



**The Highland Council Pension Fund**  
**Annual Report and Annual Accounts**  
**Aithris Chunntasan**

**2015 - 2016**

Pensions Regulator Scheme Number: 10051259

Approved at  
Pensions Committee  
22/09/16

**HIGHLAND COUNCIL PENSION FUND 2015/16**  
**ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16**

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# HIGHLAND COUNCIL PENSION FUND 2015/16

## ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

### Management Commentary

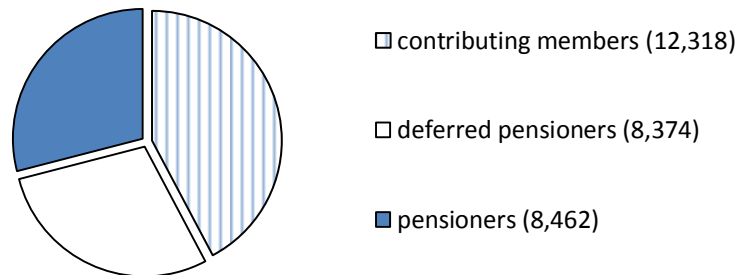
#### Background

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 dependants within the scheme.

The closing net assets of the Fund at 31 March 2016 are £1,469m (31 March 2015 £1,448m).

The fund provides benefits for those employees of The Highland Council, Comhairle Nan Eilean Siar and 30 other scheduled and admitted bodies that are active members of the Fund.

Current Scheme Membership



#### Governance

1 April 2015 saw the introduction of 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 managers 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 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 Governance Section on Page 23.

#### Business Model and Risk

HCPF is managed and administered from the Council Headquarters in Inverness.

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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; and 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>

The Administration Strategy is one of the key documents available at the above website. It is reviewed regularly in consultation with employers. Further details of this strategy are available at page 17.

#### a) General

2015/16 was a challenging year for the Pensions Administration Team. From 1 April 2015 the Local Government (Scotland) Pension Scheme was introduced and the most significant change was the introduction of a Career Average Revalued Earnings scheme (CARE) to replace the long standing Final Salary Scheme. To facilitate this change, the pension system was updated and tested well in advance of the start date to ensure that the Pension system was correctly aligned to the changes in legislation and ready to provide a smooth transition for scheme members. Also, to ensure proper administration of the new scheme the Pensions Administration Team undertook extra training to update their skills.

From a scheme member's perspective the main changes under the new scheme are:

- retirement benefits accrue at a rate of 1/49<sup>th</sup> (1/60<sup>th</sup> under the previous scheme)
- employees can now elect to pay 50% of normal contributions and accrue only 50% of their benefits
- normal retirement age is now aligned with the state pension age

#### b) Communication

During the year the Pensions Administration Team:

- provided a workshop for scheme employers on the scheme changes referred to above and the resulting differences in their employer responsibilities
- issued the Annual Benefit Statement to scheme members giving a projection of pension benefits
- published the Annual newsletter on the Council's Pension website

#### c) Performance

To help provide the best possible service to members, during 2015/16 several key processes on the Pensions system were added to an electronic workflow function. Analysis of the workflow data shows that performance during the year was generally consistent with the previous year and, matching last year, all of the transfers in and the majority of transfers out of the Fund were transacted within target times.

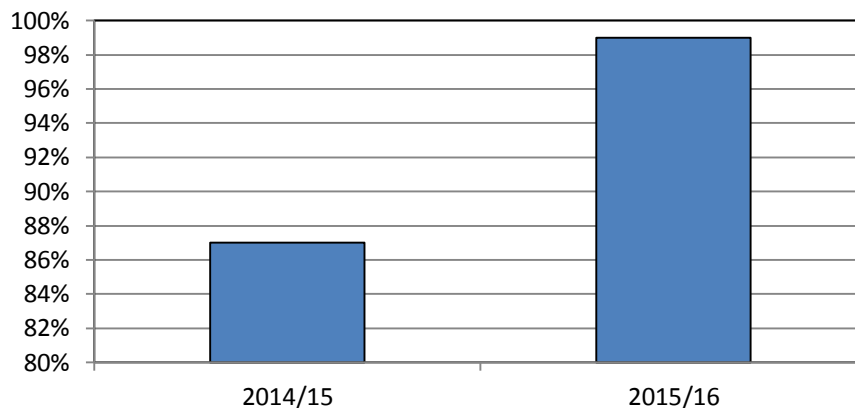
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Some aspects of administration are affected by how quickly key data is received from employers and members. Delivery against targets for these transactions can be adversely affected by this e.g. only 95% of first payments to new and deferred pensioners were able to be made within 10 days of notification (2014/15 100%).

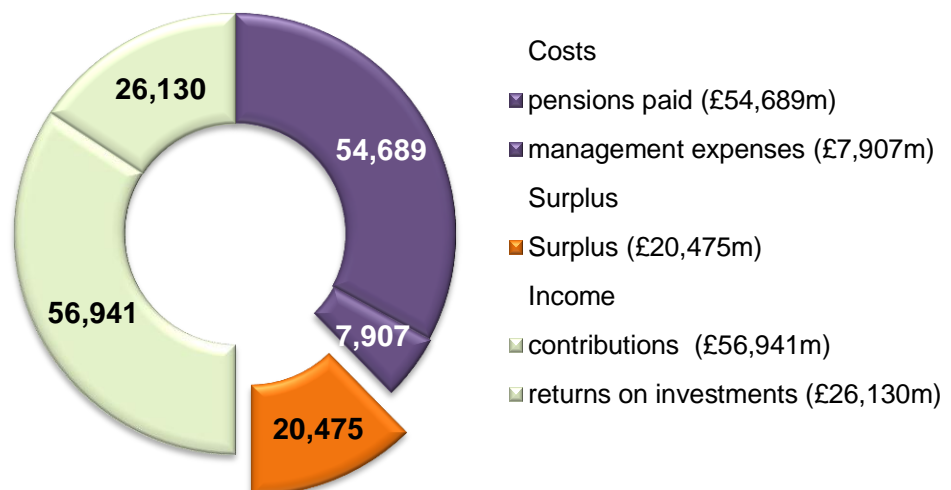
The number of new scheme entrants in the year dropped to 1,435 from 1,675 in 2015/16 and there was an improvement in the percentage of new entrants receiving statutory documentation within 14 days. The graph below shows the improvement to 99% from 87% in the previous year.

### Percentage of new entrants receiving statutory documentation within 14 days



The graph below is a summary of the key financial information in the Pension Fund account which is on page 34.

### Pension Fund Account £m



#### d) Highland Council Voluntary Severance

Towards the end of 2015, The Highland Council considered the introduction of a voluntary severance scheme. Prior to establishing the scheme the Fund's actuaries were consulted and concluded that the Fund should not expect any material impact.

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In January 2016, The Highland Council invited applications for voluntary severance from the workforce. The Pension Administration Team provided on-line estimates of benefits which were accessed by around 2,000 employees resulting in around 800 applications of which over 350 were approved. The team also dealt with hundreds of associated queries.

The additional costs to the Fund relating to the early release of pensions (strain on Fund costs) have been reimbursed in total to the Fund by Highland Council during 2015/16.

#### e) Initiatives

Following on from the development of on-line services to support the voluntary severance work, possibilities to further extend on-line services for members will be pursued in the coming year.

#### 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. Thus far the Fund has been in surplus, i.e. the income is more than the expenditure and these surpluses are invested to generate further income for the Fund.

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. The SIP is available at [http://www.highland.gov.uk/download/meetings/id/69748/item\\_5\\_-\\_statement\\_of\\_investment\\_principles](http://www.highland.gov.uk/download/meetings/id/69748/item_5_-_statement_of_investment_principles)

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

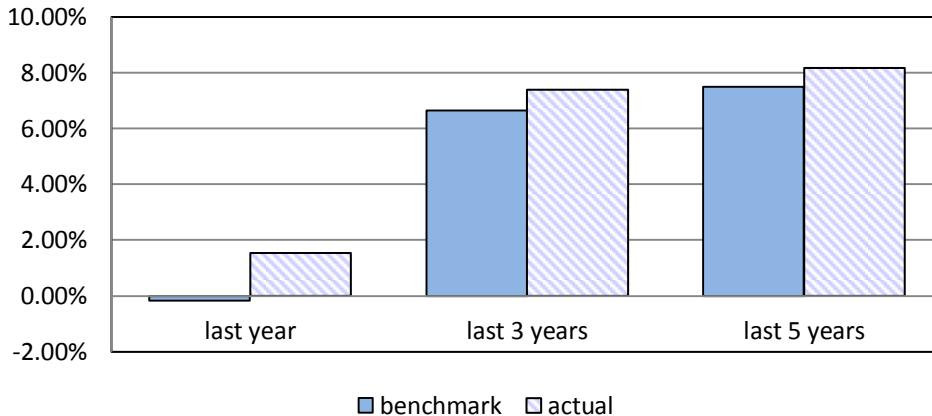
Against a backdrop of continued uncertainty in the global economy, and volatility in the financial markets, the Fund had a marginally positive year in terms of investment performance and returned an increase of 1.53% against a negative benchmark for the year of -0.71%.

Since the 31 March 2016, there was the UK referendum on membership of the European Union (EU). The result of the UK's referendum on membership of the EU may affect the pension fund's risk profile by introducing potentially significant new uncertainties and instability in financial markets as the United Kingdom negotiates its exit from the EU. These uncertainties could have a material direct or indirect effect on the fund, its financial condition and operations although the extent is not quantifiable at this time.

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The following graph shows the Fund return against the benchmark for the last year, the last 3 years and the last 5 years.



The main drag on performance in 2015/16 was in the equities sector. 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 changes. In 2015/16 the total Fund investments increased in value to £1,455m from £1,433m at the end of 2014/15.

A review of Investment activity is provided on Page 19 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 employing 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 last such valuation was in 2014 and there have been no significant changes in the Fund position since then which would trigger an interim review.

The triennial valuation as at 31 March 2014 covers the financial years 2015/16 to 2017/18 and was concluded during early 2015. The results of this valuation are that the funding level shows a slight decrease since the 2011 valuation (96.2% compared to 96.8%) and an increase in the deficit from £33m to £52m. This is due to a number of factors but primarily because of the decrease in real gilt yields.

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 2015. The strategy can be viewed at

<http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Funding%20Strategy%20Statement.pdf>

Further consideration of the funding strategy is included in this report at page 9.

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#### 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 strategies in place to minimise its adverse effects.

A risk register is maintained and can be viewed at [http://www.highland.gov.uk/download/meetings/id/68989/item\\_7\\_pension\\_fund\\_risk\\_management\\_policy\\_and\\_strategy](http://www.highland.gov.uk/download/meetings/id/68989/item_7_pension_fund_risk_management_policy_and_strategy).

The three highest identified risks are:

1. Ongoing risk of members and officers being unaware of changes to LGPS governance, administration and investment matters.
2. Inefficiencies with the portfolio can result in unintended risks.
3. If investment strategy is inconsistent with funding plans it can lead to setting inaccurate employer contribution rates.

Controls are in place to mitigate these risks and have been reported to the Pensions Committee.

#### Looking Ahead

The ongoing volatility and uncertainty in the global economy and investment markets, and, linked to that, the continuing regime of public sector austerity over the medium and quite possibly longer term have significant implications for the Fund and Fund employers.

The level of future returns on the equity markets both in the UK and globally is a particular concern and options are being considered to reduce the potential impact of this on the Fund investment portfolio.

#### In Conclusion

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

Steve Barron  
Chief Executive

Derek Yule  
B.Com. FCPFA.  
IRRV (Hons)  
Director of Finance

Dave Fallows  
Chairman  
Pensions Committee

22 September 2016



# HIGHLAND COUNCIL PENSION FUND 2015/16

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### About the Fund

The Fund is part of the national Local Government Pension Scheme (LGPS). 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 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

The Administering Authority (The Highland Council) runs The Highland Council Pension Fund, in effect the LGPS for the Highlands area, to make sure it:

- 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 employing bodies, 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 employing bodies 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. A common contribution rate for the Fund of 20.2% of payroll contributions was set by the Actuary for the period 1 April 2015 to 31 March 2018 in the Triennial Actuarial Valuation report 2014.

- 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 dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

### Funding Strategy Statement

A Funding Strategy Statement, which summaries the Fund's approach to funding liabilities, has been prepared and describes the strategy of the Highland Council acting in its capacity of Administering Authority for the funding of the Highland Council Pension Fund and is available at

<http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Funding%20Strategy%20Statement.pdf>

Employees' benefits are guaranteed by the LGPS Regulations, and do not change

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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 dependants.

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.

There is also a regulatory requirement for the Fund to have a Funding Strategy Statement.

The Funding Strategy Statement provides detail of the key elements of the funding strategy, the regulatory framework, responsibilities of key parties, links to the Investment Strategy, 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 below. The Fund's Annual Governance Statement and Governance Compliance Statement are set out later within this document (page 23).

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 from 1 April 2015 in order 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.

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#### 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 tax payers 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 final salaries. The fundamental objective is to meet these benefits on retirement, or the dependant'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 in acting in its capacity as Administering Authority for the funding of the Highland Council Pension Fund. The Statement can be viewed at:

<http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Funding%20Strategy%20Statement.pdf>

##### 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 employers' benefits accruing.

The investment policy is based upon achieving a long-term return on investments in excess of inflation through strategic benchmarking and selective asset allocation. With a target asset allocation of 79% of the Fund's investments in active management and 21% in index tracking (passive), it is anticipated that an efficient balance will be met between risk and return in light of liability profile and the funding level.

##### Asset Mix of Investments

The overall investment portfolio for the Fund is weighted to the equity market, both UK and Overseas and some Private Equity. However, the portfolio also has invested in Index-Linked Gilts, Property, UK Bonds, Overseas Bonds, Private Equity, Property

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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 in asset mix and stock selection, subject to the investment principles.

#### **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**

The majority of the investments held by the Fund are quoted on major stock markets and may be realised quickly if required. Property investment is via pooled funds which are relatively illiquid and 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 relatively illiquid.

#### **Underwriting**

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

#### **Social, Environmental and Ethical Considerations**

The Fund recognises that social, environmental and ethical considerations are among the factors which Managers will take into account, where relevant, when selecting investments for purchase, retention or sale.

In general terms, this means that there is a group of socially responsible investment concerns which investors need to be aware of and which should be taken into consideration when the decision to invest is being made. This does not mean that the decision whether or not to invest depends entirely on the assessment of these factors but that they should be weighed in the balance along with all other relevant factors when decisions to buy, hold or sell investments are being made.

The Council has instructed the Investment Managers to take into account the key principles of socially responsible investment primarily through a policy of engagement with Companies that demonstrate appropriate observance of these principles.

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#### **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 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 no stock released to a third party under a securities lending agreement at this time. An agreement was signed in financial year 2016/17 so stock lending will be undertaken in future financial years.

#### **Compliance**

Investment Managers and the Custodian will provide an annual statement to the 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'.

A detailed version of this Statement of Investment Principles (SIP) expanding on the paragraphs above can be obtained from the address below was approved by Committee and Board and can be found below.

[http://www.highland.gov.uk/download/meetings/id/69748/item\\_5\\_-\\_statement\\_of\\_investment\\_principles](http://www.highland.gov.uk/download/meetings/id/69748/item_5_-_statement_of_investment_principles)

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#### Strategic Asset Allocation

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

Portfolio	Target %	Actual %	Comment
UK Equities	30.7*	32.1	18.2% - Baillie Gifford – active 12.5% - L&G – passive
Global Equities	30.3	32.0	14.8% - Baillie Gifford – active 12.0% - Pyrford – active 3.5% - L&G – passive
Private Equity	5.0*	4.4	Partners Group – active
Property Debt	4.0*	2.4	Standard Life Investments - active
Property	10.0	11.3	Schroder – active fund of funds
Bonds	20.0	17.8	15.0% - Fidelity– active 5.0% - L&G – passive manager

\* When private equity is fully funded.

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#### 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 are outlined below.

#### Pensions Committee

Dave Fallows (Chairman)  
Cllr Ian Cockburn  
Cllr Alasdair Christie  
(replaced Cllr David Alston)  
Cllr Helen Carmichael  
Cllr Norrie Donald  
Cllr John Ford  
Cllr Michael Green  
Cllr Richard Laird  
Cllr Bill Lobban  
Cllr Alister MacKinnon  
Cllr Kenneth MacLeod  
Cllr Ben Thompson

#### Investment Sub Committee

Cllr Alister MacKinnon (Chairman)  
Cllr Helen Carmichael  
Cllr John Ford  
Cllr Richard Laird  
Cllr Bill Lobban  
Cllr Kenneth MacLeod  
Cllr Ben Thompson

#### Non-Voting Members

Cllr Angus Campbell  
(Comhairle nan Eilean Siar)  
Mr Ewen Macniven  
(Trade Union representative)

#### Pensions Board

Cllr Carolyn Caddick, Highland Council (Chair)  
Mr Angus Campbell, Comhairle nan Eilean Siar  
Ms Louise Leonard, representative for the other Employers  
Mr Domhnall Macdonald, Unison  
Ms Liz MacKay, Unison  
Mr Thomas MacLennan, Highland Council  
Mr Ewen Macniven, GMB  
Mr Alister Wemyss, Unite

#### Fund Custodian

The Northern Trust Company

#### Fund Bankers

Clydesdale Bank plc

#### Investment Advisers

AON Hewitt

#### AVC Provider

Prudential

#### Fund Actuary

Hymans Robertson

#### Fund Investment Managers

Baillie Gifford & Co

Fidelity International

Legal & General Investment Management

Partners Group

Pyrford International

Schroder Property Investment Management Limited

Standard Life Investments

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

##### Admitted Bodies

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

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



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#### Administration Strategy and Performance

On 1 July 2012 the Fund implemented an Administration Strategy which can be found on the Fund's website.

<http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Administration%20Policy.pdf>

The strategy sets out the roles and responsibilities of both the Administering Authority and scheme employers, and includes 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. The introduction of Workflow (a software solution which allows tracking processes completed against target completion dates) during 15/16 has meant the revision of some targets as detailed in the table below.

#### Administering Authority Performance

Task	Target	Number from 1/4/15 to 31/3/16	% completed within target	Previous Year %
New Entrants	Issue Statutory Notice within 14 days of receipt of a new start notice	1,435	99%	87%
Early Leaver	With the introduction of workflow the standard issue date was changed to 10 days of receipt of leaver form for refund entitlement & 15 days for deferred benefit entitlement (previous target to issue entitlement notice was within 2 months of leaving employment)	889	93%	94%
Retirements including deferred benefits coming into payment	With the introduction of Workflow the standard issue date was changed to 10 days of receipt of leaver option forms	606	98%	72%
Deaths in Service	Contact next of kin within 5 days of notification	22	95%	100%
Transfers in from out with Fund	With introduction of workflow issue statutory notice within 10 days of receipt of payment (previously 14 days)	37	100%	100%
Transfers of pension rights out with Fund	With introduction of workflow case to be finalised & payment made within 10 days of receipt of election payment (previously 14 days)	47	98%	100%
Estimate of benefits	Issue within 10 days of request	730	98%	100%

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### Scheme Employer Performance - Target performance 90%

<b>Standard</b>	<b>Number from 1/4/15 to 31/3/16</b>	<b>% on target</b>	<b>Previous year Percentage</b>
New Start Notification – within 30 days of joining (or 10 days from first deduction if later)	1,435	93%	93%
Retirement information – to allow benefits to be paid on time	392	85%	91%
Early leaver notification – within 30 days of leaving (or 10 days after last deduction if later)	889	93%	94%
Death in Service notification – within 7 days of death	22	100%	100%
Year End Queries issued to employers, responses – within 14 days	23	100%	100%

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### Investment Performance Report

##### Economic and Market Background

There were various challenging influences across the period relating to global economic situations. At the beginning of the year concerns over the Greek debt crisis hit investor sentiment leading to a sharp sales in equities and creating weak performance in the global equity markets and bonds. This less favourable position was further exacerbated by a weak sterling pushing down sterling returns.

As the year progressed concerns over a slowdown in global growth, weak Chinese economic data and commodity prices pressures also impacted on the global equity markets causing some further decline in values. The disappointing economic and market data led to global central banks maintaining accommodative monetary policy to try to stimulate economic growth.

In the third quarter of 2015 the US Federal Reserve (Fed) delivered the widely expected change in US interest rates by implementing an increase for the first time in almost a decade. As this move was generally expected, the market reaction was muted and since then the Fed has retracted somewhat on the pace of future increases which was news well received by the equity markets.

As the year closed the continuing effect of concerns over subdued Chinese economic growth, a weaker Chinese yuan, deteriorating economic data globally and falling commodity prices shook equity market investors. However a weak sterling minimised the impact on unhedged UK investors. During this period central banks continued to ease their monetary policy stance with the Bank of Japan unexpectedly taking a benchmark interest rate below zero and the European Central Bank increased its quantitative easing programme.

Equities – As a result of the factors outlined in the above paragraph, the MSCI All Country World Index returned -1.5% in local currency terms, but broad based sterling weakness boosted unhedged returns to UK Investors to 2.8%.

Bonds - Gilt yields fell to all-time lows at some points during the year as global central banks either pushed back interest rate rises or cut rates outright and as investors adopted a firmly risk-off stance. UK fixed interest gilts returned 4.9% over the first quarter 2016.

Property - The UK commercial property market continues to perform well, particularly specialist funds in industrial and central London. Overall in the property sector, rental incomes are holding up against a background of slowing capital growth.

Private Equity – Although this market is also impacted by the current challenging economic environment, fundraising in private equity continued at reasonable levels over the year. The most active region in terms of deal value is North America although activity was slower in the first quarter 2016 compared to the previous year. In the European and Asia Pacific regions activity has also declined during this period.

##### Pension Fund Investment Performance

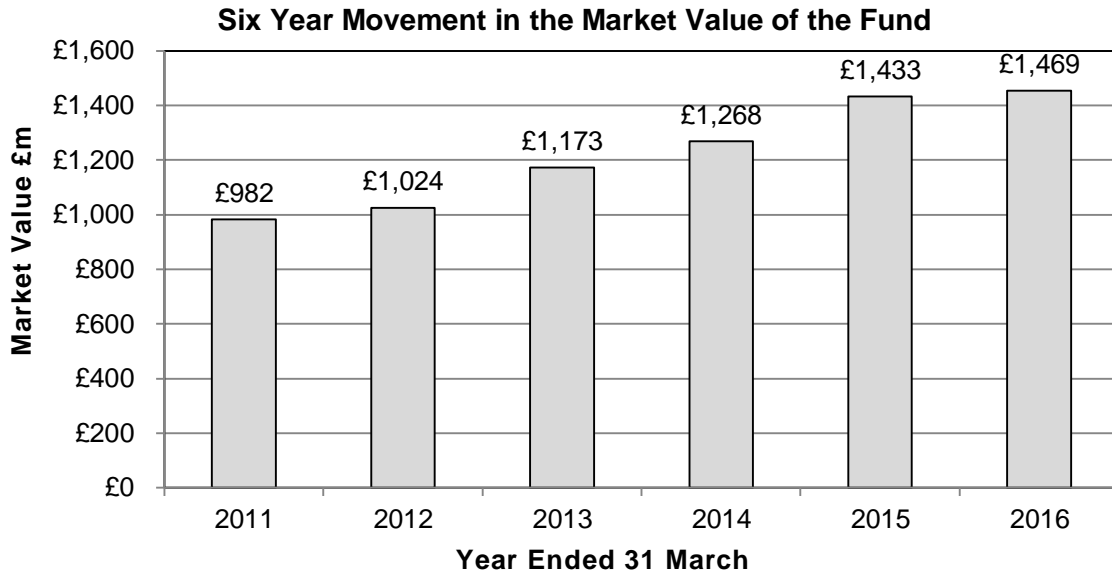
In the year to 31 March 2016, the Highland Council Pension Fund achieved a return on investments of +1.53% against its customised benchmark of -0.17%: outperformance of 1.7% against the benchmark. Although the general economy and market conditions

# HIGHLAND COUNCIL PENSION FUND 2015/16

## ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

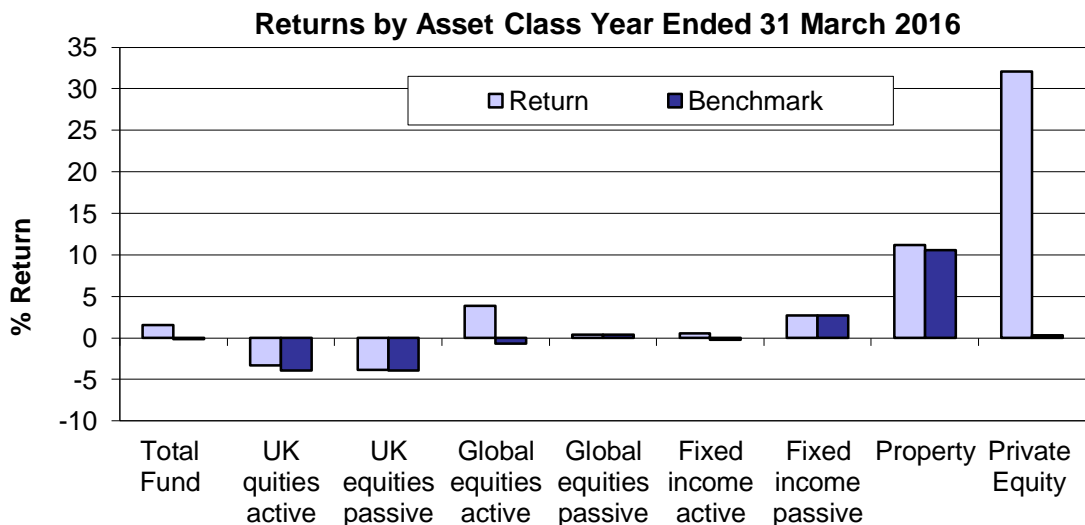
remain challenging, the overall level of performance of the Fund in the year was positive.

The market value of the Fund's net investment assets as at 31 March 2016 was £1,455m (£1,433m at 31 March 2015). Six year movement in the Market Value of the Fund is below.



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) and private equity.

Details of the Fund's investments, analysed by investment category are shown in the financial statements (note 14). There is no data for one year performance for property debt as the initial commitment to this investment was made in the first quarter 2016. The performance of the private equity investment is also monitored quarterly using other metrics such as the net internal rate of return as caution should be taken when comparing private equity to public markets in isolation.



# HIGHLAND COUNCIL PENSION FUND 2015/16

## ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

### Actuarial Position

Employer contributions are assessed every three years by an independent actuary and expressed as a percentage of pensionable pay. The Common Rate of Contribution payable by each authority under Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 is 20.2% of pensionable pay on the basis of the last actuarial valuation as at 31 March 2014, applying to financial years 2015/16 – 2017/18.

The “Projected Unit Method” was used for employers open to new staff and the “Attained Age Method” was used for employers that are closed to new staff. Individual employers’ rates will vary from the common contribution rate depending on the demographic and actuarial factors particular to each employer. Full details of the contribution rates payable can be found in the 2014 actuarial valuation report and the funding strategy statement on the Pension Fund website.

<http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Valuation%20Report%20-%20March%202014.pdf>

Demographic assumptions are used to estimate future consequences for the Fund. They take account of expected future trends (for instance future improvements in life expectancy) as well as the past experience in the Fund.

As at the 2014 actuarial valuation, the Fund was assessed as 96.2% funded (2011 valuation: 96.8%). This corresponded to a deficit of £52m at that time (2011 valuation: deficit of £33m). The 2014 funding level had decreased marginally from 96.8% in March 2011 largely due to future investment returns achieved by the Fund being less than were assessed at the previous valuation. In particular the real gilt yield has increased the value placed on the Fund’s liabilities. More information on the recent actuarial valuation can be found in the Actuary’s statement (page 72).

For the purposes of the contribution rates set for financial year 2015/16, the following assumptions from the triennial Valuation completed in 2014 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 2011		March 2014	
	Nominal p.a.	Real (RPI) p.a.	Nominal p.a.	Real (RPI) p.a.
Discount Rate	6.4%	3.4%	5.3%	2.6%
Salary Increase (excludes promotional increases)	5.0%	2.0%	4.5%	1.8%
Price Inflation/Pension Increases	3.0%	-	2.7%	-

The actuarial projection of the Market Value of the Fund’s assets as at 31 March 2014 was £1,279m (2011 Valuation £991m). 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.

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### Mortality assumptions

The key mortality 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 was:

<b>Mortality assumption at age 65</b>	<b>Male</b>	<b>Female</b>
Current pensioners	22.5	24.1
Future pensioners (assumed current age 45)	24.7	26.8

#### 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/about-us/contact-details.aspx>

Enquiries regarding Pension Fund Investments:

Corporate Budgeting, Taxation and Treasury  
The Highland Council  
Council Buildings  
Glenurquhart Road  
Inverness  
IV3 5NX  
Tel: 01463 702432  
E-mail: [treasury.team@highland.gov.uk](mailto: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](mailto:pensions.section@highland.gov.uk)  
Website: [www.highlandpensionfund.org](http://www.highlandpensionfund.org)

# HIGHLAND COUNCIL PENSION FUND 2015/16

## ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

### 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 our 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 2016 and up to the date of approval of the Annual Accounts.

#### The governance framework

The Local Code is based upon the following six 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

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

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

The Pension Fund has a separate Governance Policy Statement which is one of a number of key documents it must hold and this was last updated in May 2013 and an updated version will go to Committee in September reflecting Governance changes.

On 1 April 2015 new governance arrangements came into place as a result of the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015. As required, a Pension Board was established which holds joint meetings with the Pensions Committee.

#### **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 Depute Chief Executive/Director of Corporate Development 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 Depute Chief Executive/Director of Corporate Development 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 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 Audit and Risk Manager's responsibilities in this regard were discharged through the presentation of the Statement of Internal Control and Annual Report 2015/16 to the Audit and Scrutiny Committee on 16 June 2016.

The work undertaken by the Internal Audit Section during the year to 31 March 2016 consisted of that undertaken directly for the Fund and indirectly where the Highland Council's financial systems are used. The 2015/16 plan comprised of the following two audits:

- A review of the systems of internal control for the financial year 2015/16 consisting of a high level review of the adequacy and effectiveness of the



## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

Fund's system of internal control and targeted testing of key controls to confirm that the main financial systems are operating as intended. No control issues have been identified from this work and the audit findings will be addressed in a separate report.

As part of the 2016/17 audit plan, a review of Pensions Contributions has been undertaken which looked at transactions relating to 2015/16. No major control issues have been identified from the work undertaken.

Audit recommendations are action tracked to ensure that the management agreed actions have been satisfactorily implemented. A total of three audit recommendations were made during the year and have all been actioned as agreed. The recommendations were:

- In the Matters Arising from the Statement of Internal Control 2014/15 it was reported that the medium grade action to prepare a risk management strategy was still outstanding. This was completed and the strategy was presented to the Pensions Committee on 24 September 2015.
- The Pension Fund Investments report contained two low grade recommendations both of which were implemented at the time. These related to the need to update process notes to show that any of the authorised bank signatories could authorise payments to the Custodian and to remove the unnecessary practice of undertaking month-end book cost reconciliations.

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 2016.

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.

From January 2016 the intercompany reconciliation has been completed monthly. Conflicting priorities prevented this being the case earlier in the year. In 2016/17 further developments will be introduced to simplify the processes associated with this account and enable the reconciliation to be carried out regularly throughout the year.

Steve Barron  
Chief Executive

Dave Fallows  
Chairman  
Pensions Committee

22 September 2016

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

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### 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 2015/16.

Principle	Fully Compliant	Comments
<b>Structure</b>		
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. The Pensions Board was established from 1 April 2015 to assist 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.

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

Principle	Fully Compliant	Comments
<b>Representation</b>		
<p>That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure.</p> <p>These include:</p> <ul style="list-style-type: none"> <li>• Employing authorities (including non-scheme employers, e.g. admitted bodies);</li> <li>• Scheme members (including deferred and pensioner scheme members)</li> <li>• Where appropriate, independent professional observers, and</li> <li>• Expert advisors (on an ad-hoc basis).</li> </ul>	Yes	<p>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.</p> <p>In addition, Fund Managers attend the Investment Sub Committee on a rotational basis.</p>
<p>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.</p>	Yes	<p>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.</p> <p>From 1 April 2015, a Pensions Board was set up. The Pensions Board 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.</p>
<b>Selection and Role of Lay Members</b>		
<p>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.</p>	Yes	<p>A comprehensive training programme including induction is in place. Training for Pension Committee, Pensions Board &amp; Investment Sub Committee members includes presentations from investment managers, Custodian, actuary and investment advisors. Attendance at meetings and training is monitored and reported.</p>
<p>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.</p>	Yes	<p>The declaration of Member's interests is a standard item on the agenda of the Pension Fund Committee, Pension Board and Investment Sub Committee.</p>

**HIGHLAND COUNCIL PENSION FUND 2015/16**

**ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16**

<b>Principle</b>	<b>Fully Compliant</b>	<b>Comments</b>
<b>Voting</b>		
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.
<b>Training /Facility Time /Expenses</b>		
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 November 2013 and incorporates the CIPFA Code of Practice on Public Sector Pensions Knowledge and Skill (2011). The training policy recognises the importance of ensuring that it has the necessary resources to discharge its pension's 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.
<b>Meeting Frequency</b>		
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.
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.

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

Principle	Fully Compliant	Comments
That an administering authority who does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	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.
<b>Access</b>		
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. Voting rights are restricted to Highland Council Elected Members.
<b>Scope</b>		
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.
<b>Publicity</b>		
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. <a href="http://www.highlandpensionfund.org/about-us/forms-and-publications.aspx">http://www.highlandpensionfund.org/about-us/forms-and-publications.aspx</a>

Steve Barron  
Chief Executive

Dave Fallows  
Chairman  
Pensions Committee

22 September 2016

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

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### 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 Director of Finance.
- 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.

I confirm that these Annual Accounts were approved for signature by the Pensions Committee on 22 September 2016.

Dave Fallows  
Chairman  
Pensions Committee

22 September 2016

**HIGHLAND COUNCIL PENSION FUND 2015/16**  
**ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16**

**The Director of Finance's Responsibilities**

The Director of Finance 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 Director of Finance 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 Director of Finance 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 Director of Finance 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 2016.

Derek Yule  
B.Com. FCPFA.  
IRRV (Hons)  
Director of Finance

22 September 2016

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### **Independent Auditor's Report**

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

I certify that I have audited the financial statements of the Highland Council Pension Fund for the year ended 31 March 2016 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement and the related notes. 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 2015/16 (the 2015/16 Code).

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 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

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

As explained more fully in the Statement of Responsibilities, the Director of Finance is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

#### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report and Annual Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.



## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2015/16 Code of the financial transactions of the Fund during the year ended 31 March 2016, 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 2015/16 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.

#### Opinion on other prescribed matter

In my opinion the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Annual Governance Statement has not been prepared in accordance with Delivering Good Governance in Local Government; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

Stephen Boyle CPFA  
Assistant Director  
Audit Scotland  
4th Floor South Suite  
The Athenaeum Building  
8 Nelson Mandela Place  
GLASGOW  
G2 1BT

September 2016

# HIGHLAND COUNCIL PENSION FUND 2015/16

## ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

### 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.

2014/15 £000		Notes	2015/16 £000
	<b>Dealings with members, employers and others directly involved in the scheme</b>		
51,405	Contributions receivable	7	55,232
2,189	Transfers in from other pension funds	8	1,709
(47,381)	Benefits payable	9	(51,594)
(2,001)	Payments to and on account of leavers	10	(3,095)
<b>4,212</b>	<b>Net additions/reductions from dealings with members</b>		<b>2,252</b>
<b>(8,469)</b>	<b>Management expenses</b>	11	<b>(7,907)</b>
	<b>Returns on Investments</b>		
28,496	Investment income	12	27,910
149,008	Profit and losses on disposal of investments and changes in values of investments	14.1	(1,566)
(186)	Taxes on income	13	(214)
<b>177,318</b>	<b>Net Return on Investments</b>		<b>26,130</b>
<b>173,061</b>	<b>Net increase in the net assets available for benefits during the year</b>		<b>20,475</b>
1,275,733	Opening net assets as at the start of the year		1,448,794
<b>1,448,794</b>	<b>Closing net assets as at the end of the year</b>		<b>1,469,269</b>

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### Net Assets Statement as at 31 March 2016

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

As at 31/03/15 £000		Notes	As at 31/03/16 £000
1,407,571	Investment assets	14.1	1,430,219
26,004	Cash deposits	14.1	21,227
3,192	Investment income due	14.1	4,080
171	Amounts receivable for sales	14.1	927
(3,837)	Investment liabilities	14.1	(1,408)
<b>1,433,101</b>	<b>Total net investment assets</b>	14.1	<b>1,455,045</b>
	<b>Long term assets</b>		
<b>567</b>	<b>Long term debtors</b>	<b>23</b>	<b>1,013</b>
	<b>Current assets</b>		
5,572	Short term debtors	22	6,815
13,952	Bank accounts		10,200
	<b>Less current liabilities</b>		
(4,398)	Sundry creditors	24	(3,804)
<b>15,126</b>	<b>Net current assets</b>		<b>13,211</b>
<b>1,448,794</b>	<b>Closing net assets as at the end of the year available to fund benefits at the period end<sup>1</sup></b>		<b>1,469,269</b>

The unaudited statement of accounts was issued on 20 June 2016 and the audited statement of accounts was authorised for issue on 22 September 2016.

Derek Yule  
B.Com. FCPFA IRRV (Hons).  
Director of Finance  
22 September 2016

<sup>1</sup> 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.

# HIGHLAND COUNCIL PENSION FUND 2015/16

## ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

### 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.

For further information, reference should be made to the “Management Commentary” on page 3 and “About the Fund” section on page 9 of this document.

#### General

The Fund is governed as a Local Government Superannuation Scheme, the primary legislation being the Superannuation Act 1972.

#### 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 2015/16 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.

##### 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 (see Notes 8 and 10).

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

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

Transfers in from members wishing to use the proceeds of their additional voluntary contributions (see below) to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers in (see Note 8).

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.

#### **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

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

Government Pension Scheme Management Costs’.

- Administrative expenses

All administrative expenses are accounted for on an accruals basis. All staff costs of the pension administration team 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.

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

In advance of preparing the year end accounts a request was made to all Investment Managers for their fee to the end of March 2016 or an estimated fee which would be accrued.

The cost of obtaining investment advice from external advisers is included in the Investment Manager charges and as above a request was sent to all external advisers for their fee to the end of March 2016 or an estimated fees which would be accrued.

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 Fund of Funds, the relevant Fund Managers provided information on underlying fees to the end of March 2016 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 by the Fund.

The values of investments as shown in the net assets statement have been determined as follows:

- i) Market-quoted investments

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

- ii) Fixed interest securities

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

Fixed interest securities are recorded at net market value based on their current yields.

iii) Unquoted investments

The fair value of investments for which market quotations are not readily available is determined as follows:

- Unquoted holdings in private equity funds have been included at the Fund manager's valuation adjusted for cash movements since the last valuation date. Unquoted Fund investments are valued at fair value as determined by the Directors or General Partner. The valuations provided by the General Partners or Directors typically reflect the fair value of the Company's capital account balance of each Fund investment, including unrealised gains and losses, as reported in the Financial Statements of the respective Fund. Private equity investments are typically illiquid and resale is restricted. These valuations are used by the Custodian for reporting purposes.
- Unquoted holdings in commercial real estate loans have been included at amortised cost using the effective interest method, less any provision for impairment.

iv) Pooled investment vehicles

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

#### **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.

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

The value of futures contracts is determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin.

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

#### **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

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

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 (Code Para 6.5.2.8).

As permitted under IAS 26 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).

#### **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 their movements in the year.

AVCs are not included in the accounts in accordance with section 4 (2) (b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (Statutory Instrument 2010/233). However, Note 18 provides AVC figures for information purposes only.

## **4. 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 2016 was £63.7m (£37.2m as at 31 March 2015).

### **Unquoted property debt investment**

The unquoted holdings in property debt (commercial real estate loans) have been included at amortised cost using the effective interest method, less any provision for impairment. The value of unquoted property debt is £34.9m.

### **Pension fund liability**

The pension fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the



## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

valuations are agreed with the actuary and are summarised in the Actuarial Position (Note 17). This estimate is subject to significant variances based on changes to the underlying assumptions.

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

This Statement of Accounts contains estimated figures that are based on assumptions made by the Fund 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 2016 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

<b>Item</b>	<b>Uncertainties</b>	<b>Effect if actual results differ from assumptions</b>
<b>Actuarial present value of promised retirement benefits</b>	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension Fund assets. A firm of consulting actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, a 0.5% increase in the discount rate assumption would result in a decrease in the deficit of £119m. 1 year increase in member life expectancy would result in an increase in the deficit of £39m.
<b>Private equity</b>	Private equity investments are valued at fair value in accordance with British Venture Capital Association guidelines. 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 £63.7m. There is a risk that this investment may be under or overstated in the accounts.
<b>Property Debt</b>	The Manager uses an origin spread approach following discussion with external advisers and approval from the Manager's Fair Value Pricing Committee. 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 £34.9m. There is a risk that this investment may be under or overstated in the accounts.

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### 6. Events after the Reporting Date

The unaudited statement of accounts was issued on 20 June 2016. Events taking place after this date are not reflected in the accounts or notes.

Since the 31 March 2016, there was the UK referendum on membership of the European Union (EU). The result of the UK's referendum on membership of the EU may affect the pension fund's risk profile by introducing potentially significant new uncertainties and instability in financial markets as the United Kingdom negotiates its exit from the EU. These uncertainties could have a material direct or indirect effect on the fund, its financial condition and operations although the extent is not quantifiable at this time.

#### 7. Contributions Receivable

By category	2014/15	2015/16
	£000	£000
Members' pension contributions	12,427	12,608
Employers' pension contributions	38,978	42,624
<b>Total contributions</b>	<b>51,405</b>	<b>55,232</b>

As a result of the 2014 valuation, the future service contribution rate excluding deficit contributions has increased to 18.8% primarily due to the decrease in the real gilt yields which has increased both the employer future service rate and the past service adjustment. The outcome of the 2014 valuation meant revised contributions for 2015/16, 2016/17 and 2017/18.

#### Analysis of Contributions by Authority

2014/15		2015/16			
		Highland Council	Scheduled Bodies	Admitted Bodies	Totals
£000		£000	£000	£000	£000
35,652	Normal contribution	21,280	8,846	8,029	38,155
711	Deficit funding	0	93	637	730
36,363		21,280	8,939	8,666	38,885
2,615	Strain on Fund	3,454	211	74	6,916
38,978	Employer's contributions	24,734	9,150	8,740	42,624
12,427	Members' pension contributions	6,888	2,932	2,788	12,608
<b>51,405</b>	<b>Total contributions</b>	<b>31,622</b>	<b>12,082</b>	<b>11,528</b>	<b>55,232</b>

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### Number of Contributors and Pensioners

<b>2015/16</b>	<b>Contributors</b>	<b>Pensioners</b>	<b>Deferred Pensioners</b>
Highland Council	7,011	6,105	5,677
Scheduled Bodies	2,931	1,775	1,901
Admitted Bodies	2,376	582	796
<b>Total</b>	<b>12,318</b>	<b>8,462</b>	<b>8,374</b>
<b>2014/15</b>			
Highland Council	6,984	5,887	5,493
Scheduled Bodies	2,771	1,702	1,787
Admitted Bodies	2,393	496	679
<b>Total</b>	<b>12,148</b>	<b>8,085</b>	<b>7,959</b>

#### 8. Transfers in from other Pension Funds

	2014/15	2015/16
	£000	£000
Individual transfers	2,189	1,709
	<b>2,189</b>	<b>1,709</b>

#### 9. Benefits Payable

<b>By category</b>	2014/15	2015/16
	£000	£000
Pensions	(35,363)	(37,358)
Lump sum retirement benefits	(9,644)	(12,146)
Lump sum death benefits	(2,374)	(2,090)
	<b>(47,381)</b>	<b>(51,594)</b>
<b>By authority</b>		
	2014/15	2015/16
	£000	£000
Highland Council	(32,461)	(36,404)
Scheduled Bodies	(9,834)	(10,244)
Admitted Bodies	(5,086)	(4,946)
	<b>(47,381)</b>	<b>(51,594)</b>

## HIGHLAND COUNCIL PENSION FUND 2015/16

### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

#### 10. Payments to and on Account of Leavers

	2014/15	2015/16
	£000	£000
Refunds to members leaving service	(142)	(137)
Payments for members joining state scheme	(104)	(108)
Individual transfers	(1,755)	(2,850)
	<b>(2,001)</b>	<b>(3,095)</b>

At the year-end there are no potential liabilities (£0.223m 2014/15) in respect of individuals transferring out of the Fund upon whom the Fund is awaiting final decisions.

#### 11. Management Expenses

	31 March 2015	31 March 2016
	£000	£000
Administrative expenses	(887)	(932)
Oversight and Governance costs	(417)	(311)
Investment Management expenses	(7,165)	(6,664)
	<b>(8,469)</b>	<b>(7,907)</b>

	31 March 2015	31 March 2016
	£000	£000
<b>Administrative Costs</b>		
Administrative costs	(159)	(168)
Employee costs	(723)	(756)
Other administration	(5)	(8)
	<b>(887)</b>	<b>(932)</b>

	31 March 2015	31 March 2016
	£000	£000
<b>Oversight and Governance costs</b>		
Actuarial fees	(102)	(25)
External Audit fees	(49)	(49)
Internal Audit fees	(17)	(20)
Investment advisor fees	(109)	(53)
Tax advisor fees	(4)	-
Legal fees	(2)	(21)
Performance management	(21)	(21)
Employee costs	(96)	(103)
Sundry costs	(17)	(19)
	<b>(417)</b>	<b>(311)</b>

**HIGHLAND COUNCIL PENSION FUND 2015/16**  
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<b>Investment Management Expenses</b>	31 March 2015	<b>31 March 2016</b>
	£000	<b>£000</b>
External management fees invoiced	(2,828)	(2,975)
External management fees deducted from capital	(2,723)	(2,373)
Performance fees	(958)	(355)
Custodian fees	(70)	(68)
Investment expenses	(256)	(531)
Transaction costs	(330)	(362)
	<b>(7,165)</b>	<b>(6,664)</b>
<b>Total Management Expenses</b>	<b>(8,469)</b>	<b>(7,907)</b>

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**

	31 March 2015	<b>31 March 2016</b>
	£000	<b>£000</b>
Dividends from equities	15,969	18,211
Income from pooled investments	12,185	8,656
Interest on cash deposits	193	725
Private equity income	139	318
Other investments	10	0
	<b>28,496</b>	<b>27,910</b>

**13. Taxes on Income**

	31 March 2015	<b>31 March 2016</b>
	£000	<b>£000</b>
Withholding tax – fixed interest securities	-	-
Withholding tax - equities	(186)	(214)
Withholding tax – pooled	-	-
	<b>(186)</b>	<b>(214)</b>

# HIGHLAND COUNCIL PENSION FUND 2015/16

## ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

### 14. Investment Assets

#### 14.1. Reconciliation of Movements in Investments and Derivatives

<b>2015/16 Classifications</b>	<b>Market value at 1 April 2015</b>	<b>Purchases at cost &amp; derivative payments</b>	<b>Sales proceeds &amp; derivative receipts</b>	<b>Change in market value</b>	<b>Market value at 31 March 2016</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Investment assets</b>					
Equities	656,160	82,810	(68,791)	(17,984)	652,195
Unitised insurance policies	373,234	-	(48,500)	(6,237)	318,497
Unit trusts (property)	140,550	8,415	(1,456)	12,036	159,545
Unit trusts (other)	200,408	71,007	(67,476)	(2,592)	201,347
Private equity	37,219	18,148	(7,001)	15,319	63,685
Property debt	-	35,503	(381)	(172)	34,950
Currency forwards	-	-	-	-	-
<b>Investment liabilities</b>					
Currency Forwards	(792)	1,307	(75)	(566)	(126)
	1,406,779	217,190	(193,680)	(196)	1,430,093
<b>Other investment balances</b>					
Cash deposits	26,004	-	-	(4,777)	21,227
Investment income due	3,192	-	-	888	4,080
Amounts receivable for sales	171	-	-	756	927
Amounts payable for purchases	(3,045)	-	-	1,763	(1,282)
<b>Total net investment assets</b>	<b>1,433,101</b>	<b>217,190</b>	<b>(193,680)</b>	<b>(1,566)</b>	<b>1,455,045</b>

## HIGHLAND COUNCIL PENSION FUND 2015/16

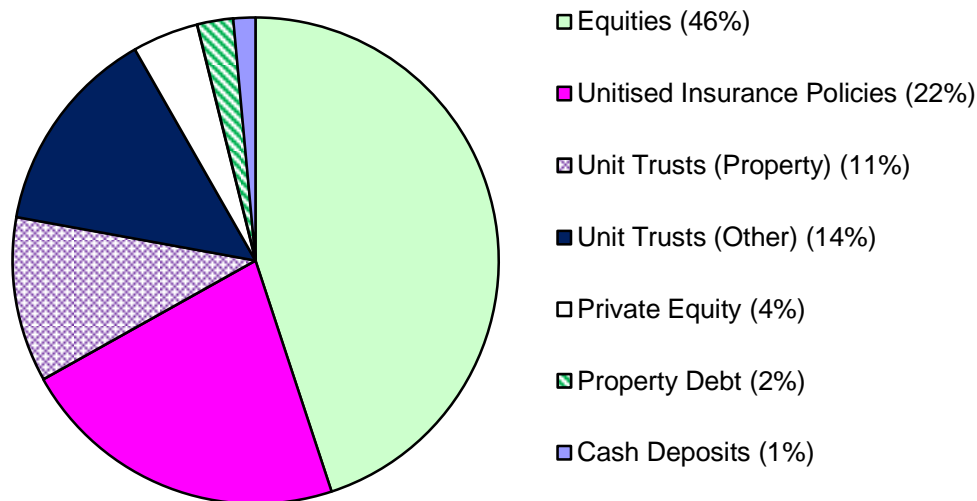
### ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16

2014/15 Classifications	Market value at 1 April 2014	Purchases at cost & derivative payments	Sales proceeds & derivative receipts	Change in market value	Market value at 31 March 2015
	£000	£000	£000	£000	£000
<b>Investment assets</b>					
Equities	582,181	97,357	(86,144)	62,766	656,160
Unitised insurance policies	359,454	-	(25,000)	38,780	373,234
Unit trusts (property)	120,045	14,988	(8,321)	13,838	140,550
Unit trusts (other)	169,682	10,271	(3,341)	23,796	200,408
Private equity	20,263	16,711	(915)	1,160	37,219
Currency forwards	125	-	-	(125)	-
<b>Investment liabilities</b>					
Currency Forwards	(305)	-	-	(487)	(792)
	1,251,445	139,327	(123,721)	139,728	1,406,779
<b>Other investment balances</b>					
Cash deposits	13,803	-	-	12,201	26,004
Investment income due	2,621	-	-	571	3,192
Amounts receivable for sales	2,112	-	-	(1,941)	171
Amounts payable for purchases	(1,494)	-	-	(1,551)	(3,045)
<b>Total net investment assets</b>	1,268,487	139,327	(123,721)	149,008	1,433,101

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.

**HIGHLAND COUNCIL PENSION FUND 2015/16**  
**ANNUAL REPORT AND ANNUAL ACCOUNTS 2015/16**

**14.2. Analysis of Investments**



2014/15		Portfolio Distribution UK & overseas	2015/16	
UK	Overseas		UK	Overseas
£000	£000	Investment assets	£000	£000
285,704	370,456	Equities	276,572	375,623
310,470	62,764	Unitised insurance policies	267,038	51,459
135,185	5,365	Unit trusts (property)	154,509	5,036
200,408	-	Unit trusts (other)	134,684	66,663
-	37,219	Private equity	-	63,685
-	-	Property debt	34,950	-
25,796	208	Cash deposits	19,096	2,131
1,705	1,487	Investment income due	1,924	2,156
-	171	Amounts receivable for sales	84	843
<b>959,268</b>	<b>477,670</b>		<b>888,857</b>	<b>567,596</b>
		<b>Investment liabilities</b>		
-	(792)	Currency forwards	-	(126)
(2,085)	(960)	Amounts payable for purchases	-	(1,282)
<b>957,183</b>	<b>475,918</b>	<b>Net total</b>	<b>888,857</b>	<b>566,188</b>
	<b>1,433,101</b>			<b>1,455,045</b>



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2014/15		Portfolio Distribution – (Quoted / Unquoted)	2015/16	
Quoted £000	Unquoted £000		Quoted £000	Unquoted £000
		<b>Investment assets</b>		
656,160	-	Equities	652,195	-
373,234	-	Unitised insurance policies	318,497	-
140,550	-	Unit trusts (property)	159,545	-
200,408	-	Unit trusts (other)	201,347	-
-	37,219	Private equity	-	63,685
-	-	Property debt	-	34,950
-	26,004	Cash deposits	-	21,227
3,192	-	Investment income due	4,080	-
-	171	Amounts receivable for sales	-	927
<b>1,373,544</b>	<b>63,394</b>		<b>1,335,664</b>	<b>120,789</b>
		<b>Investment liabilities</b>		
-	(792)	Currency forwards	-	(126)
-	(3,045)	Amounts payable for purchases	-	(1,282)
<b>1,373,544</b>	<b>59,557</b>	<b>Net total</b>	<b>1,335,664</b>	<b>119,381</b>
<b>1,433,101</b>			<b>1,455,045</b>	

#### 14.3. Funds under External Management

The Market Value of the assets (at 1 April 2015 and 31 March 2016) which were under the management of fund managers and the proportion managed by each manager are below.

2014/15		Manager Analysis	2015/16	
Market Value £000	% of Fund		Market Value £000	% of Fund
507,680	35.4	Baillie Gifford (UK & global equity)	497,610	34.2
178,629	12.5	Pyrford (global equity)	186,128	12.8
189,337	13.2	Fidelity (bond fund)	190,891	13.1
373,237	26.0	Legal and General (equity and bonds)	318,500	21.9
146,937	10.3	Schroders (property fund)	163,004	11.2
37,281	2.6	Partners Group (private equity)	63,728	4.4
-	-	Standard Life Investments	35,184	2.4
<b>1,433,101</b>	<b>100.0</b>	<b>Combined Fund</b>	<b>1,455,045</b>	<b>100.0</b>

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**14.4. Top 10 Equity Holdings by Market Value**

<b>Holding at 31 March 2016</b>	<b>Market Value £000</b>	<b>% of Total Equity Investments</b>	<b>Classification</b>
Prudential	16,256	1.73	Insurance
British American Tobacco	15,157	1.61	Tobacco
Royal Dutch Shell 'B'	12,018	1.28	Oil and gas
Legal & General	9,961	1.06	Insurance
Bunzl	9,599	1.02	Support services
St James's Place	9,541	1.01	Insurance
Ashtead	8,277	0.88	Industrial goods and services
Sabmiller	8,078	0.86	Consumer staples
Amazon	7,978	0.85	Consumer discretionary
Royal Caribbean Cruises	7,717	0.82	Travel and leisure
<b>Total</b>	<b>104,582</b>	<b>11.12</b>	

**14.5. Holdings Exceeding 5% by Total Net Assets**

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

<b>Fund Manager &amp; Category</b>	<b>Market Value at 31 March 2015</b>	<b>% of total net assets</b>	<b>Market Value at 31 March 2016</b>	<b>% of total net assets</b>
	£000	%	£000	%
Legal & General (UK Equity Index)	216,330	14.9	198,544	13.5
Fidelity Instl UK Agg Bond	94,325	6.5	95,190	6.5
Total net assets available for benefits	1,448,794		1,466,637	

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**14.6. Derivatives - Summary of Contracts at 31 March 2016**

Settlement	Currency bought	Local value	Currency sold	Local value	Asset value	Liability value
		000		000	£000	£000
One to six months	GBP	19,267	CHF	(26,510)		(126)
Up to one month	GBP	10	CHF	(13)	-	-
Up to one month	GBP	40	USD	(58)	-	-
Up to one month	GBP	530	SGD	(1,027)	-	-
Up to one month	SGD	365	GBP	(189)	-	-
Up to one month	SGD	350	GBP	(181)	-	-
Up to one month	SGD	624	GBP	(322)	-	-
					-	(126)
<b>Net forward currency contracts at 31 March 2016</b>						<b>(126)</b>
<b>Prior year comparative</b>						
<b>Open forward currency contracts at 31 March 2015</b>						<b>- (792)</b>
<b>Net forward currency contracts at 31 March 2015</b>						<b>- (792)</b>

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.

**14.7. Stock Lending**

As at 31 March 2016, no stock was released to a third party under a securities lending agreement. An agreement was signed in financial year 2016/17 so stock lending will be undertaken in future financial years.

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**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 assets were reclassified during the accounting period.

<b>31 March 2016</b>	<b>Fair value through profit &amp; loss</b>	<b>Loans &amp; receivables</b>	<b>Financial liabilities at amortised cost</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Financial assets</b>				
Equities	652,195	-	-	652,195
Unitised insurance policies	318,497	-	-	318,497
Unit trusts (property)	159,545	-	-	159,545
Unit trusts (other)	201,347	-	-	201,347
Private equity	63,685	-	-	63,685
Property debt	34,950			34,950
Cash deposits	-	21,227	-	21,227
Investment income due	4,080	-	-	4,080
Long term debtors		1,013		1,013
Amounts receivable for sales	927	-	-	927
Short term debtors	-	9,993	-	9,993
Bank	-	10,200	-	10,200
	<b>1,435,226</b>	<b>42,433</b>	<b>-</b>	<b>1,477,659</b>
<b>Financial liabilities</b>				
Derivative contracts – currency forwards	(126)	-	-	(126)
Amounts payable for purchases	(1,282)	-	-	(1,282)
Creditors		-	(9,614)	(9,614)
<b>Closing net assets</b>	<b>1,433,818</b>	<b>42,433</b>	<b>(9,614)</b>	<b>1,466,637</b>

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31 March 2015	Fair value through profit & loss	Loans & receivables	Financial liabilities at amortised cost	Total
	£000	£000	£000	£000
<b>Financial assets</b>				
Equities	656,160	-	-	656,160
Unitised insurance policies	373,234	-	-	373,234
Unit trusts (property)	140,550	-	-	140,550
Unit trusts (other)	200,408	-	-	200,408
Private equity	37,219	-	-	37,219
Cash deposits	-	26,004	-	26,004
Investment income due	3,192	-	-	3,192
Long term debtors	-	567	-	567
Amounts receivable for sales	171	-	-	171
Short term debtors	-	5,572	-	5,572
Bank	-	13,952	-	13,952
	<b>1,410,934</b>	<b>46,095</b>	<b>-</b>	<b>1,457,029</b>
<b>Financial liabilities</b>				
Derivative contracts – currency forwards	(792)	-	-	(792)
Amounts payable for purchases	(3,045)	-	-	(3,045)
Creditors	-	-	(4,398)	(4,398)
<b>Closing net assets</b>	<b>1,407,097</b>	<b>46,095</b>	<b>(4,398)</b>	<b>1,448,794</b>

#### 15.2. Net Gains and Losses on Financial Instruments

	31 March 2015 £000	31 March 2016 £000
<b>Financial assets</b>		
Fair value through profit and loss	139,728	(196)
Loans and receivables	10,831	(3,133)
Financial liabilities measured at amortised cost	-	-
<b>Financial liabilities</b>		
Fair value through profit and loss	-	-
Loans and receivables	-	-
Financial liabilities measured at amortised cost	(1,551)	1,763
<b>Total</b>	<b>149,008</b>	<b>(1,566)</b>

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#### 15.3. Valuation of Financial Instruments Carried at Fair Value

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

##### Level 1

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

Listed investments are shown at bid prices. The bid value of the instrument is based on the bid market quotation of the relevant stock exchange.

##### Level 2

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

##### Level 3

Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

<b>Values at 31 March 2016</b>	Quoted market price	Using observable input	With significant unobservable inputs	
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	£000	£000	£000	£000
<b>Financial assets</b>				
Financial assets at fair value through profit and loss	1,166,017	170,575	98,634	1,435,226
Loans and receivables	42,433	-	-	42,433
<b>Total financial assets</b>	<b>1,208,450</b>	<b>170,575</b>	<b>98,634</b>	<b>1,477,659</b>
<b>Financial liabilities</b>				
Financial liabilities at fair value through profit and loss	(1,408)	-	-	(1,408)
Financial liabilities at amortised cost	(9,614)	-	-	(9,614)
<b>Total financial liabilities</b>	<b>(11,022)</b>	<b>-</b>	<b>-</b>	<b>(11,022)</b>
<b>Net financial assets</b>	<b>1,197,428</b>	<b>170,575</b>	<b>98,634</b>	<b>1,466,637</b>

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#### Values at 31 March 2015

	Level 1	Level 2	Level 3	Total
Financial assets	£000	£000	£000	£000
Financial assets at fair value through profit and loss	1,233,144	140,571	37,219	1,410,934
Loans and receivables	46,095	-	-	46,095
<b>Total financial assets</b>	<b>1,279,239</b>	<b>140,571</b>	<b>37,219</b>	<b>1,457,029</b>
<b>Financial liabilities</b>				
Financial liabilities at fair value through profit and loss	(3,837)	-	-	(3,837)
Financial liabilities at amortised cost	(4,398)	-	-	(4,398)
<b>Total financial liabilities</b>	<b>(8,235)</b>	<b>-</b>	<b>-</b>	<b>(8,235)</b>
<b>Net financial assets</b>	<b>1,271,004</b>	<b>140,571</b>	<b>37,219</b>	<b>1,448,794</b>

## 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 on '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

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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. Except for shares sold short, the maximum risk resulting from financial instruments is determined by the fair value of the financial instruments. Possible losses from shares sold short are unlimited.

The Fund's investment managers mitigate this price risk through diversification and the selection of securities and other financial instruments is monitored by the Fund to ensure it is within limits specified in the Fund investment strategy.

#### Other price risk – sensitivity analysis

Following analysis of historical data and expected investment return movement during the financial year, in consultation with the Fund's investment advisors, the Fund has determined that the following movements in market price risk are reasonably possible for the 2016/17 reporting period.

Asset type	Potential market movement (+/-)%	Potential market movement (+/-)%
	2014/15	2015/16
UK equities	17.0	19.0
Global equities (excluding UK)	20.0	20.0
UK fixed income unit trusts	9.0	9.0
Corporate bonds (medium term)	9.0	9.0
UK fixed gilts (medium term)	11.0	11.0
UK index linked gilts (medium term)	9.0	9.0
Property	12.5	12.5
Private Equity	25.0	25.0
Property Debt	-	8.0
Cash	-	-

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



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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 in the market price would have been as follows (the prior year comparator is shown on page 58):

Asset type	Value as at 31 Mar 2016	Percentage change	Value on increase	Value on decrease
	£000	%	£000	£000
<b>Cash deposits</b>	21,227	0.0	21,227	21,227
<b>Investment portfolio assets:</b>				
UK equities	276,572	19.0	329,121	224,023
Global equities (excluding UK)	375,623	20.0	450,748	300,498
UK fixed income unit trusts	289,220	9.0	315,250	263,190
UK Corporate bonds (medium term)	95,190	9.0	103,757	86,623
Overseas Corporate bonds (medium term)	66,663	9.0	72,663	60,663
UK fixed gilts (medium term)	41,265	11.0	45,804	36,726
UK index linked gilts (medium term)	27,506	9.0	29,981	25,030
Unit trusts property	159,545	12.5	179,488	139,602
Private equity	63,685	25.0	79,606	47,764
Property debt	34,950	8.0	37,746	32,154
Net currency forwards	(126)	0.0	(126)	(126)
Investment income due	4,080	0.0	4,080	4,080
Amounts receivable for sales	927	0.0	927	927
Amounts payable for purchases	(1,282)	0.0	(1,282)	(1,282)
<b>Net investment assets</b>	<b>1,455,045</b>		<b>1,668,990</b>	<b>1,241,099</b>

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Asset type	Value as at 31 March 2015  £000	Percentage change  %	Value on increase  £000	Value on decrease  £000
<b>Cash deposits</b>	26,004	0.0	26,004	26,004
<b>Investment portfolio assets:</b>				
UK equities	285,704	17.0	334,274	237,134
Global equities (excluding UK)	370,456	20.0	444,548	296,365
UK fixed income unit trusts	385,177	9.0	419,843	350,511
Corporate bonds (medium term)	94,325	9.0	102,814	85,836
UK fixed gilts (medium term)	55,940	11.0	62,093	49,787
UK index linked gilts (medium term)	38,200	9.0	41,638	34,762
Property	140,550	12.5	158,119	122,981
Private equity	37,219	25.0	46,524	27,914
Net currency forwards	(792)	0.0	(792)	(792)
Investment income due	3,192	0.0	3,192	3,192
Amounts receivable for sales	171	0.0	171	171
Amounts payable for purchases	(3,045)	0.0	(3,045)	(3,045)
<b>Net investment assets</b>	<b>1,433,101</b>		<b>1,635,383</b>	<b>1,230,820</b>

**Interest rate risk**

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

The Fund's interest rate risk is routinely monitored by the Fund 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 2016 and 31 March 2015 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

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Asset type	As at 31 March 2015	As at 31 March 2016
	£000	£000
Bank accounts	26,004	21,227
Cash and cash equivalents	13,952	10,200
Legal & General fixed interest gilts	55,939	41,265
Legal & General index linked gilts	38,200	27,506
Fidelity unit trust equity	95,012	28,552
Fidelity unit trust bonds	94,325	95,190
<b>Total</b>	<b>323,432</b>	<b>223,940</b>

#### 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 2016 £000	Change in year in the net assets available to pay benefits	
		+1%	-1%
		£000	£000
Cash deposits	21,227	212	(212)
Bank accounts	10,200	102	(102)
Legal & General fixed interest gilts	41,265	413	(413)
Legal & General index linked gilts	27,506	275	(275)
Fidelity unit trust equity	28,552	286	(286)
Fidelity unit trust bonds	95,190	952	(952)
<b>Total change in assets available</b>	<b>223,940</b>	<b>2,240</b>	<b>(2,240)</b>

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Asset type	Carrying amount as at 31 March 2015	Change in year in the net assets available to pay benefits	
		+1%	-1%
	£000	£000	£000
Cash deposits	26,004	260	(260)
Bank accounts	13,952	140	(140)
Legal & General fixed interest gilts	55,939	559	(559)
Legal & General index linked gilts	38,200	382	(382)
Fidelity unit trust equity	95,012	950	(950)
Fidelity unit trust bonds	94,325	943	(943)
<b>Total change in assets available</b>	<b>323,432</b>	<b>3,234</b>	<b>(3,234)</b>

#### Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Fund (£ 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 2016 and as at the previous period end:

Currency exposure – asset type	Asset value as at 31 March 2015	Asset value as at 31 March 2016
	£000	£000
Overseas quoted securities	370,456	375,623
Overseas unitised insurance policies	62,764	51,459
Overseas property fund	5,365	5,036
Overseas unquoted private equity	37,219	63,685
<b>Total overseas assets</b>	<b>475,804</b>	<b>495,803</b>

#### 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.

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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 as at 31 March 2016	Change to net assets available to pay benefits	
		+13%	-13%
	£000	£000	£000
Overseas quoted securities	375,623	424,454	326,792
Overseas unitised insurance policies	51,459	58,149	44,769
Overseas property fund	5,036	5,690	4,380
Overseas unquoted private equity	63,685	71,964	55,406
<b>Total change in assets available</b>	<b>495,803</b>	<b>560,257</b>	<b>431,347</b>

Currency exposure - asset type	Asset value as at 31 March 2015	Change to net assets available to pay benefits	
		+13%	-13%
	£000	£000	£000
Overseas quoted securities	370,456	418,615	322,297
Overseas unitised insurance policies	62,764	70,923	54,605
Overseas property fund	5,365	6,062	4,668
Overseas unquoted private equity	37,219	42,057	32,381
<b>Total change in assets available</b>	<b>475,804</b>	<b>537,657</b>	<b>413,951</b>

#### 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.

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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 investment managers of the Pension Fund have a mandate to specifically manage cash and so cash is generally held by the Custodian and invested in Money Market Funds (Sterling, Euro and US Dollar Funds). The Northern Trust Money Market Funds are triple A rated. In addition, the Fund's surplus cash from scheme member's contributions is managed as part of the administering authority's treasury management function. Prior to transfer to the Fund's investment managers, cash surpluses, are deposited with the Pension Fund's bank, Svenska Handelsbanken and the Royal Bank of Scotland thus minimising credit risk. The Fund had the following cash holdings at the year end.

	<b>Moody's credit rating</b>	<b>£000</b>
Northern Trust Global Investment – liquidity funds	AAA	20,879
Northern Trust Cash deposits	A1	348
		<b>21,227</b>

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

	<b>£000</b>
Clydesdale accounts	6,177
HCPF RBS Call Account	17
Svenska Handelsbanken	4,006
	<b>10,200</b>

#### **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 2014 the Fund's actuary was asked to assess the projected cash flows of the Fund assuming a variety of possible maturity profiles. This study concluded that, provided the investment income yield remains at current levels, then the time when assets need to be sold to meet benefit payments still looks a long way off. The actuary stated that there is no need to review investment strategy in the short term in any significant way although the cash flow position should continue to be monitored.

#### **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.

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#### 17. Actuarial Present Value of Promised Retirement Benefits

CIPFA's Code of Practice on Local Authority Accounting 2015/16 requires administering authorities of LGPS Funds that prepare Pension Fund accounts to disclose what 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 IA19. There are three options for its disclosure in Pension Fund accounts:

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

If an actuarial valuation has not been prepared 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 Pension Fund's funding assumptions.

Assumptions underpinning the valuations are agreed with the actuary and are summarised in the Actuarial Position (page 21). 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:

<b>Net Pension Asset as at</b>	<b>31 March 2016 £m</b>	<b>31 March 2015 £m</b>	<b>31 March 2014 £m</b>
Present Value of Promised Retirement Benefits*	1,883	1,988	1,779

Liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2014.

The Actuary estimates that the liability at 31 March 2016 comprises of £1,060m in respect of employee members, £258m in respect of deferred pensioners and £565m 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 assumptions to 31 March 2016 is to decrease the actuarial present value by £183m.

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### Financial Assumptions

The financial assumptions used for the purposes of the actuarial calculations are calculated on an IAS 19 basis and therefore differ from the results of the 2014 triennial funding valuation (see Actuarial Statement page 72) because IAS 19 stipulates a discount rate rather than a rate which reflects market values. The Financial Assumptions are as follows:

Assumptions as at	31 March 2016		31 March 2015		31 March 2014	
	%p.a.	Real	%p.a.	Real	%p.a.	Real
Inflation/Pensions Increase Rate	2.2%	-0.9%	2.4%	-0.9%	2.6%	-0.8%
Salary Increase Rate	4.2%	1.0%	4.3%	1.0%	4.9%	1.5%
Discount Rate	3.5%	0.2%	3.2%	0.2%	4.1%	-0.7%

### Discount rate

IAS 19 states that the discount rate used to place a value on the liabilities should be “determined by reference to market yields at the end of the reporting period on high quality corporate bonds”. It further states that “the currency and term of the corporate bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations”. To that end the Actuary previously recommended a single discount rate for all LGPS employers broadly equivalent to the yield available on a basket of AA rated bonds with a duration similar to that of a ‘typical’ LGPS employer.

The Actuary’s approach to setting the discount rate as at 31 March 2016 follows the same principles to those adopted at 31 March 2015.

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.

For consistency with the assessment described in paragraph above, the Actuary’s recommended RPI inflation assumption for each discount rate category defined above has been identified at appropriate durations from the Bank of England implied inflation curve as at 31 March 2016.



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#### Pension increase assumption

Based on this evidence and as a result of discussions the Actuary has had with the accounting firm PWC as part of PWC's independent review of the assumptions made by all actuaries involved in valuing local government pension schemes, the Actuary is increasing their assumed RPI-CPI gap to 0.9% p.a. at 31 March 2016. This will lead to a reduction in the assumed rate of CPI (all else being equal).

#### Salary increase assumption

The long term assumption for salary increases is RPI plus 1% p.a. This translates to CPI plus 1.8% p.a.

#### Longevity assumptions

The life expectancy assumptions are included in the Actuary's statement on page 73.

### 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.

2014/15		2015/16
£000		£000
10,040	Opening Value	10,489
1,235	Contributions Invested	1,284
586	Interest, Bonuses & Transfers	439
(1,372)	Sale of Investments	(1,797)
<b>10,489</b>	<b>Closing Value</b>	<b>10,415</b>

### 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.

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#### 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 separate bank accounts. 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.

There is one member of the Pensions Committee (Cllr Norrie Donald) and 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 2016.

Name	Resp	Pension Contributions in year to		Accrued Pension Benefits as at 31/03/16		Difference in Accrued Pension benefits compared to March 2015
		31/03/15	31/03/16			
Derek Yule	Director of Finance	£19,362	£20,198	Pension	£52,228	£2,964
				Lump Sum	£117,251	£1,730

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 £29.194m were paid by the Highland Council to the Fund during 2015/16 and central administration costs of £1.064m (£1.004m 2014/15) were recharged to the Fund.

As at 31 March 2016, the Pension Fund had a net intercompany debtor of £2.907m representing sums due from the Highland Council. These balances in the main cover contributions payable by the Highland Council to the Pension Fund.

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#### 21. Contingent Assets, Liabilities and Contractual Commitments

##### Contingent assets

During 2006/07, the Highland Council Pension Fund joined a group litigation to recover tax credits on overseas dividends and foreign income dividends. The estimated claim, gross of fees is £1.7m. As at 31 March 2016, these claims are still active although many of the tax authorities are resisting claims thus delaying the recovery process.

During 2009/10, KPMG were contracted to submit 'EU Fokus Bank' claims for recovery of withholding tax with an estimated value of £1.3m 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 2015/16.

##### Contingent liabilities

As at 31 March 2016 there is a contingent liability of £0.522m (£0.502m 2014/15) for frozen refunds representing 2,377 (2,310 2014/15) frozen refund records.

##### Contractual commitment

During 2013/14, the Fund appointed a private equity investment manager, and made an initial €50m commitment. In order to achieve the target asset allocation of 5% for private equity in financial year 2014/15, a further €80m commitment was made to another fund operated by the same private equity investment manager. It will take several years for these commitments to be drawn down on a phased basis. As at 31 March 2016, €33.185m of the €50m commitment (66%) and €32.538m of the €80m (41%) had been made.

During 2015/16, the Fund appointed a commercial real estate debt manager, and made an initial £55m commitment with a target asset allocation of 4% of the Fund's investments. In January 2016, an initial investment of £35.5m of the £55m commitment (65%) was made.

#### 22. Debtors

2014/15	Debtors	2015/16
£000		£000
995	Contributions due - employees	1,027
3,107	Contributions due - employers	3,588
861	Strain on fund costs	834
58	Transfer values receivable	191
551	Short term debtors	1,175
<b>5,572</b>	<b>Total debtors</b>	<b>6,815</b>

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#### Analysis of Debtors

2014/15	Debtors	2015/16
£000		£000
559	Central government bodies	182
3,048	Other local authorities	4,506
404	NHS bodies	413
1,561	Other entities and individuals	1,714
<b>5,572</b>		<b>6,815</b>

#### 23. Long Term Debtors

2014/15	Debtors	2015/16
£000		£000
182	Central government bodies	59
329	Other local authorities	931
21	NHS bodies	4
35	Other entities and individuals	19
<b>567</b>		<b>1,013</b>

#### 24. Creditors

2014/15	Creditors	2015/16
£000		£000
(4,018)	Sundry creditors	(2,493)
(77)	Transfer values payable (leavers)	(76)
(303)	Benefits payable	(1,235)
<b>(4,398)</b>		<b>(3,804)</b>

#### Analysis of creditors

2014/15	Creditors	2015/16
£000		£000
(456)	Central government bodies	(533)
(2,703)	Other local authorities	(1,140)
(1)	NHS bodies	-
(1,238)	Other entities and individuals	(2,131)
<b>(4,398)</b>		<b>(3,804)</b>

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#### 25. Accounting Standards Issued but Not Yet Adopted

The code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2016/17 code:

- Amendment to IAS 19 Employee Benefits (Defined Benefit Plans: Employee Contributions)
- Annual improvements to IFRSs 2010-2012 cycle
- Amendment to IAS 1 Presentation of Financial Statements (Disclosure Initiatives)

The code requires implementation from 1 April 2016 and therefore has no impact on the 2015/16 financial statements.

#### 26. Prior year adjustment

This is the second year that management fees have been reported and with the improved transparency and information provided by the Fund Manager, this year performance fees have been disclosed.

In order to include the performance comparator for 2014/15 the results for the year ended 31 March 2015 have been restated. The change has the effect of increasing the change in market value of investments by £0.958m and increasing management expenses by £0.958m. The changes are reported in the Fund account but there is no change to the net increase in the Fund for the year ended 31 March 2015.

<b>Fund account 2014/15</b>	£000 Per 2014/15 audited accounts	£000 Changes made	£000 Fund account as restated
Profit and losses on disposal of investments and change in market values of investment	148,050	958	149,008

The inclusion of a comparator for 2014/15 performance fees required changing the management expenses (oversight and governance costs).

Administrative Costs	(887)	-	(887)
Oversight and Governance Costs	(417)	-	(417)
Investment management expenses	(6,207)	958	(7,165)
<b>Management Expenses</b>	<b>(7,511)</b>	<b>958</b>	<b>(8,469)</b>

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#### Training, Knowledge and Skills - Policy Statement

On 14 November 2013, the Highland Council Pension Committee formally adopted the CIPFA Knowledge and Skills Framework for public sector pension's finance.

In adopting that framework, the Committee agreed the following training policy statement:

1. The Pensions Committee recognises the importance of ensuring that it has the necessary resources to discharge its pension's 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.
2. It therefore seeks to utilise individuals who are both capable and experienced and it will provide and/or arrange training for staff and members of the pensions decision-making and governance bodies to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

The Pensions Committee also agreed to delegate responsibility for implementation to the Director of Finance, and that there would be annual reporting on the Pension Fund's training policy and its implementation. The table below summarises how training needs were fulfilled during the year.

<b>Cipfa Framework Core Competency</b>	<b>Training Specifics</b>	<b>Training Event</b>	<b>Attendees</b>
Pensions accounting & audit standards	CIPFA Pensions Network presentation by Audit Scotland	30/09/15: CIPFA Pensions Network Workshops	Council officers (2)
Investment performance & risk management	CIPFA Pensions Network presentation by Baillie Gifford	30/09/15: CIPFA Pensions Network Workshops	Council officers (2)
Financial markets & products knowledge	Presentations on passive investing, alternative investing, fixed income and responsible investing	09/10/15: CIPFA Investment Governance Group (IGG) training for Members	Members (2) Trade Unions (2) Employer rep Council officers (4)
	Presentation from Strathclyde Pension Fund covering Infrastructure	11/12/15: CIPFA Investment Governance Group (IGG) training	Council officers (2)

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<b>Cipfa Framework Core Competency</b>	<b>Training Specifics</b>	<b>Training Event</b>	<b>Attendees</b>
Pensions legislative & governance context	Pension Governance structures	27/05/15: CIPFA Investment Governance Group (IGG) training for Members	Council officers (2) Members (1) Trade Unions (1)
Actuarial methods, standards & practices	Presentation on The Role of the Actuary in LGPS	09/10/15: CIPFA Investment Governance Group (IGG) training for Members	As above

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.

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#### Actuary's Statement as at 31 March 2016

**HYMANS ROBERTSON LLP**

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

#### **Description of Funding Policy**

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

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return;
- 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 below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is still around a 75% chance that the Fund will return to full funding over 20 years.

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

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £1,279 million, were sufficient to meet 96% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £52 million. Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

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

Full details of the methods and assumptions used are described in the valuation report dated 24 March 2015.

#### **Method**

The liabilities were assessed using an accrued benefits method which takes into account



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pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

#### Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value. The key financial assumptions adopted for the 2014 valuation were as follows:

Financial assumptions	31 March 2014	
	% p.a. Nominal	% p.a. Real(CPI)
Discount rate	5.3%	2.6%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	-

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI 2012 model, assuming the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.5 years	24.1 years
Future Pensioners (currently aged 45)	24.7 years	26.8 years

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

#### Experience over the period since April 2014

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

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

#### Richard Warden FFA

Fellow of the Institute and Faculty of Actuaries  
For and on behalf of Hymans Robertson LLP  
21 April 2016