairle Nan Eilean Siar and 27 other scheduled and admitted bodies that are active members of the Fund.

Current Scheme Membership



Governance

The main legislation directing the governance requirements for the Fund is The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015. The main impact of these regulations was the creation of The Scheme Advisory Board and Pension Boards.

The Scheme Advisory Board is a Scottish-wide Board which provides advice to the Scottish Ministers on the desirability of changes to the LGPS. It also provides guidance to the scheme mangers or pension boards on the effective and efficient administration and management of the LGPS and the pension fund.

Each scheme has its own Pension Board to ensure the regulations and legislation relating to the governance and administration of the LGPS are complied with.

For HCPF specifically, governance is undertaken by the Pensions Committee and Pensions Board which meet simultaneously to consider the same agenda and to whom Fund business has been delegated by The Highland Council. This includes the appointment and monitoring of investment managers, which is further delegated to the Pensions Investment Sub Committee.

More information on the governance process can be found in the Annual Governance Statement on page 27 and the Governance Compliance Statement on page 30.

Business Model and Risk

HCPF is managed and administered from The Highland Council Headquarters in Inverness.

Many of the Fund's activities are managed in-house and are accountable to the Pensions Committee and Board, Fund employers, and scheme members. The in-house support teams aim to provide a quality service to meet the needs of the Fund's stakeholders.

Pension Fund support functions cover the following areas:

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

Membership and Benefits Administration

For the benefit of all HCPF stakeholders the website below includes a broad range of information relating to the Fund.

http://www.highlandpensionfund.org

a) General

During 2018/19, the focus for the Pensions Administration team was on the Guaranteed Minimum Pensions (GMP) reconciliation exercise. Pension schemes, including those in the public sector, were required to reconcile their data to HMRC records. The objective of the exercise is to ensure that details of periods of contracted out service, which are used to determine entitlement to the new single state pension, are up to date and robust.

The GMP process required both internal and external resource to compare approximately 30,000 records; analyse and investigate records that do not match; and correction of data and communication with scheme members. The exercise is now mainly complete with 90% of records matching and the next stage will be investigating the unmatched records.

Changes to the LGPS (Scotland) Regulations came into force on 1 June 2018 including the option for active and deferred members in the Scheme from 1 June 2019 to retire from age 55 without consent of their employer. However, benefits will be reduced for early payment as set out in guidance from GAD (Government Actuary's Department) which is available on the Fund's website. https://www.highlandpensionfund.org/highland-pension-fund/client-area/news/amendment-of-the-local-government-pension-scheme-scotland-regulations-2018/

It is anticipated that there may be an increase in requests for estimates once the annual benefits statements are published. Overall, there are increasing demands and complexity around pensions as well as the increased expectations of all stakeholders and statutory national requirements creating additional pressures on the Pension Administration team. Adequate resourcing is needed to prevent breaches of the regulations.

The profile of membership over the current year compared to previous years is below.

Membership statistics

	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
Contributors	12,148	12,318	12,368	12,686	12,599
Pensioners	8,085	8,462	9,186	9,577	10,035
Deferred	7,959	8,374	8,989	8,805	8,975
Total	28,192	29,154	30,543	31,068	31,609

The following sets out details of new pensioners analysed by ill health, early and normal retirement.

Retirements during 2018/19

	2018/19 Number Retirements
Early retirement	22
Ill-health retirement	35
Early payment of deferred benefits	15
Sub-total	**72**
Normal retirements	**520**
Totals	**592**

b) Communication

As highlighted earlier, the Fund communicated regularly with Fund employers as part of the valuation exercise but also received requests from employers to provide an overview of the Fund, regulations and governance.

The Fund continues to make the best use of technology and publishes Annual Benefit Statements on-line which avoids printing and postage costs.

The Fund's website features a news page which the Pensions Administration team use to upload articles of interest for scheme members to view.

c) Performance

The administration performance is generally consistent with the previous year with the exception of new entrants performance which reduced slightly due to additional work dealing with the backlog of aggregation calculations. Scheme members now have several options in respect of joining due to changes in the Regulations.

Overall, the Fund returned a surplus of £115.151m and comparators for previous years are provided below, alongside the unit costs per member.

Pension Fund Account	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£m	**£m**	**£m**	**£m**	**£m**
Contributions received	53.594	56.941	59.346	57.982	60.262
Pensions paid	(49.382)	(54.689)	(57.922)	(56.077)	(59.887)
Management expenses	(8.469)	(7.024)	(7.717)	(8.895)	(9.401)
Returns on investment	177.318	25.247	301.927	125.898	124.177
Overall surplus	**173.061**	**20.475**	**295.634**	**118.908**	**115.151**

Unit costs per member	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
Administrative unit cost	£31.48	£31.98	£34.50	£31.89	£39.25
Oversight and Governance	£14.78	£10.68	£8.55	£12.52	£10.38
Investment management expenses	£266.44	£240.95	£262.98	£241.90	£247.78
Total cost per member	**£312.70**	**£283.61**	**£306.03**	**£286.31**	**£297.41**

Investment Management

The Fund income comes from member contributions, employer contributions and interest and returns on Fund investments. Fund expenditure relates to paying of member benefits and the administration costs of looking after the Fund. Overall, taking into account returns on investment, the Fund has been in surplus, i.e. the income is more than the expenditure and these surpluses are invested to generate further income.

Investment Management of the Fund’s assets is undertaken by external Fund managers and overseen by the Pensions Accounting team with the support of AON Hewitt, the Fund’s Investment Adviser.

The investment activity of the Fund is set out in the Statement of Investment Principles (SIP) which is reviewed regularly and agreed by the Pension Committee and Board and performance of the Fund Managers is reviewed by the Investment Sub Committee.

http://www.highlandpensionfund.org/media/3463/sip-approved-at-pc0-8-02-18.pdf

Some of the main considerations in the SIP are:
- the types of investment to be held
- the balance between different types of investment
- risk, including the ways in which risks are to be measured and managed
- the expected return on investments

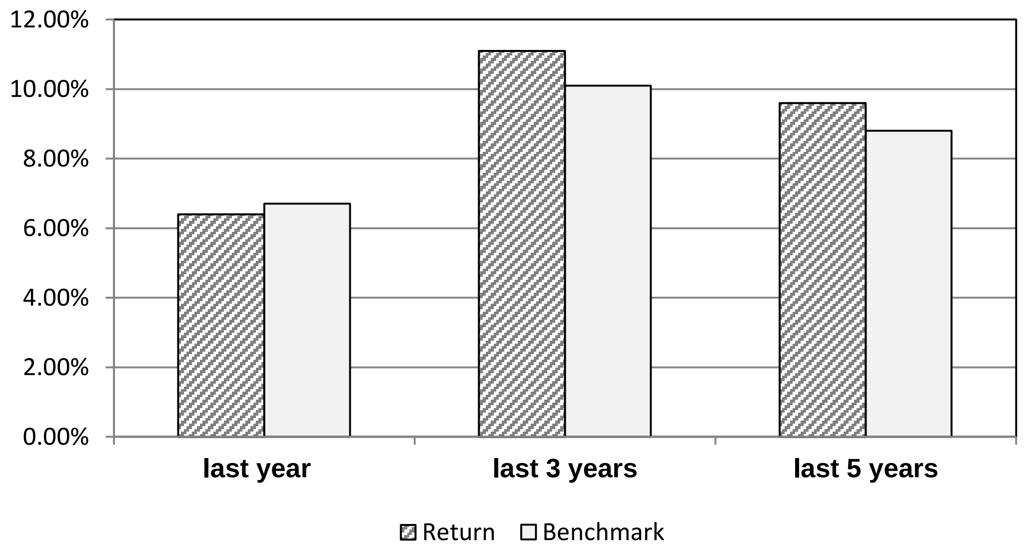
A list of the Fund's investments is published quarterly on the Fund's website.

http://www.highlandpensionfund.org/highland-pension-fund/about-us/forms-and-publications/

Against a backdrop of continued uncertainty in the global economy, and volatility in the financial markets, for the year the Fund returned 6.4%, underperforming the benchmark of 6.7%.

The total Fund performed in line with its benchmark during the quarters to June 2018 and March 2019 and marginally underperformed against benchmark during the two quarters from July to December 2018.

The following graph shows the Fund return against the benchmark for the last year, the last 3 years and the last 5 years which show that performance has been strong across the longer term periods. Further information on the benchmarks used for the Fund is in the SIP.



Investment decisions for the Fund are considered over the longer term. Short term performance is reviewed closely, but, alone, it is unlikely to lead to investment change. In 2018/19 the total Fund's investments increased in value to £1,991m from £1,874m at the end of 2017/18.

The purchase of equity protection until December 2021 was approved by the Investment Sub Committee (June 2019) in order to protect the Fund's passive equities against significant falls in value until investments in alternative assets classes are implemented).

A review of Investment performance is provided on page 23 of this report.

Funding and Accounting

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

Every three years the actuary carries out a valuation of the Fund. The main purpose of the valuation is to review the financial position of the Fund and determine the rate at which the employer bodies participating in the Fund should contribute in the future to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the Fund.

The triennial valuation as at 31 March 2017 applies to financial years 2018/19 until 2020/21.

At the 2017 actuarial valuation the Fund was assessed as 101% funded (2014 valuation 96%) with a surplus of £13m (2014 deficit £52m). The 2017 funding level increased due to investment returns being higher than expected since 2014 and membership experience actuals being different to forecast (lower than expected salary and pension increases and lower than expected ill health retirements).

Alongside the completion of the Actuarial Valuation, the Funding Strategy Statement, which explains the setting of the employer contribution rates, was updated and approved at Pensions Committee in February 2018. The strategy can be viewed at

http://www.highlandpensionfund.org/media/3743/funding-strategy-statement-2018.pdf

Risk

Awareness of risk and risk mitigation is a key aspect of the Fund's strategic and operational activities. Whilst it is not possible to eliminate risk entirely, the Fund has taken steps to evaluate risk and put mitigating controls in place to minimise its adverse effects.

A risk register is maintained and reported to the Pensions Committee.

https://www.highland.gov.uk/meetings/meeting/4089/pensions_committee_and_board

The seven highest identified risks are:

1. Ongoing risk of members and officers being unaware of changes to LGPS. governance, administration and investment matters and of non-compliance with Pension Fund Regulator requirements.
2. Ultra vires pension fund actions leading to financial loss and reputational damage.
3. If the investment strategy is inconsistent with funding plans it can lead to setting inaccurate employer contribution rates.

4. Volatility in markets created by global uncertainty could adversely impact returns leading to increasing deficits and additional costs.
5. Brexit risks (rising inflation, falling gilt yields, capital value loss on UK property) potentially could impact the Fund's assets and liabilities.
6. Increasing demands and complexity around pensions as well as the increased expectations of all stakeholders and statutory national requirements has created additional pressures on the Pension Administration team. Without adequate resourcing, there is a risk of non-compliance with regulations.
7. The outcome of the recent McCloud judgement will impact future liabilities of the Fund and potentially increase pressure on contributions depending on the remedy decided (see note 17 Actuarial present value of promised retirement benefits).

These risks and the mitigating controls in place to manage them have been reported to the Pensions Committee.

Looking Ahead

- Ongoing volatility and uncertainty in the global economy and investment markets may have significant financial implications for the Fund and Fund employers.

- The anticipated level of future returns on the equity markets both in the UK and globally is of particular concern and changes to the strategic asset allocation will continue be implemented during 2019/20 to reduce the potential impact of this on the Fund.

- The Scheme Advisory Board (SAB) has completed a consultation on a Structure Review of the Scottish LGPS Funds. The four options under consideration are as follows and a report with recommendations is due to be published during 2019/20:
  a) Maintain status quo of 11 Funds in Scotland;
  b) Retain the 11 Funds but with closer collaboration;
  c) One or more common investment pools;
  d) Merge the funds into 1 or more new funds.

- We will need to review our staffing structures in the year ahead to ensure we are well positioned to meet the increasing demands and complexity around pensions as well as the increased expectations of all stakeholders and statutory national requirements.

- The outcome of the Guaranteed Minimum Pensions (GMP) exercise completed in 2018/19, whereby data was matched between the Council and HMRC to check that records in relation to period of contracted out employment are correct, is that 90% of records have been matched. Investigations will continue in 2019/20 to review the unmatched records.

  Regulations are likely to be introduced in 2019/20 whereby if there is a GMP related overpayment identified, an LGPS pension in payment should not be reduced and will be converted into an "increased pension entitlement".

- During 2019/20 data will be collated in preparation for the next Actuarial Valuation to be completed as at 31 March 2020.

- Other ongoing developments likely to impact on the Pensions Administration in future years include the consultation on an exit payments cap and issues surrounding refunding payments within 5 years of leaving (effective in Scotland from 2020/21 but affecting England/Wales this year).

- In order to manage the Fund moving towards a cash flow negative position, during 2018/19 daily monitoring of the Pension Fund cash flows was implemented. The current position is that existing cash balances held by the fund managers are where necessary used to meet cash requirements without the need to disinvest. Provided the investment income yield remains at current levels, then the time when assets need to be sold to meet benefit payments still looks sometime in the future.

- We will continue to engage with members to identify training needs and provide appropriate training opportunities.

- We await a decision on remedy for the legal case (McCloud/Sargeant) regarding an age discrimination challenge to the transitional protections put in place when the LGPS benefit structure was reformed in 2015. There is more information about this case and the potential implications at page 46 and the Fund Actuary provided an updated estimate for the actuarial present value of promised retirement benefits (Note 17).

In Conclusion

Our thanks and appreciation is extended to all Councillors and Officers for their continued input to the strong governance and management of the Fund.

Donna Manson Chief Executive	Edward Foster CPFA Head of Corporate Finance and Commercialism	Richard Gale Chairman Pensions Committee

12 August 2019

About the Fund

The Fund is part of the national Local Government Pension Scheme (LGPS) and is a contributory defined benefit pension scheme. The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK.

The LGPS scheme is governed by the Public Service Pensions Act 2013 and the fund is administered in accordance with the following secondary legislation:

- the Local Government Pension Scheme (Scotland) Regulations 2018
- the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014
- the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2016
- the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015

The Administering Authority (The Highland Council) runs The Highland Council Pension Fund, to make sure the Fund achieves the following objectives:

- Receives the proper amount of contributions from employees and employers, and any transfer payments.

  The Fund is built up by contributions from both employees and employers, together with interest and dividends from investments, out of which defined pensions and other benefits are paid.

  Employees' contributions to the Fund are fixed by statute and contributions payable by employers are fixed every three years following a report by an independent actuary who determines the level of contribution necessary to ensure that the Fund will be able to meet future benefits.

  The primary contribution rate (future service contributions) for the whole Fund of 17.8% of pay for payroll contributions was set by the Actuary for the period 1 April 2019 to 31 March 2021 in the Triennial Actuarial Valuation report 2017. In addition to this, the secondary rate (past service contributions) for 2018/19 is £3,973,000.

- Invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth.

  The Fund's assets are managed by appointed Investment Fund Managers. Once the cost of current benefits is met, all surplus cash income is invested to meet future liabilities to employees within the Fund and deferred pension benefits.

- Uses the assets to pay Fund benefits to its members (as and when they retire, for the rest of their lives) and to their dependents (as and when members die), as defined in the LGPS Regulations (pre 1 April 2014 pensions benefits payable were based on final pensionable pay and length of pensionable service. After 1

April, the scheme became a career average scheme whereby members accrue benefits based on their pensionable pay in that year at an accrual rate of 1/49th which is updated annually in line with the Consumer Price Index). Assets are also used to pay transfer values and administration costs.

Funding Strategy Statement

Implementing a Funding Strategy Statement is a regulatory requirement which summarises the Fund's approach to funding liabilities. The Funding Strategy Statement describes the strategy of The Highland Council acting in its capacity as Administering Authority for the funding of the Highland Council Pension Fund and is published on the Fund's website.

http://www.highlandpensionfund.org/media/3743/funding-strategy-statement-2018.pdf

Employees' benefits are guaranteed by LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but with no guarantee as to the level of funding. Employees' contributions are fixed in the Regulations, at a level which covers only part of the cost of the benefits.

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

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

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

The Funding Strategy Statement provides details of the key elements of the funding strategy, the regulatory framework, responsibilities of key parties, links to the SIP, key risks (financial, demographic, regulatory and governance), calculation of employer contributions and actuarial assumptions.

Statement of Investment Principles

A Statement of Investment Principles (SIP) details the policy governing the Fund's investments. A summary of the SIP is set out on the following page.

The detailed version of the SIP expanding on the paragraphs below was approved by Committee and Board in February 2018.

http://www.highlandpensionfund.org/media/3463/sip-approved-at-pc0-8-02-18.pdf

The Highland Council has delegated authority to the Pensions Committee to take decisions on behalf of the Pension Fund. The Pensions Board was set up to comply with the LGPS (Governance) (Scotland) 2015 Regulations and is responsible for assisting the Committee in securing compliance with pension governance and administration legislation and regulations and requirements of the Pensions Regulator. The Investment Sub Committee is responsible for overseeing the management of the investments of the Fund and scrutinises the performance of the Fund's seven investment managers.

The Highland Council Pension Fund qualifies as an HMRC 'exempt approved scheme'.

Statement of Investment Principles – Summary

Background

The Highland Council is the administering authority of the Highland Council Pension Fund. Elected members recognise that they have fiduciary duties and responsibilities towards beneficiaries, employers and local taxpayers that are similar to those of Trustees in the private sector.

Advisors

Independent Investment Managers, Investment Consultants, Actuaries and Performance Measurement Consultants are employed to give ongoing expert advice and assistance in the managing of the Fund.

Funding Policy

The Fund is a defined benefit pension scheme which provides members with pensions and lump sums related to their salaries. The fundamental objective is to meet these benefits on retirement, or the dependent's benefits on death before or after retirement.

The funding policy is directed to ensuring that in normal market conditions, all accrued benefits are fully covered by the actuarial value of the Fund's assets and that the appropriate level of contributions is agreed by the administering authority to meet the cost of future benefits accruing.

A Funding Strategy Statement for the Pension Fund has been prepared in accordance with Regulation 75A (1) of the Local Government Pension Scheme (Scotland) Regulations 1998 as amended by the Local Government Pension Scheme (Scotland) Amendment Regulations 2005. The Statement describes the strategy of The Highland Council acting in its capacity as Administering Authority for the funding of the Highland Council Pension Fund.

Investment Policy

The Fund's Investment Policy will be directed to ensuring that in normal market conditions, all accrued benefits are fully covered by the actuarial value of the Fund's assets and that an appropriate level of contributions is agreed by the administering authority to meet the cost of future employees' benefits accruing.

The long term investment objective of the Fund is to achieve a real rate return of 3-4% per annum on average. The Fund has a strategic benchmark for each Manager. In broadly defining the assets to be held and setting the asset allocation this benchmark provides an efficient balance between risk and return in light of the liability profile, and funding level of the Fund. There are changes proposed to the current asset allocation in order to reduce the overall risk in the Fund.

The strategic benchmark is expected to produce a return over the long term in excess of the investment return assumed in the Actuarial Valuation. The Fund's assets are currently managed approximately 84% on an active basis and these are expected to outperform their respective benchmarks over the long term. The remainder is managed on an index tracking (passive) basis. The plan to reduce equities and bonds will eventually result in the Fund's assets being managed approximately 89% on an active basis and 11% on a passive basis.

Asset Mix of Investments

The overall investment portfolio for the Fund is weighted to the equity market, both UK and Overseas. However, the portfolio also has investments in Index-Linked Gilts, Property, UK Bonds, Overseas Bonds, Private Equity, Property Debt and Cash. This diverse range of investments over 7 different Managers (6 active and 1 passive) is employed to minimise the effect of risk and enhance overall performance of the Fund for its Members.

Each Manager, with the exception of the index tracking Manager, has full discretion within the parameters of their mandate in the asset mix and stock selection, subject to the investment principles.

Strategic Asset Allocation

The Fund's strategic asset allocation targets are as follows.

	Fund Actual 31/03/18	**Fund Actual 31/03/19***	**Target set Feb 2018**
Asset Class	**%**	**%**	**%**
UK equities - active	18.6	20.2	18.2
UK equities - passive	4.8	4.9	3.3
Global equities - active	30.9	30.0	26.8
Global equities - passive	11.9	11.8	7.7
Total equities	**66.2**	**66.9**	**56.0**
Fixed income - active	11.5	11.5	12.0
Fixed income - passive	4.4	4.0	-
Total fixed income	**15.9**	**15.5**	**12.0**
Property – active	**9.9**	**9.5**	**10.0**
Property debt – active	**3.0**	**2.8**	**4.0**
Private equity - active	**5.0**	**5.3**	**5.0**
Other illiquid alternatives*	**-**	**-**	**8.0**
Absolute return strategies*	**-**	**-**	**5.0**
Total Assets	**100.00**	**100.00**	**100.0**

*work has been progressing during 2018/19 to appoint 2 new fund managers and mandates should be in place by 2020.

Monitoring

The Fund's officers and, when required, advisers meet with each of its Investment Managers on a rotational basis and monitor performance quarterly relative to performance targets.

Adoption of the strategic benchmark and the performance monitoring constrains the Investment Managers from deviating significantly from the intended approach. It also permits flexibility to manage the Fund in such a way as to enhance returns.

Risk

The Fund pursues a policy of lowering risk through diversification of both investments and investment managers. A management agreement is in place for each Investment Manager, which sets out the relevant benchmark performance target, asset allocation ranges, and any restrictions, as determined by the Fund.

Realisation of Investments

Approximately 82% of the investments held by the Fund at 31 March 2019 are quoted on major stock markets and may be realised quickly if required. Property investment is via pooled funds which are relatively illiquid. These currently make up approximately 10% of the total Fund. There are also private equity (target asset allocation 5%) and property debt investments (target asset allocation 4%) which are very illiquid.

Underwriting

The Fund's Investment Managers are permitted to underwrite and sub-underwrite stock issues only on the basis that the subject stock is already held in the portfolio or that the Manager wishes to acquire a long term holding.

Environmental, Social and Governance (ESG)

The Fund recognises that environment, social and corporate governance considerations are among the factors which Investment Managers will take into account, where relevant, when selecting investments for purchase, retention or sale. However, the over-riding consideration for Pension Committee members is their fiduciary duty to the scheme employers and scheme members.

Whilst recognising its over-riding fiduciary duties the Fund will continue to encourage its managers to engage on issues with companies in which it holds investments as the Fund believes that environmental, social and corporate governance (ESG) issues will have a significant effect on the performance of investment portfolios through time.

Engagement in this context is to involve the Investment Managers in:
- Meeting and corresponding with Companies on relevant issues;
- Working with the representatives of other shareholders, where appropriate;
- Voting against adverse proposals at Company AGM/EGMs;
- Reporting regularly on actions taken in this regard.

The managers are instructed to summarise their engagement activity in their quarterly Investment Reports.

Corporate Governance

The Fund ensures that the votes attached to its holdings in all UK quoted companies are exercised whenever practical. The Fund's votes are exercised by its Investment Managers in accordance with their own policies and practices and taking account of the Combined Code on Corporate Governance.

Custody

The Fund has a Global Custodian (Northern Trust) who ensures the safekeeping of all assets separate from each Investment Manager and other officials.

The Global Custodian also provides all the reporting data to the Council for performance monitoring and independent reconciliation purposes for each Investment Manager.

Stock Lending

The Fund has had a stock-lending agreement with Northern Trust since 2015. Adequate collateral is held which consists of acceptable securities and government debt and as at 31 March 2019 the Fund held collateral (via the custodian) of 106.6% of stock lent.

The amount of lendable securities is limited to a maximum of 25% of the value of the Fund. This arrangement will be regularly reviewed to take account of changing market circumstances.

Compliance

Investment Managers and the Custodian will provide an annual statement to The Highland Council confirming that they have adhered to the investment principles contained in this document so far as is reasonably practicable.

Adhering to guidance given by Scottish Ministers, The Fund is compliant with the six revised principles on investment decision making for occupational pension schemes, as set out in guidance published by the Chartered Institute of Public Finance and Accountancy in December 2009 called 'Investment Decision Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles'.

HIGHLAND COUNCIL PENSION FUND

ANNUAL REPORT AND ANNUAL ACCOUNTS 2018/19

Members & Advisors

All councillors on the Pensions Committee have been appointed by The Highland Council. The membership of the Pensions Committee, Pensions Board and Investment Sub Committee as at 31 March 2019 is outlined below.

Pensions Committee

Cllr R Gale (Chairman)
Cllr R Bremner
Cllr J Gray
Cllr H Carmichael
Cllr C Fraser
Cllr A Jarvie
Cllr B Lobban
Cllr D Louden
Cllr A MacKinnon
Cllr P Saggers
Cllr B Thompson

Investment Sub Committee

Cllr B Thompson (Chairman)
Cllr R Bremner
Cllr H Carmichael
Cllr R Gale
Cllr B Lobban
Cllr D Louden
Cllr P Saggers

Non-Voting Members

Mr E Macniven, GMB
Cllr C Nicolson, Comhairle nan Eilean Siar

Pensions Board

Cllr C Caddick, The Highland Council
Cllr G Cruickshank, The Highland Council
Mr R Fea, Cromarty Port Authority, Representative for Other Employers'
Cllr C Nicolson, Comhairle nan Eilean Siar
Ms L MacKay, Unison
Mr D Macdonald, Unison
Mr D Main, UNITE/UCATT
Mr E Macniven, GMB

Fund Custodian

Northern Trust

Fund Bankers

Clydesdale Bank

Investment Advisers

AON Hewitt

AVC Provider

Prudential Assurance

Fund Investment Managers

Baillie Gifford
Fidelity International
Legal & General Investment Management
Partners Group
Pyrford International
Schroder Property Investment Management
Standard Life Investments

Fund Actuary

Hymans Robertson

External Auditor

Grant Thornton

Admitted & Scheduled Bodies with Active Members

Administering Authority

The Highland Council (also Scheduled Body)

Scheduled Bodies

(specified in legislation as participating in the HCPF)

The Highland Council
Comhairle Nan Eilean Siar
Highland and Western Isles Valuation Joint Board
Scottish Fire & Rescue
Highlands of Scotland Tourist Board
Western Isles Tourist Board
HITRANS
Inverness College
Lews Castle College
Scottish Police Authority
Scottish Police Service Authority
The North Highland College

Admitted Bodies

(have applied and been accepted to participate in an LGPS fund under the terms of an 'Admission Agreement ')

Bord Na Gaidhlig
An Comunn Gaidhealach
Cromarty Firth Port Authority
Eden Court Theatre
Forth & Oban Limited
Hebridean Housing Partnership
Highland Blindcraft
Highland & Islands Enterprise (HIE)
Highlife Highland
Inverness Harbour Trust
Morrison FM
NHS Highland
Skills Development Scotland
Stornoway Port Authority
University of the Highlands & Islands
Sight Action
WIPRO Holdings (UK)

Administration Strategy and Performance

The Fund's Administration Strategy and Discretionary Policy can be found on the Fund's website at

https://www.highlandpensionfund.org/media/4625/administration-policy.pdf

The strategy sets outs the roles and responsibilities of both the Administering Authority and scheme employer. The strategy also sets out a number of key processes and tasks to be benchmarked against expected results. Service level standards for the administering authority performance are based on industry standard Performance Indicators and are detailed in the following tables.

Administering Authority Performance

Task	Target	Number from 1/4/18 to 31/3/19	% on target	Number from 1/4/17 to 31/3/18	% on target
New Entrants (includes re-employments)	Issue Statutory Notice within 14 days of receipt of a new start notice.	1,786	78%	1,870	87%
Early Leavers	The standard issue date is 10 days from receipt of leavers forms and 15 days for deferred benefit entitlement.	1,023	90%	956	90%
Retirements including deferred benefits coming into payment	The standard issue date is 10 days of receipt of leaver option forms.	591	100%	539	100%
Deaths in Service	Contact next of kin within 5 days of notification being received.	19	100%	16	100%
Transfers in from out with Fund	The standard is to issue statutory notice within 10 days of receipt of payment.	98	98%	81	85%
Transfers of pension rights out with Fund	Case to be finalised & payment made within 10 days of receipt of election payment.	10	100%	62	97%
Estimate of benefits	Issue within 10 days of request.	1,318	99%	1,081	99%

Scheme Employer Performance - Target performance 90%

Standard	Number from 1/4/18 to 31/3/19	% on target	Number from 1/4/17 to 31/3/18	% on target
New Start Notification – within 30 days of joining (or 10 days from first deduction if later).	1,786	93%	1,870	94%
Retirement information – to allow benefits to be paid on time.	290	90%	279	87%
Early leaver notification – within 30 days of leaving (or 10 days after last deduction if later).	1,023	92%	956	93%
Death in Service notification – within 7 days of death.	19	100%	16	100%
Year End Queries issued to employers, responses – within 14 days.	13	100%	11	100%

Investment Performance Report

Economic and Market Background

From April to September 2018 equity markets returned well in all regions with US and Japanese equities delivering strong performances.

In the quarter to December 2018 global equities were rocked by rising concerns of slowing global growth and trade wars and earnings growth expectations moderated over the period. Following this poor quarter, global equities rebounded in the quarter to March 2019 as fears of a global economic slowdown and trade war escalation eased although concerns of moderating earning growth are likely to continue into 2019/20.

During the quarter to March 2019, central banks shifted towards a more accommodative stance. Interest rate hike expectations were pushed out further into the future by both the US Federal Reserve and the European Central Bank. Also, additional monetary easing in China and the Eurozone, or less tightening in the case of the UK, were adopted – marking a shift in central bank policy in the last several months.

Accommodative monetary policy intentions, alongside downgraded growth and inflation outlooks, drove developed market bond yields lower over the quarter. This occurred despite improved risk appetite compared to the previous quarter. Both the FTSE Actuaries UK Conventional Gilts All Stocks Index and the FTSE Actuaries UK Index Linked Gilts All Stocks Index posted positive returns of 3.4% and 5.9% respectively.

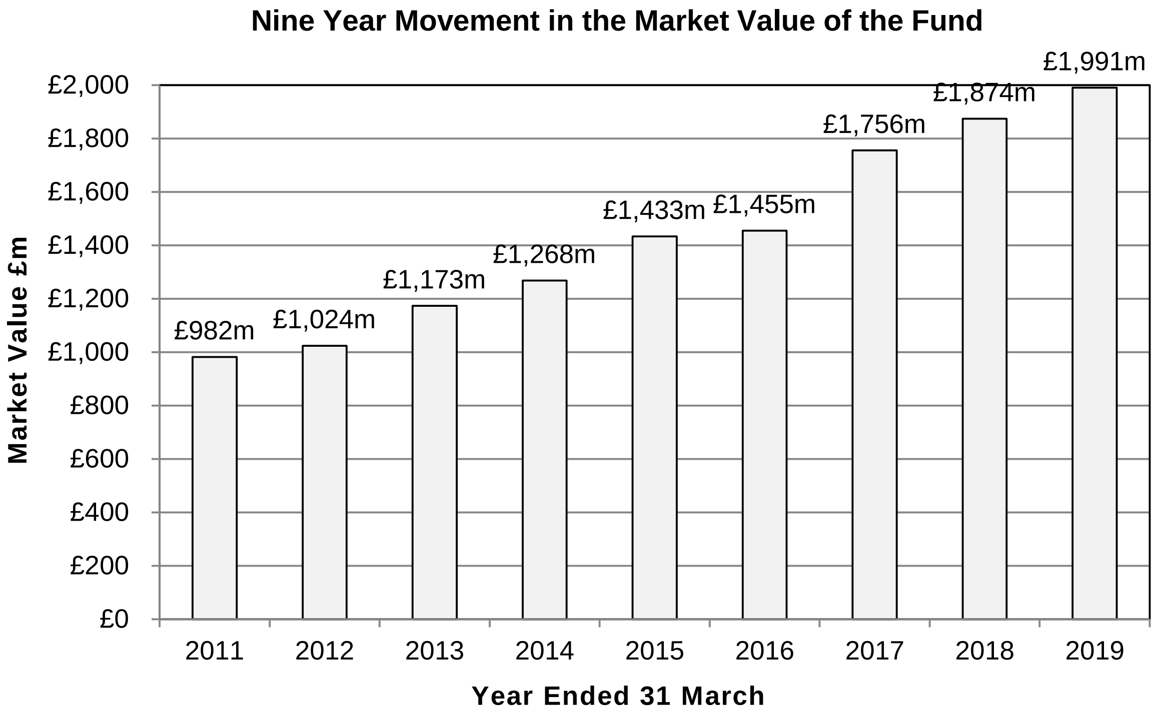
Credit markets performed well over the last quarter with narrowing credit spreads supporting a 4.1% return for UK investment grade corporate bonds.

Property as an asset class performed well during 2018/19 due to steady income returns though there has been a downward trend on capital values that began in late 2018.

Pension Fund Investment Performance

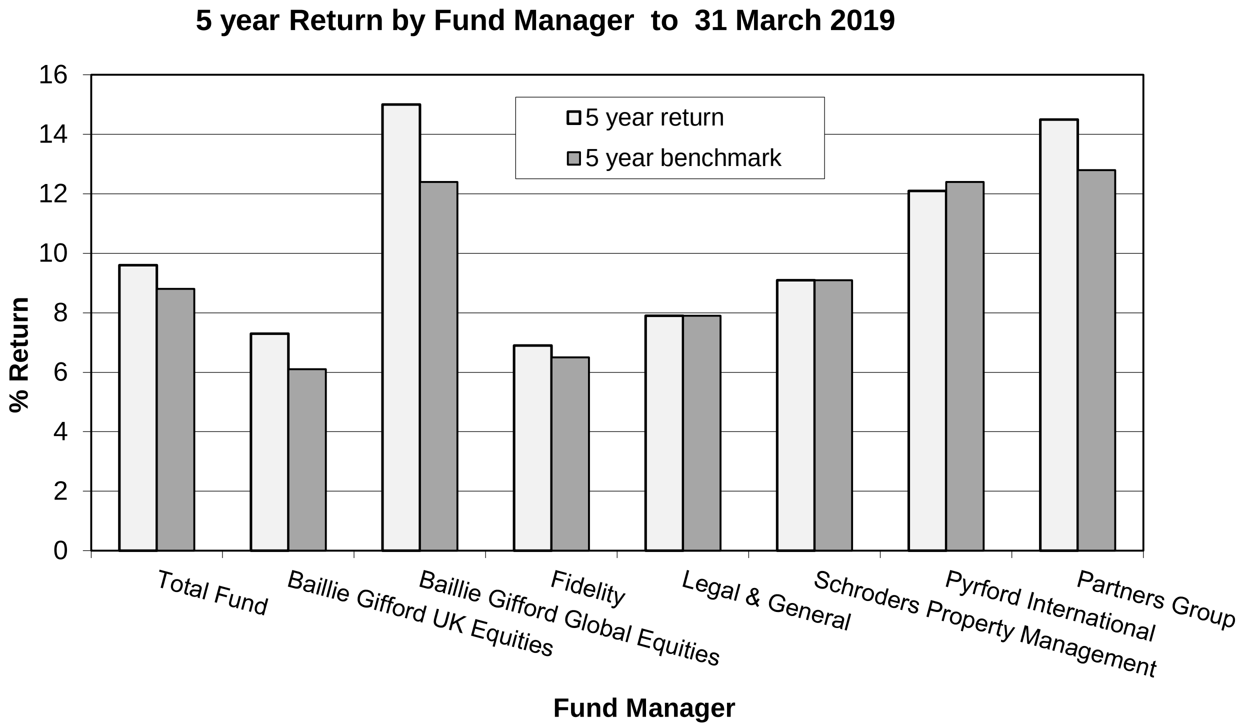
In the year to 31 March 2019, the Highland Council Pension Fund achieved a return on investments of 6.4% which was less than the benchmark of 6.7%; longer term performance has been strong in absolute and relative terms, with the Fund outperforming the benchmark by 1.0% p.a. and 0.8% p.a. over the 3 year and 5 year period respectively to 31 March 2019.

The market value of the Fund’s net investment assets as at 31 March 2019 was £1,991m (£1,874m at 31 March 2018). The nine year movement in the market value of the Fund’s net investment assets is on the following page.



Across the longer term, the main contributors to the positive performance have been global equities, as a result of overall equity market performance (benchmark return) and strong manager stock selection and market out-performance (excess return).

Details of the Fund's investments, analysed by investment category are shown in the financial statements (Note 13) and performance against benchmark for each Fund Manager is below.



Actuarial Position

Employer contributions are assessed every three years by an independent actuary and expressed as a percentage of pensionable pay.

The actuarial valuation as at 31 March 2017 will apply to financial years 2018/19 to 2020/21. Full details of the contribution rates payable can be found in the 2017 actuarial valuation report and the funding strategy statement on the Pension Fund website.

http://www.highlandpensionfund.org/media/3737/hcpf-fund-actuarial-valuation-2017-final.pdf

As at the 2017 actuarial valuation, the Fund was assessed as 101% funded (2014 valuation: 96%) with a surplus of £13m (2014 deficit £52m). The 2017 funding level increased due to investment returns being higher than expected since 2014 and membership experience actuals being different to forecast (lower than expected salary and pension increases and lower than expected ill health retirements).

Due to regulatory changes there is now a primary rate which is the payroll weighted average of the underlying individual employer primary rates and the secondary rate which is the underlying individual employer secondary rates, calculated in accordance with the Regulations and CIPFA guidance. As at the 31 March 2017 Valuation the primary rate was 17.8%.

More information on the recent actuarial valuation can be found in the Actuary's statement (page 88).
For the purposes of the contribution rates set for financial year 2018/19, the following assumptions from the triennial Valuation completed in 2017 were used.

Financial assumptions

Financial assumptions are used to estimate the amount of benefits and contributions payable and to place a current value on these benefits and contributions. The key financial assumptions are:

Financial Assumptions	**March 2014**		**March 2017**	
	Nominal p.a.	**Real (RPI) p.a.**	**Nominal p.a.**	**Real (RPI) p.a.**
Discount Rate	5.3%	2.6%	3.7%	1.3%
Salary Increase (excludes promotional increases)	4.5%	1.8%	3.4%	1.0%
Price Inflation/Pension Increases	2.7%	-	2.4%	-

The actuarial projection of the Market Value of the Fund's assets as at 31 March 2017 was £1,768m (2014 Valuation £1,279m). 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.

Longevity assumptions

The key longevity assumptions are that all members will follow the mortality experience based on the latest industry standard and using information from longevity experts.

Future life expectancy based on the Actuary's Fund-specific mortality review at age 65 are in the table below.

	31 March 2014		31 March 2017	
	Male	**Female**	**Male**	**Female**
Current pensioners	22.5	24.1	21.9	24.3
Future pensioners*	24.7	26.8	23.3	26.1

* assumed current age 45 at date of valuation

Commutation assumption

Half the members will commute their commutable pension for cash at retirement. Active members will retire one year later than they are first able to do so without reduction.

How to Contact Us

Website: http://www.highlandpensionfund.org/highland-pension-fund/about-us/contact-details/

Enquiries regarding Pension Fund Investments:

Treasury and Investments Section
The Highland Council
Council Buildings
Glenurquhart Road
Inverness
IV3 5NX

Tel: 01463 702432
E-mail: treasury.team@highland.gov.uk

Enquiries regarding Pensions Contributions & Benefits:

Pensions Section
The Highland Council
Council Buildings
Glenurquhart Road
Inverness
IV3 5NX

Tel: 01463 702441
E-mail: pensions.section@highland.gov.uk
Website: www.highlandpensionfund.org

Annual Governance Statement

Scope of responsibility

The Highland Council acts as Administering Authority for the Highland Council Pension Fund. The Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards, and that public money is safeguarded, properly accounted for, and used economically, efficiently and effectively. The Council has a statutory duty to make arrangements to secure best value under the Local Government in Scotland Act 2003.

In discharging this overall responsibility, the Council is responsible for putting in place proper arrangements for the governance of its affairs and facilitating the effective exercise of its functions. This includes arrangements for the management of risk.

The Council has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles of the CIPFA/SOLACE framework ‘Delivering Good Governance in Local Government’. The Code is available on The Highland Council website. The authority's financial and management arrangements conform with the governance requirements of the CIPFA Statement on the role of the Chief Financial Officer in local government.

The Local Code of Corporate Governance evidences the Council’s commitment to achieving good governance and demonstrates how it complies with the governance standards recommended by CIPFA. The document is regularly reviewed and updated.

The purpose of the governance framework

The governance framework comprises the systems and processes, and cultures and values, by which the Council is directed and controlled, and the activities used to engage with and lead the community. It enables the Council to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost effective services.

The system of internal control is a significant part of that framework and is designed to manage risk to an acceptable level, and provide reasonable, but not absolute, assurance that policies, aims and objectives can be delivered. The system of internal control is based on an ongoing process designed to identify and prioritise the risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place for the year ended 31 March 2019 and up to the date of approval of the Annual Accounts.

The governance framework

The Local Code is based upon the following seven principles:

1. Focusing on the purpose of the Authority and on outcomes for the community and creating and implementing a vision for the local area.
2. Members and officers working together to achieve a common purpose with clearly defined functions and roles.

3. Promoting values for the Authority and demonstrating the values of good governance through upholding high standards of conduct and behaviour.
4. Taking informed and transparent decisions which are subject to effective scrutiny and managing risk.
5. Developing the capacity and capability of members and officers to be effective.
6. Engaging with local people and other stakeholders to ensure robust public accountability.
7. Implementing good practices in transparency, reporting and audit to deliver effective accountability.

The Pension Fund has a separate Governance Policy Statement which is one of a number of key documents it must hold and this was updated to reflect the changes in governance arrangements as a result of the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015. This Statement was approved by the Pensions Committee in August 2018.

Review of effectiveness

The Highland Council has put in place appropriate management and reporting arrangements to enable it to satisfy itself that its approach to corporate governance is adequate and effective in practice. The Head of Corporate Governance has been given responsibility for:

- overseeing the implementation of the Local Code of Corporate Governance and monitoring its operation.
- reviewing the operation of the Local Code of Corporate Governance in practice.
- reporting annually to the Council on compliance with the Local Code and any changes required to maintain it and ensure its effectiveness.

In fulfilling these duties, the Head of Corporate Governance has taken into account the results of reviews of internal control that have been carried out by Internal Audit.

The Council's corporate governance arrangements are subject to annual review by Internal Audit and the work undertaken in respect of the Local Code during this year has not identified any control weaknesses in these arrangements.

The Internal Audit Service operates in accordance with the Public Sector Internal Audit Standards (the Standards). Section 2450 of the Standards states that "the annual Internal Audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control". In addition, the annual report must incorporate:

- the opinion;
- the summary of work that supports that opinion; and
- a statement on conformance with the Standards and the results of the quality assurance and improvement programme.

The Corporate Audit Manager's responsibilities in this regard were discharged through the presentation of the Internal Audit Annual Report 2018/19 to the Audit and Scrutiny Committee on 13 June 2019.

A review of the adequacy and effectiveness of the systems of internal control for the financial year 2018/19 has not identified any control issues.

The seven Fund Managers and the Global Custodian each provide an annual assurance report (AAF 01/06/ ISAE 3402) which sets out the control procedures in place during the year, and includes an assessment, by an independent accountant, of the effectiveness of the systems of internal controls in operation throughout the period examined. These reports were obtained and reviewed, and it was confirmed that the appropriate assurances were provided by the independent accountants.

The 2018/19 Internal Audit plan comprised of the following:

- Review of the systems of internal control to inform the Fund's Annual Governance Statement and the Internal Audit Annual Report 2018/19.
- Review of Pension Fund Investments. The fieldwork for this audit is substantially complete and testing of the internal controls found these to be operating as expected. The outstanding work relates to value for money considerations and once completed, the audit report will be issued in the normal manner and recommendations made for any areas for improvement.

Audit recommendations are action tracked to ensure that the management agreed actions have been satisfactorily implemented. There are no outstanding actions at present.

On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems for the year to 31 March 2019.

We have been advised on the implications of the result of the review of the effectiveness of the governance framework by the Audit and Scrutiny Committee and that the arrangements continue to be regarded as fit for purpose in accordance with the governance framework. Internal Audit commits to monitoring implementation of any future recommendations as part of the next annual review.

Donna Manson
Chief Executive

Richard Gale
Chairman
Pensions Committee

12 August 2019

On behalf of the members and senior officers of the Highland Council

Governance Compliance Statement

The Regulations that govern the management of LGPS funds in Scotland require that a Governance Compliance Statement is published. The Governance Compliance Statement sets out the extent to which governance arrangements comply with best practice. The following arrangements were in place for financial year 2018/19.

Principle	Fully Compliant	Comments
Structure		
The management of the administration of benefits and strategic management of Fund assets clearly rests with the main committee established by the appointing Council.	Yes	The Highland Council as administering authority has delegated all pension scheme matters to the Pensions Committee. Meeting at the same time as the Committee, the Pensions Board assists the Committee in complying with Pensions Regulator requirements. In addition a small Investment Sub Committee has been established to enhance the Council's management and investment of the assets of the Pension Fund in accordance with the respective objectives and strategies of the Fund.
That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes	The Pensions Committee has members representing other employers and two voting members representing scheme members. The Pensions Board has 4 trade union members and 4 employer representatives. The Investment Sub Committee has two non-voting members representing other employers.
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	The Pensions Committee and the Pensions Board meet concurrently. The minutes of the Investment Sub Committee are presented to the Pensions Committee and Board and there is significant commonality in the membership of the two committees.
That where a secondary committee or panel has been established, at least one seat of the main committee is allocated for a member from the secondary committee or panel.	Yes	The minutes of the Investment Sub Committee are presented to the Pensions Committee and Board and there is significant commonality in the membership of the two committees.

Principle	Fully Compliant	Comments
Representation		
That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: • Employing authorities (including non-scheme employers, e.g. admitted bodies). • Scheme members (including deferred and pensioner scheme members). • Where appropriate, independent professional observers. • Expert advisors (on an ad-hoc basis).	Yes	As stated above there are employer and employee representatives on both Pension Fund Committees and the Pension Board. The Fund's investment advisers regularly attend the Pension Investment Sub-Committee and the Fund's actuaries attend the Pension Committee and Board when appropriate. In addition, Fund Managers attend the Investment Sub Committee on a rotational basis.
That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes	All Pensions Committee and Board members are provided with training, as well as access to papers in advance of Committee meetings and have the opportunity to contribute to the decision making process. There is a Pensions Board which is a bipartite body with an equal number of representatives from local government employers and relevant trade unions. There must be a minimum of 4 from each side.
Selection and Role of Lay Members		
That committee or panel members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	A comprehensive training programme including induction is in place. Training for Pension Committee, Pensions Board and Investment Sub Committee members includes presentations from investment managers, Custodian, actuary and investment advisors. Attendance at meetings and training is monitored and reported.
That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes	The declaration of Member's interests is a standard item on the agenda of the Pension Fund Committee, Pension Board and Investment Sub Committee.

Principle	Fully Compliant	Comments
Voting		
The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	The policy on voting rights is clearly stated in the remits of the Pension Fund Committee, Board and Investment Sub Committee.
Training /Facility Time /Expenses		
That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision making process.	Yes	There is a training, knowledge and skills policy in place which was approved by Pensions Committee in August 2018 which incorporates the CIPFA Local Pensions Boards Technical Knowledge and Skills framework, including the self-assessment matrix. This Policy also highlights the assessment and training resources provided by the Pensions Regulator and sets out a training programme for 2018/19. The training policy recognises the importance of ensuring that it has the necessary resources to discharge its pension administration responsibilities and that all staff and members charged with financial administration, governance and decision-making with regard to the pension scheme are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them.
That where such a policy exists it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	Yes	All members are treated equally under the training policy regardless of whether or not they have voting rights.
That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	Yes	Members receive training each year and this is monitored and reported.
Meeting Frequency		
That an administering authority's main committee or committees meet at least quarterly.	No	The Pensions Committee and Board meet twice a year with the option to hold special meetings as necessary.

Principle	Fully Compliant	Comments
That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	Yes	The Investment Sub Committee meets at least four times a year with the option to hold special meetings as necessary. The Investment Sub-Committee meetings will be timed so minutes can be presented to the Pensions Committee and Board.
That an administering authority which does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	N/A	There is a Scheme Members' representative on the Pensions Committee. The Pensions Board has an equal number of representatives from local government employers and relevant trade unions.
Access		
That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	All Members of the Pension Fund committees, Board and Investment Sub Committee have full access to agendas, reports and minutes.
Scope		
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Pension Committee has an overview of investment, funding and member benefit matters. The Pensions Board assists the Committee with securing compliance with pension legislation and regulations.
Publicity		
That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express interest in wanting to be part of those arrangements.	Yes	The Highland Council publishes governance documents and communicates regularly with employers and scheme members. http://www.highlandpensionfund.org/highland-pension-fund/about-us/forms-and-publications/

Donna Manson
Chief Executive

Richard Gale
Chairman
Pensions Committee

12 August 2019

On behalf of the members and senior officers of the Highland Council

Statement of Responsibilities

The Authority's Responsibilities

The Highland Council, as the administering authority for the Highland Council Pension Fund, is required to:

- Make arrangements for the proper administration of its financial affairs and to secure that the proper officer of the authority has responsibility for the administration of those affairs (section 95 of the Local Government (Scotland) Act 1973). In this authority that officer is the Head of Corporate Finance and Commercialism.
- Manage its affairs, to secure economic, efficient and effective use of resources and safeguard its assets.
- Ensure that Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003).
- Approve the Annual Accounts for signature.

Richard Gale
Chairman
Pensions Committee
12 August 2019

The Responsibilities of the Head of Corporate Finance and Commercialism

The Head of Corporate Finance and Commercialism is responsible for the preparation of the Pension Fund's statement of accounts in accordance with proper practices as set out in the CIPFA/ LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code).

In preparing this statement of accounts, the Head of Corporate Finance and Commercialism has:

- selected suitable accounting policies and applied them consistently
- made judgements and estimates that were reasonable and prudent
- complied with legislation
- complied with the local authority Accounting Code (in so far as it is compatible with legislation)

The Head of Corporate Finance and Commercialism has also:

- kept adequate accounting records which are up to date
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

I, the Head of Corporate Finance and Commercialism of Highland Council as Chief Finance Officer certify that the financial statements give a true and fair view of the financial transactions of the Fund for the year ended 31 March 2019.

Edward Foster CPFA
Head of Corporate Finance and Commercialism

12 August 2019

Independent Auditor's Report

Independent auditor's report to the members of The Highland Council as administering authority for the Highland Council Pension Fund and the Accounts Commission

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual report of the Highland Council Pension Fund (the fund) for the year ended 31 March 2019 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement, and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 (the 2018/19 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2018/19 Code of the financial transactions of the fund during the year ended 31 March 2019 and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2018/19 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Basis for opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We were appointed by the Accounts Commission on 31 May 2016. The period of total uninterrupted appointment is 3 years. We are independent of the fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the council. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern basis of accounting

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or

- the Head of Corporate Finance and Commercialism has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the fund's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Risks of material misstatement

We have reported in a separate Annual Audit Report, which is available from the Audit Scotland website, the most significant assessed risks of material misstatement that we identified and our conclusions thereon.

Responsibilities of the Head of Corporate Finance and Commercialism and the Pensions Committee for the financial statements

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

In preparing the financial statements, the Head of Corporate Finance and Commercialism is responsible for assessing the fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

The Pensions Committee is responsible for overseeing the financial reporting process.

Auditor’s responsibilities for the audit of the financial statements

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

A further description of the auditor’s responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor’s report.

Other information in the annual report

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

In connection with our audit of the financial statements, our responsibility is to read all the other information in the annual report and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Report on other requirements

Opinions on matters prescribed by the Accounts Commission

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

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003;
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016); and
- the information given in the Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018.

Matters on which we are required to report by exception

We are required by the Accounts Commission to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Conclusions on wider scope responsibilities

In addition to our responsibilities for the annual accounts, our conclusions on the wider scope responsibilities specified in the Code of Audit Practice, including those in respect of Best Value, are set out in our Annual Audit Report.

Use of our report

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

Joanne Brown (for and on behalf of Grant Thornton UK LLP)

110 Queen Street

Glasgow

G1 3BX

Pension Fund Account

This statement shows a summary of the income and expenditure that the Pension Fund has generated and incurred in delivering the Local Government Pension Scheme. Included is the income generated from employer and employees' contributions and investment income, as well as the cost of providing benefits and administration of the Fund.

2017/18 £000		Notes	**2018/19 £000**
	Dealings with members, employers and others directly involved in the scheme		
54,596	Contributions receivable	8	58,407
3,386	Individual Transfers in from other pension funds		1,855
57,982			60,262
(52,840)	Benefits payable	9	(57,286)
(3,237)	Payments to and on account of leavers	10	(2,601)
(56,077)			(59,887)
1,905	**Net additions/(reductions) from dealings with members**		**375**
(8,895)	Management expenses	11	**(9,401)**
(6,990)	**Net additions/(withdrawals) including fund management expenses**		**(9,026)**
	Returns on Investments		
38,686	Investment income	12	40,174
(875)	Taxes on income from equities		(832)
88,087	Profit and losses on disposal of investments and changes in values of investments	13.1	84,835
125,898	**Net Return on Investments**		**124,177**
118,908	**Net increase in the net assets available for benefits during the year**		**115,151**
1,764,903	Opening net assets as at the start of the year		**1,883,811**
1,883,811	**Closing net assets as at the end of the year**		**1,998,962**

Net Assets Statement as at 31 March 2019

The Net Assets Statement sets out the value, as at the Statement date, of all assets and liabilities of the Fund.

As at 31/03/18 £000		Notes	**As at 31/03/19 £000**
1,823,983	Investment assets		1,955,781
-	Investment liabilities		(15,176)
1,823,983		13.1	1,940,605
44,359	Cash deposits		43,401
5,316	Investment income due		6,475
644	Amounts receivable for sales		90
(735)	Amounts payable for purchases		-
1,873,567	**Total net investment assets**		**1,990,571**
	Long term assets		
509	**Long term debtors**	23	**353**
	Current assets		
7,173	Short term debtors		8,230
5,137	Bank accounts		3,897
12,310		22	12,127
	Less current liabilities		
(2,575)	Sundry creditors	24	(4,089)
9,735	**Net current assets**		**8,038**
1,883,811	**Closing net assets as at the end of the year available to fund benefits at the period end**[1]		**1,998,962**

Edward Foster CPFA
Head of Corporate Finance and Commercialism
12 August 2019

[1] The Fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end. The actuarial present value of promised retirement benefits is disclosed at Note 17.

Accounting Policies and Notes to Accounts

1. Description of Fund

The Highland Council is the administering authority of the Highland Council Pension Fund ("the Fund") and is the reporting entity for the Fund.

General

The Fund is part of the national Local Government Pension Scheme (LGPS) and is a contributory defined benefit pension scheme. The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK.

The Fund is constituted under legislation governing the Local Government Superannuation Scheme. The primary Act of governance is the Superannuation Act 1972. Detailed regulations for the Scheme are contained in the Local Government Pension Scheme (Scotland) Regulations 1998, the Local Government Pension Scheme (Management & Investment of Funds) Regulations 2010, the Local Government Pension Scheme (Transitional Provisions and Saving) (Scotland) Regulations 2014, the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 and the Local Government Pension Scheme (Scotland) Regulations 2018.

The Administering Authority (The Highland Council) runs The Highland Council Pension Fund, to make sure the Fund achieves the following objectives:

- Receives the proper amount of contributions from employees and employers, and any transfer payments;

  The Fund is built up by contributions from both employees and employers, together with interest and dividends from investments, out of which defined pensions and other benefits are paid.

  Employees' contributions to the Fund are fixed by statute and contributions payable by employers are fixed every three years following a report by an independent actuary who determines the level of contribution necessary to ensure that the Fund will be able to meet future benefits.

- Invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth.

  The Fund's assets are managed by appointed Investment Fund Managers. Once the cost of current benefits is met all surplus cash income is invested to meet future liabilities to employees within the Fund and deferred pension benefits.

- Uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives) and to their dependents (as and when members die), as defined in the LGPS Regulations (pre 1 April 2014 pensions benefits payable were based on final pensionable pay and length of pensionable service. After 1 April the scheme became a career average scheme whereby members accrue benefits based on their pensionable pay in that year at an accrual rate of 1/49th which is updated annually in line with the Consumer Price Index). Assets are also used to pay transfer values and administration costs.

2. Basis of Preparation

The Pension Fund Accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 which is based upon International 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. The actuarial present value of the promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis is disclosed at Note 17 of these accounts.

3. Summary of Significant Accounting Policies

Fund account – revenue recognition

a. Contribution income

Normal contributions, both from the members and from the employer, are accounted for on an accruals basis at the percentage rate recommended by the Fund actuary in the payroll period 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 scheme actuary or on receipt if earlier than the due date.

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

b. Transfer 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 2013.

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 (see paragraph m) to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers in.

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

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

ii) Dividend income

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

iii) Distributions from pooled funds

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as investment income due.

iv) Property-related income

The Fund does not invest directly in property. All property investments are on a 'fund of funds' basis.

v) Movement in the net market value of investments

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

vi) Stock lending income

Income from stock lending is recognised when the deal has been agreed to lend stock and any amount not received by the end of the reporting period is disclosed in the net assets statement as investment income due.

Fund account – expense items

d. Benefits payable

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

e. Taxation

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

f. Management expenses

The Code does not require any breakdown of pension fund administrative expenses. However, in the interests of greater transparency, the Fund discloses its pension Fund management expenses in accordance with the CIPFA guidance, Accounting for Local Government Pension Scheme Management Costs (2016).

- Administrative expenses

All administrative expenses are accounted for on an accruals basis. All pension administration team costs are charged to the Fund. Associated management, accommodation and other overheads are apportioned to this activity and charged as expenses to the Fund.

- Oversight and governance costs

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

- Investment management expenses

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

Investment management fees charged by the external Fund Managers and the Fund Custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change.

In advance of preparing the year end accounts a request was made to all Fund Managers, the Fund Custodian and the Fund Advisors for their fee invoice to the end of March 2019 or an estimated fee for accrual purposes.

A proportion of the Council's costs representing management time spent by officers on investment management are also charged to the Fund.

For private equity fees and property debt fees, the relevant Fund Managers provided information on fees to the end of March 2019 or a basis for estimating these fees.

Net Assets Statement

g. Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the Fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes in the fair value of the asset are recognised in the Fund account.

The values of investments as shown in the net assets statement have been determined at fair value in accordance with the requirements of the Code and IFRS13 (see Note 13.1). For the purposes of disclosing levels of fair value hierarchy, the Fund has adopted the classification guidelines recommended in Practical Guidance on Investment Disclosures (PRAG/Investment Association 2016).

h. Foreign currency transactions

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

i. 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 (see Note 13.7).

j. Cash and cash equivalents

Cash comprises cash in hand and demand deposits and includes amounts held by the Fund's external managers. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

k. Financial liabilities

The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net asset 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.

l. Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme 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 the promised retirement benefits by way of a note to the Net Assets Statement (Note 17). The Fund's actuary has provided an updated calculation of the Actuarial present value of promised retirement benefits which includes an allowance for the McCloud ruling i.e. an estimate of the potential increase in past service benefits arising from this case affecting public service pension schemes (Note 17).

McCloud ruing

When the LGPS benefit structure was reformed in 2015, transitional protections were applied to certain older members close to normal retirement age. The benefits accrued from 1 April 2015 by these members are subject to an 'underpin' which means that they cannot be lower than what they would have received under the previous benefit structure. The underpin ensures that these members do not lose out from the introduction of the new scheme, by effectively giving them the better of the benefits from the old and new schemes.

In December 2018 the Court of Appeal upheld a ruling ("McCloud/Sargeant") that similar transitional protections in the Judges' and Firefighters' Pension Schemes were unlawful on the grounds of age discrimination. The implications of the ruling are expected to apply to the LGPS (and other public service schemes) as well. The recent ruling by the Supreme Court has denied the Government's right to appeal the McCloud judgement. With this decision, it is understood that the Government's right to appeal is now fully exhausted.

As the Government's request for appeal is now rejected, benefits accrued from 2015 may need to be enhanced so that all members, regardless of age, will benefit from the underpin. Alternatively, restitution may be achieved in a different way, for example by paying compensation. In either case, the clear expectation is that many more members would see an enhanced benefit rather than just those currently subject to these protections. In this outcome, there would likely be a retrospective increase to members' benefits, which in turn would give rise to a past service cost for the Fund employers when the outcome is known.

Quantifying the impact of the above at this stage is very difficult because it will depend on the compensation awarded, members' future salary increases, length of service and retirement age, and whether (and when) members withdraw from active service. Salary increases in particular can vary significantly from year to year and from member to member depending on factors such as budget restraint, job performance and career progression. The Government Actuary's Department (GAD) has estimated that the impact for the LGPS as a whole could be to increase active member liabilities by 3.2%, based on a given set of actuarial assumptions. A full description of the data, methodology and assumptions underlying these estimates is provided in GAD's paper, dated 10 June 2019.

m. Additional voluntary contributions

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

AVCs are not included in the accounts in accordance with Regulation 4(1)(b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 but are disclosed as a note only (Note 18).

n. Contingent assets and contingent liabilities

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

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

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

o. Prior year adjustments

Changes in accounting policies are only made when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Fund's financial position or financial performance. Where a change is made, it is applied retrospectively by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Changes in accounting estimates are accounted for prospectively, i.e. in the current and future years affected by the change and do not give rise to a prior period adjustment.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

4. Accounting Standards Issued but Not Yet Adopted

The following accounting standards will be adopted within the 2019/20 Code effective from 1 April 2019. There is therefore no impact on the 2018/19 financial statements.

- Amendments to IAS 40 Investment Property: Transfers of Investment Property (clarifies guidance regarding transfers in and out of investment properties)
- Annual improvements to IFRS Standards 2014-2016 cycle
  - The improvement to IFRS 1 First-time Adoption of International Financial Reporting (deletion of short term exceptions)
  - IFRS 12 Disclosure of Interests in Other Entities (disclosure requirements of an entity's interests that are classified as held for sale, held for distribution or as discontinued operations)
  - IAS 28 Investments in Associates and Joint Ventures (clarifies the election to measure at fair value through profit and loss an investment in an associate or joint venture that is held by an entity)
- IFRIC 22 Foreign Currency Transactions and Advance Considerations (where a non-monetary asset or liability arises from either the payment or receipt of an advance consideration)
- IFRIC 23 Uncertainty over Tax Treatments (clarifies the accounting for uncertainties in income taxes)
- Amendments to IFRS 9 Financial Instruments: Prepayment Features with Negative Compensation (alters the existing requirements in IFRS 9 regarding termination rights)

Changes arising from the adoption of these standards are not expected to have any impact on the Pension Fund balance.

5. Critical Judgements in Applying Accounting Policies

Unquoted private equity investments

It is important to recognise the highly 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 guidelines set out by the British Venture Capital Association. The value of unquoted private equities at 31 March 2019 was £102.6m (£83.3m as at 31 March 2018).

Unquoted property debt investment

The unquoted holdings in property debt (commercial real estate loans) have been included at fair value. The value of unquoted property debt at 31 March 2019 is £55.0m (£55.0m as at 31 March 2018).

Pension fund liability

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

The estimate is subject to significant variances based on changes to the underlying assumptions which are agreed with the actuary and have been summarised in Note 17.

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

6. Assumptions Made About the Future and Other Major Sources of Estimation Uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because outcomes cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Financial Statements at 31 March 2019 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
Actuarial present value of promised retirement benefits	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.	The effects on the net pension liability of changes in individual assumptions can be measured. • 0.5% p.a. increase in the pension increase rate would result in an increase of approximately 8% to liabilities (£204m). • 0.5% p.a. increase in salary rate would result in an increase of approximately 1% to liabilities (£38m). • 0.5% p.a. decrease in the discount rate assumption would result in an increase of approximately 10% to liabilities (£258m). • 1 year increase in member life expectancy would result in an increase in the liabilities of 3-5%.
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 £102.6m. There is a risk that this investment may be under or overstated in the accounts. For example a potential market movement of 25.0% up or down could result in an increase in value to £128.2m or decrease to £77.0m.
Property Debt	Investment is valued by the Fund Manager using critical accounting estimates and judgements from the fund's financial statement. These investments are not publicly listed and as such there is a degree of estimation involved in the valuation.	The total property debt investments in the financial statements are £55.0m. There is a risk that this investment may be under or overstated in the accounts. For example a potential market movement of 8.0% up or down could result in an increase in value to £59.4m or decrease to £50.6m.

7. Events after the Reporting Date

The unaudited statement of accounts was issued on 12 August 2019. Events taking place after this date are not reflected in the accounts or notes. During the period 31 March 2019 and up to the date these accounts were authorised on 12 August 2019, there was the McCloud ruling and Note 17 includes an estimate of the potential increase in past service benefits arising from this case.

8. Contributions Receivable

By category	2017/18	**2018/19**
	£000	**£000**
Employees' pension contributions	12,858	13,378
Employers' pension contributions	41,738	45,029
Total contributions	**54,596**	**58,407**

As a result of the 2017 valuation, the primary contribution rate (future service contributions) for the whole Fund of 17.8% of pay for payroll contributions was set by the Actuary for the period 1 April 2019 to 31 March 2021 in the Triennial Actuarial Valuation report 2017. In addition to this, the secondary rate (past service contributions) for 2018/19 is £3,973,000. The 2017 valuation is complete and applies to contributions from 1 April 2018.

Analysis of Contributions by Authority

	2018/19			
	Highland Council	**Scheduled Bodies**	**Admitted Bodies**	**Totals**
	£000	£000	£000	£000
Normal contribution	21,512	9,471	9,026	40,009
Deficit funding	2,458	935	1,334	4,727
	23,970	10,406	10,360	44,736
Strain on Fund	42	208	43	293
Employer's contributions	**24,012**	**10,614**	**10,403**	**45,029**
Members' pension contributions	**7,272**	**3,285**	**2,821**	**13,378**
Total contributions	**31,284**	**13,899**	**13,224**	**58,407**

	2017/18			
	Highland Council	**Scheduled Bodies**	**Admitted Bodies**	**Totals**
	£000	£000	£000	£000
Normal contribution	22,430	9,353	8,070	39,853
Deficit funding	712	429	384	1,525
	23,142	9,782	8,454	41,378
Strain on Fund	185	150	25	360
Employer's contributions	**23,327**	**9,932**	**8,479**	**41,738**
Members' pension contributions	**7,076**	**3,072**	**2,710**	**12,858**
Total contributions	**30,403**	**13,004**	**11,189**	**54,596**

Number of Contributors and Pensioners

2018/19	Contributors	Pensioners	Deferred Pensioners	Total
Highland Council	7,330	7,047	5,821	20,198
Scheduled Bodies	2,957	2,089	2,134	7,180
Admitted Bodies	2,312	899	1,020	4,231
Total	**12,599**	**10,035**	**8,975**	**31,609**
2017/18				
Highland Council	7,424	6,793	5,774	19,991
Scheduled Bodies	2,942	1,991	2,091	7,024
Admitted Bodies	2,320	793	940	4,053
Total	**12,686**	**9,577**	**8,805**	**31,068**

9. Benefits Payable

By category	2017/18	**2018/19**
	£000	**£000**
Pensions	(42,981)	(45,352)
Lump sum retirement benefits	(8,265)	(9,717)
Lump sum death benefits	(1,594)	(2,217)
	(52,840)	**(57,286)**

By authority	2017/18	**2018/19**
	£000	**£000**
Highland Council	(34,928)	(38,798)
Scheduled Bodies	(11,432)	(11,854)
Admitted Bodies	(6,480)	(6,634)
	(52,840)	**(57,286)**

10. Payments to and on Account of Leavers

	2017/18	**2018/19**
	£000	**£000**
Refunds to members leaving service	(204)	(213)
Payments for members joining state scheme	(5)	-
Individual transfers	(3,028)	(2,388)
	(3,237)	**(2,601)**

At the year-end there are no potential liabilities in respect of individuals transferring out of the Fund upon whom the Fund is awaiting final decisions.

11. Management Expenses

	2017/18 £000	**2018/19 £000**
Administrative costs	(991)	(1,241)
Investment Management expenses	(7,515)	(7,832)
Oversight and Governance costs	(389)	(328)
	(8,895)	**(9,401)**

Analysis of Management Expenses

Administrative Costs

	2017/18 £000	**2018/19 £000**
Administrative costs	(182)	(182)
Employee costs	(783)	(1,049)
Other administration	(26)	(10)
Total administrative costs	**(991)**	**(1,241)**

Investment Management Expenses

	2017/18 £000	**2018/19 £000**
External management fees invoiced		
Unitised insurance policies	(62)	(116)
Equities	(2,946)	(3,121)
Bonds	(258)	(260)
Property	(362)	(395)
	(3,628)	**(3,892)**
External management fees deducted from capital		
Private equity	(1,216)	(2,012)
Property debt	(187)	(192)
Performance fees (private equity)	(1,137)	(978)
	(2,540)	**(3,182)**
Transaction costs*	**(307)**	**(327)**
Custodian fees	**(97)**	**(96)**
Investment expenses	**(943)**	**(335)**
Total investment management expenses	**(7,515)**	**(7,832)**

*Transaction costs are brokers’ charges and other costs incurred on the purchase and sale of equities (non-pooled). The transaction costs on purchases were £0.277m and sales were £0.050m for 2018/19 (2017/18 transaction costs on purchases were £0.230m and sales were £0.077m).

Oversight and Governance costs	2017/18 £000	**2018/19 £000**
Actuarial fees	(110)	(46)
External Audit fees	(29)	(30)
Internal Audit fees	(10)	(12)
Investment advisor fees	(52)	(80)
Performance management	(24)	(24)
Employee costs	(139)	(117)
Sundry costs	(25)	(19)
Total oversight and governance costs	**(389)**	**(328)**
Total Management Expenses	**(8,895)**	**(9,401)**

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales.

12. Analysis of Investment Income

	2017/18 £000	**2018/19 £000**
Income from equities	22,222	26,354
Income from pooled investments (unit trusts and other managed funds)	6,472	4,266
Pooled property investments	8,100	6,153
Interest on cash deposits	144	754
Private equity income	1,061	2,186
Stock lending and other income	687	461
	38,686	**40,174**

13. Investment Assets

13.1. Reconciliation of Movements in Investments and Derivatives

2018/19 **Classifications**	**Market value 1 Apr 18**	**Purchases at cost derivative payments**	**Sales proceeds derivative receipts**	**Change in market value**	**Market value 31 Mar 19**
	£000	**£000**	**£000**	**£000**	**£000**
Investment assets					
Equities	877,608	131,260	(102,119)	55,578	962,327
Pooled investments					
Unitised ins policies (equities)	311,039	-	(5,000)	25,063	331,102
Unitised ins policies (bonds)	83,031	-	-	(4,091)	78,940
Unit trusts (equities)	13,639	191	-	(1,253)	12,577
Unit trusts (bonds)	214,472	7,241	(2,796)	3,681	222,598
Unit trusts (property)	184,779	4,626	(10,945)	5,774	184,234
Venture capital and partnerships					
Private equity	83,292	21,348	(9,455)	7,373	102,558
Property debt	55,000	-	(1,486)	1,486	55,000
Currency forwards	1,123	-	-	(1,123)	-
Equity options	-	-	-	6,445	6,445
Total Investment assets	1,823,983	164,666	(131,801)	98,933	**1,955,781**
Investment liabilities					
Currency forwards	-	2,870	(3,875)	45	(960)
Equity options	-	-	-	(14,216)	(14,216)
Total investment liabilities	-	2,870	(3,875)	(14,171)	**(15,176)**
Net investment assets	1,823,983	167,536	(135,676)	84,762	**1,940,605**
Other investment balances					
Cash deposits	44,359	-	-	73	43,401
Investment income due	5,316	-	-	-	6,475
Amounts receivable for sales	644	-	-	-	90
Amounts payable for purchases	(735)	-	-	-	-
Total net investment assets	1,873,567	-	-	84,835	**1,990,571**

2017/18 **Classifications**	**Market value 1 Apr 17**	**Purchases at cost derivative payments**	**Sales proceeds derivative receipts**	**Change in market value**	**Market value 31 Mar 18**
	£000	**£000**	**£000**	**£000**	**£000**
Investment assets					
Equities	816,130	123,103	(104,417)	42,792	877,608
Pooled investments					
Unitised ins policies (equities)	302,045	-	(10,000)	18,994	311,039
Unitised ins policies (bonds)	82,527	-	-	504	83,031
Unit trusts (equities)	13,047	182	-	410	13,639
Unit trusts (bonds)	210,606	6,337	(1,349)	(1,122)	214,472
Unit trusts (property)	159,328	50,035	(34,699)	10,115	184,779
Venture capital and partnerships					
Private equity	83,760	2,689	(14,059)	10,902	83,292
Property debt	35,649	19,309	(977)	1,019	55,000
Currency forwards	715	3,517	(7,753)	4,644	1,123
Equity options	-	-	-	-	-
Total Investment assets	1,703,807	205,172	(173,254)	88,258	1,823,983
Investment liabilities					
Currency forwards	-	-	-	-	-
Equity options	-	-	-	-	-
Total investment liabilities	1,703,807	205,172	(173,254)	88,258	1,823,983
Net investment assets	1,703,807	205,172	(173,254)	88,258	1,823,983
Other investment balances					
Cash deposits	37,479	-	-	(171)	44,359
Investment income due	3,764	-	-	-	5,316
Amounts receivable for sales	10,612	-	-	-	644
Amounts payable for purchases	(135)	-	-	-	(735)
Total net investment assets	1,755,527	-	-	88,087	1,873,567

The change in market value of investments during the year comprises of all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

13.2. Analysis of Investments

2017/18		**Portfolio Distribution UK & overseas**	**2018/19**	
UK	Overseas		**UK**	**Overseas**
£000	£000	**Investment assets**	**£000**	**£000**
347,589	530,019	Equities	379,798	582,529
		Pooled investments		
89,163	221,876	Unitised insurance policies (equities)	96,870	234,232
83,031	-	Unitised insurance policies (bonds)	78,940	-
13,639	-	Unit trust (equities)	12,577	-
140,232	74,240	Unit trust (bonds)	182,530	40,068
183,257	1,522	Unit trust (property)	183,121	1,113
		Venture capital and partnerships		
-	83,292	Private equity	-	102,558
55,000	-	Property debt	55,000	-
37,463	6,896	Cash deposits	43,179	222
3,500	1,816	Investment income due	2,622	3,853
-	644	Amounts receivable for sales	-	90
-	1,123	Currency forwards	-	-
-	-	Equity options	2,220	4,225
		Investment liabilities		
-	-	Currency forwards	-	(960)
-	-	Equity options	(4,820)	(9,396)
-	(735)	Amounts payable for purchases	-	-
952,874	**920,693**	**Net total**	**1,032,037**	**958,534**
	1,873,567			**1,990,571**

2017/18		**Portfolio Distribution (Quoted / Unquoted)**	**2018/19**	
Quoted	Unquoted		**Quoted**	**Unquoted**
£000	£000	**Investment assets**	**£000**	**£000**
877,608	-	Equities	962,327	-
		Pooled investments		
311,039	-	Unitised insurance policies (equities)	331,102	-
83,031	-	Unitised insurance policies (bonds)	78,940	-
13,639	-	Unit trust (equities)	12,577	-
214,472	-	Unit trust (bonds)	222,598	-
-	184,779	Unit trust (property)	-	184,234
		Venture capital and partnerships		
-	83,292	Private equity	-	102,558
-	55,000	Property debt	-	55,000
-	44,359	Cash deposits	-	43,401
4,320	996	Investment income due	6,475	-
-	644	Amounts receivable for sales	90	-
-	1,123	Currency forwards	-	-
-	-	Equity options	6,445	-
		Investment liabilities		
-	-	Currency forwards	(960)	-
-	-	Equity options	(14,216)	-
-	(735)	Amounts payable for purchases	-	-
1,504,109	**369,458**	**Net total**	**1,605,378**	**385,193**
	1,873,567			**1,990,571**

13.3. Investments Analysed by Fund Manager

The market value of the assets which were under the management of fund managers and the proportion managed by each manager are below.

2017/18			2018/19	
Market Value £000	% of Fund	**Manager Analysis**	**Market Value £000**	**% of Fund**
686,416	36.6	Baillie Gifford (UK and global equity)	737,048	37.0
242,642	13.0	Pyrford (global equity)	269,159	13.5
215,915	11.5	Fidelity (bonds and gilts)	223,957	11.3
394,071	21.0	Legal and General (unitised insurance - equity and bonds)	402,271	20.2
185,038	9.9	Schroders (property fund)	196,741	9.9
93,517	5.0	Partners Group (private equity)	106,031	5.3
55,968	3.0	Standard Life Investments	55,364	2.8
1,873,567	**100.0**	**Combined Fund**	**1,990,571**	**100.0**

13.4. Top 10 Equity Holdings by Market Value

Holding at 31 March 2019	Market Value £000	% of Total Equity Investments	Classification
Prudential	29,373	2.13	Insurance
BHP Billiton Plc	19,053	1.38	Mining
Royal Dutch Shell 'B'	17,164	1.25	Oil and gas
Diageo	15,121	1.10	Beverages
Naspers	14,166	1.03	Media
St James's Place	12,616	0.92	Diversified Financials
Amazon	12,447	0.90	Consumer discretionary
Bunzl	12,014	0.87	Capital Goods
Legal & General	12,005	0.87	Insurance
British American Tobacco	11,760	0.85	Tobacco
Total	**155,719**	**11.3**	

13.5. Holdings Exceeding 5% by Total Net Assets

The Fund holds the following investments that exceed 5% of the net assets available for benefits.

Fund Manager & Category	Market Value at 31 March 2018	% of total net assets	**Market Value at 31 March 2019**	**% of total net assets**
	£000	%	£000	%
Fidelity (Institutional UK Aggregated Bond)	107,586	5.7	111,258	5.6
Total net assets available for benefits	1,883,811		1,998,962	

13.6. Stock Lending

The Fund’s investment strategy sets parameters for the Fund’s stock-lending programme.

At the year-end, the value of quoted equities on loan was £152.088m (31 March 2018 - £145.159m). These equities continue to be recognised in the Fund’s financial statements.

Counterparty risk is managed through holding collateral at the Fund’s custodian bank. At the year end, the Fund held collateral (via the custodian) at fair value of £162.162m (31 March 2018 - £155.940m) representing 106.6% of stock lent. Collateral consists of acceptable securities and government debt.

Stock Lending commissions are remitted to the Fund via the custodian. During the period the stock is on loan, the voting rights of the loaned stock pass to the borrower.

The income from stock lending in 2018/19 was £0.245m (2017/18 £0.219m) which is included in investment income in the Pension Fund account and is part of the “Stock lending and other income” in Note 12 Analysis of Investment Income £0.461m (2017/18 £0.687m).

There are no liabilities associated with the loaned assets.

13.7. 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 agreements in place between the Fund and the various investment managers. The derivatives that the

Fund uses are forward foreign currency (currency forwards) and options. In December 2018, options were purchased to minimise the risk of loss of value through adverse equity price movements until December 2021.

Forward foreign currency (currency forwards)

To maintain appropriate diversification and to take advantage of overseas investment returns, a significant proportion of the Fund's quoted equity portfolio is in overseas stock. The Investment Managers Pyrford International and Baillie Gifford hold short term currency forwards for the Fund. The use of these forward foreign currency contracts is in line with the investment management agreement between the Fund and these Fund Managers.

This currency hedging is in place to reduce the extent to which the Fund is exposed to certain currency movements. These investments are used to ensure that cash can remain invested short term in equities. The sale of currency forwards, traded over the counter (OTC), is undertaken in order to hedge foreign currency exposure risk back to the portfolio's base currency of GBP.

Investment underlying option contract	Currency bought	Local value	Currency sold	Local value	Asset value	Liability value
		000		000	£000	£000
Up to six months	GBP	28,141	CHF	(36,841)	-	(447)
Up to six months	GBP	22,170	AUD	(41,599)	-	(405)
Up to six months	GBP	9,835	CAD	(17,376)	-	(108)
Net forward currency contracts at 31 March 2019					-	(960)
Prior year comparative						
Net forward currency contracts at 31 March 2018					**1,123**	-

Purchased/written options

Equity protection options were purchased in December 2018 to protect passive equities (pooled investment - unitised insurance equities) from losses caused by adverse equity price movements until December 2021. These options are held by Legal and General Investment Management (LGIM) within a bespoke pooled vehicle but have been shown as separate assets and liabilities in note 13.1.

When an entity buys an options contract it grants them the right, but not the obligation to buy or sell an underlying asset at a set price on or before a certain date. A call option gives the holder the right to buy stock and a put option gives the holder the right to sell stock.

The basis of valuing the options (which are "over-the-counter" derivatives) is the Black-Scholes model. Black-Scholes is a pricing model used to determine the fair value or theoretical value for a derivative option based on six variables such as volatility, type of option, underlying stock price, time strike price, and risk-free rate. Outstanding over-the-counter options held in the bespoke equity protection pooled fund are as follows.

Investment underlying option contract	Expires	Put/ call	Notional holding	Market value 31 March18	Notional holding	Market value 31 March 19
				£000		£000
Assets						
UK equities	June 2019	Put	-	-	263	78
	Dec 2019	Put	-	-	307	342
	Dec 2020	Put	-	-	304	815
	Dec 2021	Put	-	-	301	985
Overseas equities	June 2019	Put	-	-	336	175
	Dec 2019	Put	-	-	392	691
	Dec 2020	Put	-	-	387	1,432
	Dec 2021	Put	-	-	384	1,927
						6,445
Liabilities						
UK equities	June 2019	Put	-	-	(263)	(8)
	June 2019	Call	-	-	(263)	(841)
	Dec 2019	Put	-	-	(307)	(66)
	Dec 2019	Call	-	-	(307)	(1,139)
	Dec 2020	Put	-	-	(304)	(255)
	Dec 2020	Call	-	-	(304)	(1,060)
	Dec 2021	Put	-	-	(301)	(328)
	Dec 2021	Call	-	-	(301)	(1,123)
Overseas equities	June 2019	Put			(336)	(13)
	June 2019	Call			(336)	(1,255)
	Dec 2019	Put			(392)	(133)
	Dec 2019	Call			(392)	(2,029)
	Dec 2020	Put			(387)	(428)
	Dec 2020	Call			(387)	(2,248)
	Dec 2021	Put			(384)	(708)
	Dec 2021	Call			(384)	(2,582)
						(14,216)
Net purchased/written options at 31 March 2019						**(7,771)**

14.1. Fair Value – Basis of Valuation

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

Description of Asset	Valuation hierarchy	Basis of valuation	Observable and unobservable inputs	Key sensitivities affecting the valuations provided
Market quoted investments	Level 1	Published bid market price ruling on the final day of the accounting period	Not required	Not required
Quoted bonds	Level 1	Fixed interest securities are valued at a market value based on current yields	Not required	Not required
Exchange traded pooled investments (includes unitised insurance policies (equities and bonds))	Level 1	Closing bid value on published exchanges	Not required	Not required
Pooled investments – overseas unit trusts and property funds	Level 2	Closing bid price where bid and offer prices are published. Closing single price where single price published	Net Asset Value (NAV) based pricing set on a forward pricing basis	Not required
Pooled investments – property funds which are not listed	Level 3	Financial statements or other market indicators or information are used to calculate valuation	The following is used: Estimated rental growth Covenant strength for existing tenancies Discount rate Estimated rental growth Land/building valuation survey	Significant changes in rental growth, vacancy levels or the discount rate could affect valuations as could more general changes to market prices.

Description of Asset	Valuation hierarchy	Basis of valuation	Observable and unobservable inputs	Key sensitivities affecting the valuations provided
Unquoted equity	Level 3	Comparable valuation of similar companies in accordance with International Private Equity and Venture Capital Valuation Guidelines (2012)	Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA) multiple Revenue multiple Discount for lack of marketability Control premium	Valuations could be affected by material events occurring between the date of the financial statements and the Fund's own reporting date, by changes to expected cash flows, and any differences between audited and unaudited accounts.
Unquoted commercial real estate debt	Level 3	Valued by the Fund Manager using critical accounting estimates and judgements from the fund's financial statement	Observable and unobservable input are critical accounting estimates and judgements from the fund's financial statement	Valuations could be affected by material events occurring between the date of the financial statements provided and the pension fund's own reporting date, by changes to expected cash flows, and by any differences between audited and unaudited accounts.

14.2. Sensitivity of assets valued at level 3

Having consulted the Fund's independent investment advisors (Aon Hewitt), it was determined that the valuation methods described above for Level 3 investments are likely to be accurate to within the following ranges, and has set out below the consequent potential impact on the closing value of investments held at 31 March 2019.

Asset type	Value as at 31 Mar 2019	Assessed valuation range	Value on increase	Value on decrease
	£000	%	£000	£000
Pooled investment vehicles				
Units trust (property)	184,234	12.5%	207,263	161,205
Venture capital and partnerships				
Private equity	102,558	25%	128,198	76,919
Property debt	55,000	8%	59,400	50,600

14.3. Fair Value Hierarchy

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

Level 1

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

1 comprise quoted equities, quoted fixed securities, quoted index linked securities and unit trusts.

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

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

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

Values at 31 March 2019	**Quoted market price**	**Using observable input**	**With significant unobservable inputs**	
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets	**£000**	**£000**	**£000**	**£000**
Equities	962,327	-	-	962,327
Pooled investments				
Unitised insurance policies (equities)	-	331,102	-	331,102
Unitised insurance policies (bonds)	-	78,940	-	78,940
Unit trust (equities)	-	12,577	-	12,577
Unit trust (bonds)		222,598	-	222,598
Unit trust (property)		-	184,234	184,234
Venture capital and partnerships				
Private equity	-	-	102,558	102,558
Property debt	-	-	55,000	55,000
Cash deposits	43,401	-	-	43,401
Investment income due	6,475	-	-	6,475
Amounts receivable for sales	90	-	-	90
Equity options	-	6,445	-	6,445
Total investment assets	**1,012,293**	**651,662**	**341,792**	**2,005,747**
Investment liabilities				
Currency forwards	(960)	-	-	(960)
Amounts payable for purchases	-	(14,216)	-	(14,216)
Equity options				
Total investment liabilities	**(960)**	**(14,216)**	**-**	**(15,176)**
Net investments total	**1,011,333**	**637,446**	**341,792**	**1,990,571**

Values at 31 March 2018	**Quoted market price**	**Using observable input**	**With significant unobservable inputs**	
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets	**£000**	**£000**	**£000**	**£000**
Equities	877,608	-	-	877,608
Pooled investments				
Unitised insurance policies (equities)	-	311,039	-	311,039
Unitised insurance policies (bonds)	-	83,031	-	83,031
Unit trust (equities)	-	13,639	-	13,639
Unit trust (bonds)		214,472	-	214,472
Unit trust (property)		-	184,779	184,779
Venture capital and partnerships				
Private equity	-	-	83,292	83,292
Property debt	-	-	55,000	55,000
Cash deposits	44,359	-	-	44,359
Investment income due	5,316	-	-	5,316
Amounts receivable for sales	644	-	-	644
Currency forwards	1,123	-	-	1,123
Total investment assets	**929,050**	**622,181**	**323,071**	**1,874,302**
Investment liabilities				
Amounts payable for purchases	(735)	-	-	(735)
Total investment liabilities	**(735)**	**-**	**-**	**(735)**
Net investments total	**928,315**	**622,181**	**323,071**	**1,873,567**

14.4. Reconciliation of Fair value Measurements within Level 3

	Pooled investment vehicles	Venture capital and partnerships	
	Units trust (property)	Private equity	Property debt
	£000	£000	£000
Market value 1 Apr 2018	184,779	83,292	55,000
Purchases during the year and derivative payments	4,626	21,348	-
Sales during the year and derivative receipts	(10,945)	(9,455)	(1,486)
Unrealised gains/ (losses)	4,323	(294)	1,294
Realised gain/(losses)	1,451	7,667	192
Market value 31 March 2019	184,234	102,558	55,000

15. Financial Instruments

15.1. 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 amount of financial assets and liabilities by category and net assets statement heading. No financial instruments were reclassified during the accounting period.

31 March 2019	**Fair value through profit & loss**	**Loans & receivables**	**Financial liabilities at cost**	**Total**
	£000	**£000**	**£000**	**£000**
Financial assets				
Equities	962,327	-	-	962,327
Pooled investments				
Unitised ins policies (equities)	331,102	-	-	331,102
Unitised ins policies (bonds)	78,940	-	-	78,940
Unit trust equity	12,577	-	-	12,577
Unit trusts (bonds)	222,598	-	-	222,598
Unit trusts (property)	184,234	-	-	184,234
Venture capital and partnerships				
Private equity	102,558	-	-	102,558
Property debt	55,000	-	-	55,000
Equity options	6,445			6,445
Amounts receivable for sales	90	-	-	90
Cash deposits	-	43,401	-	43,401
Investment income due	-	6,475	-	6,475
Long term debtors	-	353	-	353
Short term debtors	-	8,230	-	8,230
Bank	-	3,897	-	3,897
Total financial assets	**1,955,871**	**62,356**	**-**	**2,018,227**
Financial liabilities				
Currency forwards	-	-	(960)	(960)
Equity options	-	-	(14,216)	(14,216)
Creditors	-	-	(4,089)	(4,089)
Total financial liabilities	**-**	**-**	**(19,265)**	**(19,265)**
Closing net financial assets	**1,955,871**	**62,356**	**(19,265)**	**1,998,962**

31 March 2018	Fair value through profit & loss	Loans & receivables	Financial liabilities at cost	Total
	£000	**£000**	**£000**	**£000**
Financial assets				
Equities	877,608	-	-	877,608
Pooled investments				
Unitised ins policies (equities)	311,039	-	-	311,039
Unitised ins policies (bonds)	83,031	-	-	83,031
Unit trust equity	13,639	-	-	13,639
Unit trusts (bonds)	214,472	-	-	214,472
Unit trusts (property)	184,779	-	-	184,779
Venture capital and partnerships				
Private equity	83,292	-	-	83,292
Property debt	55,000	-	-	55,000
Derivative contracts	1,123	-	-	1,123
Amounts receivable for sales	644	-	-	644
Cash deposits	-	44,359	-	44,359
Investment income due	-	5,316	-	5,316
Long term debtors	-	509	-	509
Short term debtors	-	7,173	-	7,173
Bank	-	5,137	-	5,137
Total financial assets	**1,824,627**	**62,494**	**-**	**1,887,121**
Financial liabilities				
Amounts payable for purchases	(735)	-	-	(735)
Creditors		-	(2,575)	(2,575)
Total financial liabilities	**(735)**	**-**	**(2,575)**	**(3,310)**
Closing net financial assets	**1,823,892**	**62,494**	**(2,575)**	**1,883,811**

15.2. Net Gains and Losses on Financial Instruments

	2017/18	**2018/19**
	£000	**£000**
Financial assets		
Fair value through profit and loss	88,258	85,885
Amortised cost – unrealised gains	-	73
Loans and receivables	(171)	
Financial liabilities		
Fair value through profit and loss		(1,123)
Total	**88,087**	**84,835**

16. The Nature and Extent of Risks Arising from Financial Instruments

Risk and risk management

The Fund's primary long-term risk is that the Fund's assets will fall short of its liabilities (i.e. promised benefit 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 the Fund's forecast cash flows. The Fund manages these investment risks as part of its overall Pension Fund risk management programme.

The Pensions Committee is responsible for the Fund's risk management strategy. There is a risk register in place which follows the CIPFA guidance Managing risk in the LGPS. This is regularly reviewed and significant risks are reported to the Pensions Committee.

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, whilst optimising the return on risk.

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 Fund and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

The Fund manages these risks by ensuring that specific risk exposure is limited by applying risk-weighted maximum exposures to individual investments.

Equity futures contracts and exchange traded option contracts on individual securities may also be used to manage market risk on equity investments. It is possible for over-the-counter equity derivative contracts to be used in exceptional circumstances to manage specific aspects of market risk.

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 instruments or its issuer or factors affecting all such instruments in the market.

The Fund is exposed to share and derivative price risk. This arises from investments held by the Fund for which the future price is uncertain. All securities investments present a risk of loss of capital. The maximum risk resulting from financial instruments is determined by the fair value of the financial instruments.

The Fund's investment managers mitigate this price risk through diversification and the selection of securities and other financial instruments.

Other price risk – sensitivity analysis

Following analysis of historical data and expected investment return movement and in consultation with the Fund's investment advisors, the Fund has determined that the following movements in market price risk are reasonably possible for the 2018/19 reporting period.

Asset type	**Potential market movement (+/)**
UK equities	19.0%
Global equities (excluding UK)	20.0%
UK fixed income unit trusts	11.0%
Corporate bonds (medium term)	9.0%
Overseas corporate bonds	9.0%
UK fixed gilts (medium term)	11.0%
UK index linked gilts (medium term)	9.0%
Property	12.5%
Private Equity	25.0%
Property Debt	8.0%
Cash	0.0%

The potential price changes disclosed above are broadly consistent with a one-standard deviation movement in the value of the assets. The sensitivities are consistent with the assumptions contained in the investment advisors' most recent review. The Fund's investment advisors suggest that the approach to modelling market price risk should take account of the diversification of assets in the Fund. This approach is different to that outlined in the CIPFA recommended code of practice, where the sum of all potential changes in asset class values are taken to determine the impact on the total value of the

Fund. Consequently the total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

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 Mar 2019**	**Percentage change**	**Value on increase**	**Value on decrease**
	£000	**%**	**£000**	**£000**
Cash deposits	43,401	0.0	43,401	43,401
Investment portfolio assets:				
UK equities	489,245	19.0	582,202	396,288
Global equities (overseas)	816,761	20.0	980,113	653,409
UK fixed income unit trusts	80,135	11.0	88,950	71,320
UK Corporate bonds (medium term)	102,395	9.0	111,611	93,180
Overseas Corporate bonds (medium term)	40,068	9.0	43,674	36,462
UK fixed gilts (medium term)	45,961	11.0	51,017	40,905
UK index linked gilts (medium term)	32,979	9.0	35,947	30,011
Unit trusts property	184,234	12.5	207,263	161,205
Private equity	102,558	25.0	128,198	76,919
Property debt	55,000	8.0	59,400	50,600
Investment income due	6,475	0.0	6,475	6,475
Amounts receivable for sales	90	0.0	90	90
Net equity options (UK)	(2,600)	19.0	(3,094)	(2,106)
Net equity options (overseas)	(5,171)	20.0	(6,205)	(4,137)
Net currency forwards	(960)	0.0	(960)	(960)
Net investment assets	**1,990,571**		**2,328,082**	**1,653,062**

Asset type	Value as at 31 Mar 2018	Percentage change	Value on increase	Value on decrease
	£000	%	£000	£000
Cash deposits	44,359	0.0	44,359	44,359)
Investment portfolio assets:				
UK equities	450,391	19.0	535,965	364,817
Global equities (excluding UK)	751,895	20.0	902,274	601,516
UK fixed income unit trusts	32,646	11.0	36,237	29,055
UK Corporate bonds (medium term)	107,586	9.0	117,269	97,903
Overseas Corporate bonds (medium term)	74,240	9.0	80,922	67,558
UK fixed gilts (medium term)	49,818	11.0	55,297	44,338
UK index linked gilts (medium term)	33,213	9.0	36,202	30,224
Unit trusts property	184,779	12.5	207,876	161,682
Private equity	83,292	25.0	104,115	62,468
Property debt	55,000	8.0	59,400	50,600
Net currency forwards	1,123	0.0	1,123	1,123
Investment income due	5,316	0.0	5,316	5,316
Amounts receivable for sales	644	0.0	644	644
Amounts payable for purchases	(735)	0.0	(735)	(735)
Net investment assets	**1,873,567**		**2,186,264**	**1,560,868**

Interest rate risk

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

The Fund's interest rate risk is routinely monitored by officers and its investment advisors in accordance with the Fund's risk management strategy, including monitoring the exposure to interest rates and assessment of actual interest rates against the relevant benchmarks.

The Fund's direct exposure to interest rate movements as at 31 March 2019 and 31 March 2018 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value.

Asset type	31 March 2018	**31 March 2019**
	£000	**£000**
Cash and cash equivalents	44,359	43,401
Bank accounts	5,137	3,897
Legal & General fixed interest gilts	49,818	45,961
Legal & General index linked gilts	33,213	32,979
Fidelity unit trust bonds	214,472	222,598
Total	**346,999**	**348,836**

Interest rate risk sensitivity analysis

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

The Fund's investment advisors suggest that a 100 basis point (BPS) movement in interest rates is appropriate for carrying out the interest rate sensitivity analysis.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits of a +/- 100 BPS (1%) change in interest rates:

Asset type	**Carrying amount as at 31 March 2019**	**Change in year in the net assets available to pay benefits**	
		+1%	**-1%**
	£000	**£000**	**£000**
Cash and cash equivalents	43,401	434	(434)
Bank accounts	3,897	39	(39)
Legal & General fixed interest gilts	45,961	460	(460)
Legal & General index linked gilts	32,979	330	(330)
Fidelity unit trust bonds	222,598	2,226	(2,226)
Total	**348,836**	**3,489**	**(3,489)**

Asset type	Carrying amount as at 31 March 2018	Change in year in the net assets available to pay benefits	
		+1%	**-1%**
	£000	**£000**	**£000**
Cash and cash equivalents	44,359	444	(444)
Bank accounts	5,137	51	(51)
Legal & General fixed interest gilts	49,818	498	(498)
Legal & General index linked gilts	33,213	332	(332)
Fidelity unit trust bonds	214,472	2,145	(2,145)
Total	**346,999**	**3,470**	**(3,470)**

Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the base currency of the Fund (£ Sterling).

The Fund's currency rate is routinely monitored by the Council and its investment advisors in accordance with the Fund's risk management strategy, including monitoring the range of exposure to currency fluctuations.

The following table summarises the Fund's currency exposure as at 31 March 2019 and as at the previous period end.

Currency exposure – asset type	Asset value as at 31 March 2018	Asset value as at 31 March 2019
	£000	**£000**
Overseas quoted securities	530,019	582,529
Overseas unitised insurance policies	221,876	234,232
Overseas property fund	1,522	1,113
Overseas unquoted private equity	83,292	102,558
Overseas unit trust (bonds)	74,240	40,068
Total overseas assets	**910,949**	**960,500**

Currency risk - sensitivity analysis

A 13% fluctuation in the currency is considered reasonable based on the Fund advisor's analysis of long-term historical movements in the month-end exchange rates over a rolling 36 month period. This analysis assumes that all other variables, in particular interest rates, remain constant. A 13% strengthening/weakening of the pound against the various currencies in which the Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Currency exposure - asset type	**Asset value 31 March 2019**	**Change to net assets available to pay benefits**	
		+13%	**-13%**
	£000	**£000**	**£000**
Overseas quoted securities			
Australian dollar (AUD)	24,239	27,390	21,088
Brazilian real (BRL)	7,587	8,573	6,601
Canadian dollar (CAD)	13,625	15,396	11,854
Danish krone (DKK)	3,647	4,121	3,173
Euro (EUR)	54,519	61,606	47,432
Hong Kong dollar (HKD)	32,694	36,944	28,444
Japanese yen (JPY)	34,486	38,969	30,003
Malaysian ringgit (MYR)	10,015	11,317	8,713
New Israeli shekel (ILS)	1,345	1,520	1,170
New Taiwan dollar (TWD)	13,499	15,254	11,744
Norwegian krone (NOK)	6,866	7,759	5,973
Singapore dollar (SGD)	12,589	14,226	10,952
South African rand (ZAR)	14,670	16,577	12,763
Swedish krona (SEK)	13,410	15,153	11,667
Swiss franc (CHF)	35,860	40,522	31,198
United States dollar (USD)	303,478	342,930	264,025
Total	582,529	658,257	506,800
Overseas unitised insurance policies (quoted in GBP no other values available)	234,232	264,682	230,782
Overseas property fund (EUR)	1,113	1,258	968
Overseas unquoted private equity (EUR)	102,558	115,891	89,225
Overseas unit trust (bonds)	40,068	45,277	34,859
Total change in assets available	**960,500**	**1,085,365**	**835,634**

Currency exposure - asset type (Restated)	Asset value 31 March 2018	Change to net assets available to pay benefits	
		+13%	**-13%**
Overseas quoted securities	**£000**	**£000**	**£000**
Australian dollar (AUD)	21,370	24,148	18,592
Brazilian real (BRL)	6,156	6,956	5,356
Irish investments in British pound sterling (GBP)	7,995	9,034	6,956
Canadian dollar (CAD)	11,806	13,341	10,271
Danish krone (DKK)	4,140	4,678	3,602
Euro (EUR)	50,041	56,546	43,536
Hong Kong dollar (HKD)	20,556	23,229	17,884
Japanese yen (JPY)	38,007	42,948	33,066
Malaysian ringgit (MYR)	9,746	11,013	8,479
New Israeli shekel (ILS)	1,408	1,591	1,225
New Taiwan dollar (TWD)	11,669	13,186	10,152
Norwegian krone (NOK)	5,690	6,430	4,950
Singapore dollar (SGD)	11,383	12,863	9,903
South African rand (ZAR)	13,792	15,585	11,999
Swedish krona (SEK)	14,613	16,513	12,713
Swiss franc (CHF)	32,888	37,163	28,613
United States dollar (USD)	268,759	303,698	233,820
Total	530,019	598,922	461,117
Overseas unitised insurance policies (quoted in GBP no other values available)	221,876	250,720	193,032
Overseas property fund (EUR)	1,522	1,720	1,324
Overseas unquoted private equity (EUR)	83,292	94,120	72,464
Overseas unit trust (bonds)	74,240	83,891	64,589
Total change in assets available	**910,949**	**1,029,373**	**792,526**

The restatement refers to the inclusion of Overseas unit trust (bonds)

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 value of investments generally reflects 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 financial 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, where the risk equates to the net market value of a positive derivative position. However the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

Contractual credit risk is represented by the net payment or receipt that remains outstanding and the cost of replacing the derivative position in the event of a counterparty default. The residual risk is minimal due to the various insurance policies held by the exchanges to cover defaulting counterparties.

None of the Fund Managers have a mandate to specifically manage cash and so cash is generally held by the Custodian and invested in Money Market Funds (Sterling and Euro Funds). The Northern Trust Money Market Funds are triple A rated. In addition, the Fund's surplus cash from scheme members' contributions is managed as part of The Highland Council's treasury management function. Prior to transfer to the Fund's investment managers, cash surpluses, are deposited with the Pension Fund's bank (Clydesdale) and Svenska Handelsbanken thus minimising credit risk. The Fund had the following cash holdings at the year end.

	Moody's credit rating 31 March 2019	31 March 2018 £000	31 March 2019 £000
Northern Trust Global Investment liquidity funds	AAA	43,289	43,199
Northern Trust Cash deposits	P-1	1,070	202
		44,359	**43,401**

The following cash balances are held and managed in accordance with the Highland Council Treasury Management Strategy Statement.

	31 March 2018 £000	31 March 2019 £000
Clydesdale accounts	5,137	**3,897**

Liquidity risk

Liquidity risk represents the risk that the Fund will not 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.

Following the triennial valuation at 31 March 2017 the Fund's Actuary was asked to assess the projected cash flows of the Fund assuming a variety of possible maturity profiles.

The cash flow position has changed since the 2014 valuation (cash flow positive until 2026) due to the total payroll, and therefore contributions paid, at 31 March 2017 being around 9% lower than assumed in the 2014 projections; and the total benefit payment at 31 March 2017 being around 6% lower than assumed in the 2014 projections indicating the possibility that the Fund could move into a negative cash flow position.

However, assuming the current investment income yield is maintained (2018/19 investment income £40.2m, 2017/18 investment income £38.7m), then this would generate sufficient income to meet benefit payments for the immediate future. Provided the investment income yield remains at current levels then the time when assets need to be sold to meet benefit payments still looks sometime in the future.

It should be noted though that the negative cash flow position could be increased by a combination of public sector cuts, member opt-outs or outsourcing which reduces the pensionable payroll.

Refinancing risk

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

17. Actuarial Present Value of Promised Retirement Benefits

CIPFA's Code of Practice on Local Authority Accounting 2018/19 requires administering authorities of LGPS Funds that prepare Pension Fund accounts to disclose what IAS 26 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 IAS 19. There are three options for its disclosure in the 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 as at the date of the financial statements as is the case, IAS 26 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 IAS 19 and not the Fund's funding assumptions.

Assumptions underpinning the valuations are agreed with the actuary and are summarised in the Actuary's Statement (page 88). This estimate is subject to significant variances based on changes to the underlying assumptions.

The actuarial present value of promised retirement benefits is as follows:

	31 March 2018 £m	31 March 2019 £m
Present Value of Promised Retirement Benefits*	2,209	2,501
Net Assets per Annual Accounts	1,884	1,999

* Liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2017.

Note that the above figures include an allowance for the "McCloud ruling" i.e. an estimate of the potential increase in past service benefits arising from this case affecting public service pension schemes.

The Actuary estimates that the liability at 31 March 2019 is £2,501m which comprises of £1,308m in respect of employee members, £398m in respect of deferred pensioners and £795m in respect of pensioners. 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, the Actuary is satisfied the aggregate liability is a reasonable estimate of the actuarial present value of benefit promises. The Actuary has not made any allowance for unfunded benefits.

Assumptions

The assumptions used are those adopted for the Administering Authority's IAS 19 report as required by the Code of Practice. These are given below. The Actuary estimates that the impact of the change of financial assumptions to 31 March 2019 is to increase the actuarial present value by £188m. There is no impact from any change in the demographic and longevity assumptions because they are identical to the previous period.

Financial Assumptions	**31 March 2018 %p.a.**	**31 March 2019 %p.a.**
Inflation/Pension Increase Rate	2.4	2.5
Salary Increase Rate	3.4	3.5
Discount Rate	2.7	2.4

Discount rate

IAS 19 states that the discount rate used to place a value on the liabilities should be "determined by reference to market on high quality corporate bonds at the reporting date". It further states that "the currency and term of the corporate bonds used to set the discount rate should be consistent with the currency and term of the liabilities".

The Actuary's approach to setting the discount rate as at 31 March 2019 follows the same principles to those adopted at 31 March 2018 which was to use a "Hymans Robertson" corporate bond yield curve constructed based on the constituents of the iBoxx AA Corporate bond index.

Separate discount rates are then set (and corresponding RPI/CPI inflation assumptions – see below) for individual employers, dependent on their own weighted average duration. Each employer is allocated to a duration category, as defined below:

Weighted average duration	**Discount rate category**
Less than 17 years	Short
Between 17 and 23 years	Medium
More than 23 years	Long

Retail price inflation assumption

This assumption is typically derived from yields available on fixed interest and index linked government bonds, and should be consistent with the derivation of the discount rate.

The Actuary uses a market implied inflation curve over a range of maturities. Cash flow weighted single RPI rates are derived from the market implied inflation curve that recognise the weighted average duration of each corresponding duration category defined above.

Pension increase assumption

The pension increase assumption is set in line with the Actuary's default Consumer Prices

Index (CPI) assumption. As a market in CPI linked bonds does not exist, the Actuary estimates the long term gap between RPI and CPI in order to derive a CPI assumption for accounting purposes. The default assumed RPI-CPI gap will be 1.0% p.a. (unchanged from the 2018 accounting exercise).

Salary increase assumption

The long term assumption for salary increases is RPI plus 1% p.a.

Longevity assumptions

The life expectancy assumptions are included in the Actuary's statement on page 88.

18. Additional Voluntary Contributions (AVCs)

The AVC facility is provided by the Prudential Assurance Company Limited and is a money purchase arrangement where members have the choice to invest in a range of low, medium and high risk investment funds. In accordance with regulation 5 (2) (c) of the Pension Scheme (Management and Investment of Funds) Regulations 1998 (S1 1998 No. 1831), these figures do not form part of the accounts of the Pension Fund and are stated for information only.

The value of Prudential AVCs at 31 March 2019 was £9.710m (£9.530m in 2017/18) and AVC contributions of £1.097m (£1.106m in 2017/18) were paid directly to Prudential during the year.

19. Agency Services

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 (Section 31) allows employers to pay additional pensions on a voluntary basis.

As is typical within the Local Government Pension Schemes (LGPS), arrangements exist whereby additional teachers' pensions and employee pensions are paid with the payment of funded pensions. In order that such are not regarded as "unauthorised payments" by HMRC these pension payments are met by the administering authority and recharged to the body or service which granted the benefits.

As unfunded payments are discretionary benefits, they are not relevant to the sums disclosed in the Fund accounts. As such Highland Council Pension Fund provides payment and billing services to employers on a no charge agency agreement basis.

20. Related Parties

The Highland Council Pension Fund is administered by the Highland Council. As a result there is a strong relationship between the Council and the Fund. The Council is also the largest employer in the Fund.

The Pension Fund operates its own bank account. The Council's Treasury Management team manage surplus cash balances prior to transmission of funds to the Fund Managers for investment.

The Pension Fund does not directly employ any staff. Therefore no remuneration report is included within the Annual Report and Annual Accounts. All staff are employed by the Highland Council and their costs reimbursed by the Pension Fund.

The Councillors, who are members of the Pension Fund Sub-Committee and Pension Board are also remunerated by the Highland Council. Details of Councillor and Senior Employee remuneration can be found in the accounts of the Highland Council on the Council's website.

http://www.highland.gov.uk/downloads/download/539/annual_accounts

At 31 March 2019, there was one member of the Pensions Board (Mr Ewen Macniven (Trade Union representative)) in receipt of a pension. Each member of the Fund is required to declare their interests at each meeting.
The following Senior Officer of the Highland Council held a key position in the financial management of the Pension Fund during the financial year to 31 March 2019.

Name	Resp	Pension contributions in year to		Accrued pension benefits as at 31/03/19		Difference in accrued pension benefits compared to Mar 2018
		31/03/18	31/03/19			
Derek Yule	Depute Chief Executive/Director of Corporate Resources	£22,124	£23,549	Pension Lump Sum	£62,523 £124,321	£3,522 £2,478

Pension receipts and payments are transacted using the Highland Council financial systems and the Fund's banking arrangements. Throughout the year, the Fund maintains a cash balance for this purpose which is listed as Bank accounts in the net assets statement.

Contributions of £31.284m were paid by the Highland Council to the Fund during 2018/19 as set out in Note 8 (£30.403m in 2017/18) and central administration costs of £1.377m (£1.139m in 2017/18) were recharged to the Fund.

As at 31 March 2019, the Pension Fund had a net intercompany debtor of £4.653m (31 March 2018 £3.544m) representing sums due from the Highland Council. These balances in the main cover contributions payable by the Highland Council to the Pension Fund which were paid over in the first quarter of 2019.

21. Contingent Assets, Liabilities and Contractual Commitments

Contingent assets

- During 2009/10, KPMG were contracted to submit “EU Fokus Bank” claims for recovery of withholding tax with an estimated value of £1.228m (€1.429m) gross of fees. An additional revised contract was agreed in April 2012 with KPMG to continue with the claim. There have been no further repayments in 2019/20.

Contingent liabilities

- As at 31 March 2019 there is a contingent liability of £0.598m (£0.545m in 2017/18) for frozen refunds representing 2,543 (2,438 in 2017/18) frozen refund records.

Contractual commitment

As at 31 March 2019 the Highland Council had contractual commitments in respect of private equity. The property debt portfolio is now fully committed (£55m).

	Commitment	**Undrawn commitments**
Partners Group 2011	£43.030m (€50.000m)	£7.780m (€9.040m)
Partners Group 2014	£68.848m (€80.000m)	£23.572m (€27.390m)
Partners Group 2017	£57.660m (€67.000m)	£47.673m (€55.395m)

22. Current Assets

2017/18 £000	**Debtors**	**2018/19 £000**
1,010	Contributions due - employees	1,364
3,295	Contributions due - employers	4,640
571	Strain on fund costs	389
55	Transfer values receivable	-
2,242	Short term debtors	1,837
5,137	Bank accounts	3,897
12,310	**Total current assets**	**12,127**

23. Long Term Debtors

2017/18 £000	Debtors	2018/19 £000
480	Long term debtors	278
29	Reimbursement of lifetime tax allowances	75
509		**353**

24. Current Liabilities

2017/18 £000	Creditors	2018/19 £000
(1,681)	Sundry creditors	(3,067)
(178)	Transfer values payable (leavers)	(121)
(716)	Benefits payable	(901)
(2,575)		**(4,089)**

Training, Knowledge and Skills - Policy Statement

The Highland Council Pensions Committee approved a Training Policy for 2018/19 on 9 August 2018 which set out the following requirements:

- the CIPFA Code of Practice on Public Sector Pensions Finance Knowledge and Skills, and CIPFA's supporting Framework and guidance documentation.
- the legal requirements for individual Pension Board members to have the correct level of knowledge and understanding to undertake their role.

The Policy sets out planned and recorded training attended during 2018/19.

In October 2018, a training needs assessment was distributed to Pension Board and Committee members to identify training requirements. Following on from this exercise, a training session was held covering Pensions Governance and Administration in February 2019.

The Pensions Committee has delegated responsibility for implementation to the Depute Chief Executive/Director of Corporate Resources, and requires that there is annual reporting on the Pension Fund's training policy and its implementation. The table below summarises how training needs were fulfilled during the year 2018/19.

CIPFA framework core competency	Training specifics	Training event	Attendees
Pensions accounting & audit standards	Investment Fee Transparency – Chair of FCA Institutional Disclosure Working Group	10/09/18: IGG training for Members and Officers (video conferencing)	Members (4) Employer rep (3) Union rep (2) Council officers (4)
Investment performance & risk management	Local Government Chronicle (LGC) seminar: Investment Strategy	23/10/18: LGC seminar - training provided by BlackRock and JP Morgan	Members (2)
	Local Government Chronicle (LGC) seminar: Responsible investment	23/10/18: LGC seminar Training provided by Strathclyde Pension Fund	Members (2)
	Local Government Chronicle (LGC) seminar: Merits of Low volatility equities	23/10/18: LGC seminar - training provided by Lothian Pension Fund.	Members (2)
	Climate change and investment strategy – Richard Keery Strathclyde Pension Fund	10/09/18: IGG training for Members and Officers (video conferencing)	Members (4) Employer rep (3) Union rep (2) Council officers (4)

CIPFA framework core competency	Training specifics	Training event	Attendees
Financial markets & products knowledge	Overview of private debt asset class	07/06/18 Training provided by BlueBay Asset Management	Members (6) Employer rep (1) Union rep (2) Council officers (4)
	Overview of Bonds asset class	07/06/18 Training provided by Fidelity	
	Infrastructure as an asset class – ISC presentation	31/08/18: Training seminar provided by Aon Hewitt	Members (8) Employer rep (1) Union rep (1) Council officers (2)
Actuarial methods, standards and practices	Government oversight of Funding of Scottish LGPS – Government Actuary Department	10/09/18: IGG training for Members and Officers (video conferencing)	Members (4) Employer rep (3) Union rep (2) Council officers (4)
	Current topics - Hymans		
Pensions legislative & governance context	Pensions Governance	28/02/19: Pensions training provided by Hymans Robertson following Pensions Committee	Members (9) Employer rep (2) Union rep (4) Council officers (4)
	Committee Role and Pensions Legislation		
	Pensions Admin		
	Complexities of LGPS Benefits and new flexibilities (Alastair McGirr Falkirk Pension Fund)	10/09/18: IGG training for Members and Officers (video conferencing)	Members (4) Employer rep (3) Union rep (2) Council officers (4)
	The Pensions Regulator – provided by the Pensions Regulator		
	The Role of the Pension Board - SPPA		

The specific training events set out above are supplemented by additional knowledge and skills acquired through other ‘on the job’ activities including participation in working groups, attendance at meetings, general reading and research e.g. agenda reports and presentations, investment manager reports and briefings, magazines and other periodicals, online reading etc.

Actuary's Statement as at 31 March 2019

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2018. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated April 2018. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependents' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return;
- to reflect the different characteristics of different employers in determining contribution rates; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is an acceptable likelihood that the Fund will return to full funding over 20 years.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £1,755 million, were sufficient to meet 101% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2017 valuation was £13 million.

Each employer had contribution requirements set at the valuation, with the aim of achieving full funding within a time horizon and probability measure as per the FSS. Individual employers' contributions for the period 1 April 2018 to 31 March 2021 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2017 valuation report.

Method

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

Assumptions

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

The key financial assumptions adopted for the 2017 valuation were as follows:

Financial assumptions	31 March 2017
Discount rate	3.7%
Salary increase assumption	3.4%
Benefit increase assumption (CPI)	2.4%

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	21.9 years	24.3 years
Future Pensioners*	23.3 years	26.1 years

*Currently aged 45

Copies of the 2017 valuation report and Funding Strategy Statement are available on request from the Administering Authority to the Fund.

Experience over the period since 31 March 2017

Since the last formal valuation, real bond yields have fallen placing a higher value on the liabilities but there have been positive asset returns over the 2 years. Both events are of broadly similar magnitude with regards to the impact on the funding position.

The next actuarial valuation will be carried out as at 31 March 2020. The Funding Strategy Statement will also be reviewed at that time.

Robert Bilton FFA

24 April 2019

For and on behalf of Hymans Robertson LLP

Glossary

Actuarial assumptions/basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of **liabilities**. The main assumptions will relate to the **discount rate**, salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value.
Administering Authority	The council with statutory responsibility for running the Fund, in effect the Fund's trustees.
Admission Bodies	Employers which voluntarily participate in the Fund, so that their employees and ex-employees are **members**. There will be an Admission Agreement setting out the employer's obligations.
Common contribution rate	The Fund-wide **future service rate** plus **past service adjustment**. It should be noted that this will differ from the actual contributions payable by individual **employers**.
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Currency forwards	A currency forward contract is essentially a hedging tool that does not involve any upfront payment. It locks in the exchange rate for the purchase or sale of a currency on a future date. It can be tailored to a particular amount and delivery period, unlike standardized currency futures. Currency forwards are over-the-counter (OTC) instruments, as they do not trade on a centralized exchange.
Deficit	The shortfall between the assets value and the **liabilities** value. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions).
Deficit repair/recovery period	The target length of time over which the current **deficit** is intended to be paid off. A shorter period will give rise to a higher annual **past service adjustment** (deficit repair contribution), and vice versa.
Discount rate	The annual rate at which future assumed cash flows (in and out of the Fund) are discounted to the present day. This is necessary to provide a **liabilities** value which is consistent with the present day value of the assets, to calculate the **deficit**. A lower discount rate gives a higher liabilities value, and vice versa. It is similarly used in the calculation of the **future service rate** and the **common contribution rate**.

Employer	An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **liabilities** values for each employer are individually tracked, together with its **future service rate** at each **valuation**.
Funding level	The ratio of assets value to **liabilities** value.
Future service rate	The actuarially calculated cost of each year's build-up of pension by the current active **members**, excluding members' contributions but including Fund administrative expenses. This is calculated using a chosen set of **actuarial assumptions**.
Gilt	A UK Government bond, i.e. a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency.
Gilt yield curves	The line on a graph plotting the relationship between gilt yields and their maturity dates. A yield curve can show the relation between gilts of varying maturities and their yields. Yield curves can be normal/up-sloped (indicates yield on longer term bonds may continue to rise, responding to periods of economic expansion), inverted/down-sloped (suggests yields on longer-term bonds may continue to fall, corresponding to periods of economic recession) or flat (when economy is transitioning from expansion to slower development and even recession, yields on longer maturity bonds tend to fall and yields on shorter-term securities likely to rise).
Gilt yields	The yield of a gilt is the annual return on the market price of the bond, expressed as a percentage. To calculate yield amount, the face value of the gilt is multiplied by the yield in decimal form.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's.
Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority.

Liabilities	The actuarially calculated present value of all pension entitlements of all **members** of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the **deficit**. It is calculated on a chosen set of **actuarial assumptions**.
LGPS	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 101 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Maturity	A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.
Members	The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferred (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependents of deceased ex-employees).
Past service adjustment	The part of the employer's annual contribution which relates to past service **deficit** repair.
Pooling	Employers may be grouped together for the purpose of calculating contribution rates, so that their combined membership and asset shares are used to calculate a single contribution rate applicable to all employers in the pool. A pool may still require each individual employer to ultimately pay for its own share of **deficit**, or (if formally agreed) it may allow **deficits** to be passed from one employer to another.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's **members**, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also.
Rates and Adjustments	A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal **valuation**. This is completed by the actuary and

Certificate	confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, police and fire authorities etc., other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).
Securities Lending	Securities lending is the act of loaning a stock, derivative or other security to an investor or firm. Securities lending requires the borrower to put up collateral, whether cash, security or a letter of credit. When a security is loaned, the title and the ownership are also transferred to the borrower.
Solvency	In a funding context, this usually refers to a 100% **funding level**, i.e. where the assets value equals the **liabilities** value.
Stabilisation	Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these.
Theoretical contribution rate	The employer's contribution rate, including both **future service rate** and **past service adjustment**, which would be calculated on the standard **actuarial basis**, before any allowance for **stabilisation** or other agreed adjustment.
Underwriting	Securities underwriting is the process by which investment banks raise investment capital from investors on behalf of corporations and governments that are issuing securities (both equity and debt capital). The services of an underwriter are typically used during a public offering in a primary market.
Valuation	An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is normally carried out in full every three years (last done as at 31 March 2017), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date also.