

Section Two - The Pension Fund Accounts

Introduction

The Council's Pension Fund is a funded defined benefit scheme operated under the provisions of the Local Government Superannuation Acts and provides for pensions, grants on age or ill health retirement, short service grants, death grants, injury allowances and widows' pensions. The Council is the administering authority for the Fund.

The Fund is financed by contributions from employers and employees of the Council, admitted and scheduled bodies and by earnings arising from fund's investments. A full list of the admitted and scheduled bodies is shown in Note 10.

The total numbers of active members and beneficiaries at 31 March were as follows:

	2011-12	2010-11
Active members	3,385	3,562
Pensioners and dependents	2,430	2,331
Former employees - deferred benefits	3,706	3,429
Total	9,521	9,322

The Fund is governed by the Superannuation Act 1972 and is administered in accordance with the following secondary legislation: the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended); the Local Government Pension Scheme (Administration) Regulations 2008 (as amended); and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended). The regulations are updated on a regular basis by central government.

The Council has delegated the investment arrangements of the scheme to the Investment Committee, which decides on the investment policy most suitable to meet the liabilities of the Fund. The Committee is made up of six elected representatives of the Council, including one opposition party representative. Each has voting rights. Co-opted members attend the committee meetings as advisers, but have no voting rights.

The Committee has delegated the management of the Fund's investments to professional investment managers, appointed in accordance with the regulations, and whose activities are specified in detailed investment management agreements and monitored on a quarterly basis.

Statements of Main Principles Adopted in Compiling the Accounts

The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2011-12 (the Code) issued by the Chartered Institute of Public Finance and Accountancy ("CIPFA") which is based upon International Financial Reporting Standards (IFRS) as amended for the UK public sector. The accounts have been prepared on an accrual basis in accordance with the Code, apart from inter-fund transfer values which have been accounted for on a cash basis.

Investments

In accordance with the requirements of the Code, investments are stated at market value with any surplus or deficit on revaluation being credited direct to the Fund. The market value of securities is determined by closing bid prices on 31 March. Valuations in foreign currencies are converted to sterling using a pooled average exchange rate by the Fund's global custodian. The property fund of funds is valued at the bid price quoted for 31 March. The private equity investment is the Fund's only unquoted investment and is valued from the manager's 31 December 2011 valuation of the investment assets and the cash cost of new investments made between 1 January and 31 March 2012 as permitted by the Code.

External managers' costs are shown in the Fund. Internal administration expenses are charged directly to the Pension Fund on the basis of direct costs plus apportioned overheads.

Cash and cash equivalents

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

Fund account - revenue recognition

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.

Employers' pensions strain contributions are accounted for in the period in which the liability arises. Any amount due in year but unpaid will be classed as a current financial asset.

Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund during the financial

year and are calculated in accordance with the Local Government Pension Scheme Regulations.

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

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

Investment income

i. Interest on cash

Interest income is recognised on the date it is paid. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

ii. Dividend income

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

iii. Distribution from pooled funds

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

iv. Movement in the net market value of investments

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

Fund accounts – expense items

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.

Staff pensions are provided from the Fund, whose summarised accounts are shown below. All pension payments, including added years relating to early retirements prior to 1998-99, were paid from the Fund and from 1998-99 to 2010-11, added year payments were made directly from the Council's Revenue Account. Employers' contributions, at rates advised by the Fund's actuaries - Barnett Waddingham - at the 2010 valuation, were credited to the Fund when received. Since 1998-99, additional employers'

contributions have been made as a capital sum to the Pension Fund following the early retirement of employees. The contributions are based on a formula, provided by the actuary, to cover the cost of early payment of pension benefits and discretionary enhancements.

Taxation

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

Administrative expenses

All administrative expenses are accounted for on an accruals basis. All staff costs of the pensions administration team are charged direct to the fund, management, accommodation and other overheads are apportioned to the fund in accordance with council policy.

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.

A proportion of the council's costs representing management time spent by officers on investment management is charged to the fund.

Other information

The accounts summarise the transactions and net assets of the Fund. They do not take account of liabilities to pay pensions and other benefits after the period end. The ability of the Fund's contributions and investments to meet its overall obligations is reviewed in detail by a firm of independent actuaries.

The Fund excludes transactions in respect of teachers, lecturers and youth workers. Pensions for these employees are administered by the Department for Education, to whom the Council makes a payment for this purpose.

Tri-Borough Working

The City of Westminster, London Borough of Hammersmith & Fulham and the Royal Borough of Kensington and Chelsea have combined certain parts

of their operational areas to provide a more efficient service and greater resilience. One of the first areas that have been joined together has been the treasury and pension teams of the three boroughs. The combined team was formed in February 2012 and is responsible for the management of the pension fund investments and the treasury operations across the three boroughs. The team is based at the City of Westminster's offices.

The pension funds and treasury operations will continue to be managed separately in accordance with Government Regulations and the current strategies agreed by each borough, who will continue to have sovereignty over their pension fund and treasury strategy.

The Pension Fund Income and Expenditure Statement

	31 March '12	31 March '11	Notes
	£'000	£'000	
<u>Expenditure – Pension Benefits</u>			
Benefits payable			
Pensions	17,435	14,747	2/3
Lump sums	6,136	4,209	2/3
Payments to and on behalf of leavers			
Refund of contributions	11	27	
Transfer values Paid	2,861	4,913	
Pension administration and other expenses	515	650	
Total expenditure	26,958	24,546	
<u>Income – Contributions</u>			
Employers' contributions	(19,012)	(20,825)	4
Employers' contributions - early retirements	(1,366)	(644)	
Employees' contributions	(6,187)	(6,762)	4
Transfer values received	(1,548)	(4,911)	
Other income	(796)	-	
Total income	(28,908)	(33,142)	
Net (addition)	(1,950)	(8,596)	
<u>Returns on Investments</u>			
Investment income	(5,251)	(6,987)	6
Other investment Income	(179)	(234)	6
Change in market value (realised and unrealised)	(16,988)	(42,380)	
Taxation (irrecoverable Withholding Tax)	196	244	
Investment management expenses	2,634	1,725	
Net returns on investments	(19,589)	(47,632)	
Net increase / (decrease) in the Fund during the year	21,539	56,228	
Opening net assets of the Fund	519,254	463,026	
Closing net assets of the Fund	540,793	519,254	

The Pension Fund Net Assets Statement

	%	2012 £'000	%	2011 £'000
Fixed Interest Securities				
UK public sector	-	-	-	-
Index Linked Securities				
UK public sector	-	-	-	-
UK other	-	-	-	-
Equities				
United Kingdom	2.2	11,883	2.0	10,563
Overseas	18.3	99,231	18.0	93,286
Pooled Investment Vehicles				
Overseas equities	-	-	-	-
Global equities	39.2	212,105	59.1	306,687
UK index-linked gilt funds	0.8	4,250	9.9	51,532
UK property	4.0	21,678	-	-
Global absolute return funds	29.5	159,735	4.0	20,937
Overseas private equity	4.5	24,386	3.8	19,952
Derivative Contracts				
	-	-	-	-
Short Term Investments				
Fixed term bank deposit	-	-	1.0	5,000
Cash				
Non-current (with managers)	0.3	1,606	0.2	829
Current (held directly by Fund)	1.0	5,347	2.1	10,924
Accrued investment income	-	269	-	211
Current assets				
Contributions due	0.2	896	0.1	340
Current liabilities				
Accrued fees due	(0.1)	(340)	(0.1)	(364)
Accrued lump sums payable	-	(254)	(0.1)	(643)
Net assets and liabilities	100.0	540,793	100	519,254

The Pension Fund Investment Movement Summary

	Market Value at 31/3/2011 £'000	Purchases at Cost £'000	Sales Proceeds £'000	Change in Market Value £'000	Market Value at 31/3/2012 £'000
Baillie Gifford Global Equities	104,161	-	-	1,577	105,739
Longview Global Equities	104,677	30,824	(29,219)	6,439	112,721
Legal and General Global Equities	104,753	-	-	1,613	106,367
Northern Trust Global Equities	97,772	-	(96,016)	(1,756)	-
Barings Global Absolute Return	-	76,628	-	3,585	80,213
Pyrford Global Absolute Return	-	77,039	(427)	2,910	79,522
Legal and General Indexed Gilts	51,531	4,000	(51,397)	116	4,250
CBRE (formerly ING) Property	20,937	-	-	740	21,678
Adams Street Private Equity	19,952	5,479	(2,809)	1,764	24,386
Fixed Term Bank Deposits	5,000	6,000	(11,000)	-	-
Total investments	508,785	199,970	(190,868)	16,988	534,876
Debtors	551				1,164
Creditors	(1,007)				(594)
Cash	10,924				5,347
Net assets	519,254				540,793

Notes to the Pension Fund Account

1. The Scheme Regulations require that a full actuarial **valuation** is carried out every third year. The purpose of this is to establish that the Royal Borough of Kensington and Chelsea Pension Fund is able to meet its liabilities to past and present contributors and to review employer contribution rates.

The latest full triennial valuation of the Royal Borough of Kensington and Chelsea Pension Fund was carried out by Barnett Waddingham, the fund's actuary, as at 31 March 2010 in accordance with the Funding Strategy Statement of the Fund and Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008. The results were published in the triennial valuation report dated 31 March 2011.

The 2010 valuation certified a common contribution rate of 21.2 per cent of pensionable pay to be paid by each employing body participating in the Royal Borough of Kensington and Chelsea Pension Fund, based on a funding level of 89 per cent. In addition to this, each employing body has to pay an individual adjustment to reflect its own particular circumstances and funding position within the Fund. Details of each employer's contribution rate are contained in the Statement to the Rates and Adjustment Certificate in the triennial valuation report.

(a) The market value of the scheme's assets at 31 March 2010 was £463 million and the actuary assessed the present value of the funded obligation at £509 million indicating a net deficit of £58 million. As at 31 March 2012 the market value of the scheme's assets was £541 million and the actuary assessed the present value of the funded obligation at £833 million indicating a net liability of £292 million under International Accounting Standard (IAS) 26.

(b) The actuarial valuation, done using the projected unit method, is based on economic and statistical assumptions, the main ones being:

- i. The rate of accumulation of income and capital on new investments over the long-term and the increase from time to time of income from existing investments.
- ii. Future rises in pensionable pay due to inflation and etc, and pension increases.
- iii. Withdrawals from membership due to mortality, ill health and ordinary retirement.
- iv. Progression of pensionable pay due to promotion.

(c) The contribution rate is set on the basis of the cost of future benefit accrual, increased to bring the funding level back to 100 per cent over a period of 10 years, as set out in the Funding Strategy Statement. It is set to be sufficient to meet the additional annual accrual of benefits allowing for future pay increases and increases to pension in payment when these fall due plus an amount to reflect each participating employer's notional share of value of the Fund's assets compared with 100 per cent of their liabilities in the Fund in respect of service to the valuation date.

(d) The 2010 Actuarial Valuation and the 2012 IAS26 update are published with these accounts.

(e) The next actuarial revaluation of the Fund will be as at 31 March 2013.

2. Benefits payable were as follows (including all pension and lump sum payments):

Body	2011-12 £'000	2010-11 £'000
Administering authority	21,567	17,575
Admitted bodies	1,620	1,239
Scheduled bodies	384	142
Total	23,571	18,956

Payments to pensioners exclude potential liabilities in respect of fifteen deferred members who have reached retirement age, but cannot be contacted or located.

3. Lump sum payments included above are summarised as shown below:

Payment Type	2011-12 £'000	2010-11 £'000
Commutation of pensions and lump Sum retirement benefits	5,615	4,019
Lump sum death benefits	521	190
Total	6,136	4,209

4. Contributions were received from the following sources:

	Employer's 2011-12 £'000	Employer's 2010-11 £'000
Body		
Administering authority	16,602	17,591
Admitted bodies	1,578	2,347
Scheduled bodies	832	887
Total	19,012	20,825
Of which deficit funding through payroll*	5,670	7,661

	Employees' 2011-12 £'000	Employees' 2010-11 £'000
Body		
Administering authority	5,271	5,646
Admitted bodies	599	828
Scheduled bodies	317	288
Total	6,187	6,762

The contributions receivable from employers relating to early retirements will vary from year to year, depending on the number of early retirements.

5. Related Party Transactions

Pension administration and other expenses were £515,000 and included: the costs of administering pension entitlements; contributions and etc; the apportioned costs of Corporate Finance time spent on pension administration; and direct costs. The exact costs and benefits of key management personnel cannot be apportioned on a reasonable basis between the authority and pension fund' and have therefore not been disclosed in detail.

There were no material transactions between the fund and members of the Investment Committee or between the fund and senior officers of the Council during the financial years 2010-11 and 2011-12.

6. Investment Income

	2011-12 £'000	2010-11 £'000
Dividends from equities	3,500	5,635
Income from property	1,213	848
Income from private equity	456	308
Interest on cash deposits	82	196
Investment income	5,251	6,987
Other investment income	179	234

Now that so much of the income from the Fund's investments is through pooled investment vehicles, income is also included within the change in market value of these investments.

None of the UK Equities is unlisted. The scheme has no material holdings of unlisted investments in other markets except for the Adams Street holdings in private equity, which are shown separately in these accounts.

Pooled Investment Vehicles (previously known as Managed Funds) are Open Ended Investment Companies investing in equities and bonds.

7. Statement of Investment Principles

The Investment Committee regularly reviews its Statement of Investment Principles (SIP), which is revised following any change in circumstances. A copy of the latest version is published on the Council's website or can be obtained from the Town Clerk and Executive Director of Finance.

8. Investments

The market value of assets under management at 31 March was as follows:

Managed by:	2012		2011	
	£'000	% of Total	£'000	% of Total
Baillie Gifford	105,739	19.6	104,163	20.0
Longview	112,721	20.9	104,678	20.1
Legal and General	106,367	19.7	104,753	20.2
Northern trust	-	-	97,772	18.8
Barings	80,213	14.8	-	-
Pyrford	79,522	14.7	-	-
Legal and General	4,250	0.8	51,531	9.9
ING	21,678	4.0	20,937	4.0
Adams Street*	24,386	4.5	19,952	3.9
Total managers	534,875	99.0	503,786	96.9
RBKC cash investment	5,347	1.0	15,924	3.1
Subtotal	540,222	100.0	519,710	100.0
Debtors	1,164		551	
Creditors	(594)		(1,007)	
Net assets	540,793		519,254	

* The valuation is taken from the 31 December 2011 valuation of the investment assets and the cash cost of new investments made between 1 January and 31 March 2012.

** Cash held by managers is included in the totals. Interest on cash held internally is calculated at market rates of interest and credited to the Pension Fund.

The level of activity in the Fund's investments at cost during 2011-12 is shown in the Investment Movement Summary.

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

9. Net Current Assets

Amounts due to and from the Fund at the Balance Sheet date have been included within the Fund Account as follows:

<u>Current Liabilities</u>	£'000
Accrued fees due	340
Accrued lump sum payments	254
Total	594
<u>Current Assets</u>	£'000
Dividends and interest	269
Accrued income	896
Total	1,165

10. Admitted and Scheduled Bodies:

Admitted Bodies

Medequip
Specialist Schools & Academies Trust
Tenant Management Organisation
Westway Development Trust

Scheduled Bodies

Kensington and Chelsea College
St Charles Roman Catholic Sixth Form College
Chelsea Academy

The following former admitted bodies have no active members and are included within the Royal Borough of Kensington and Chelsea Pool:

Housing Action Centre
Maxilla Nursery
Portobello Business Centre
West London Family Service Units

11. Nature and Extent of Risks arising from Financial Instruments

(a) Market Risk

The Fund's primary long-term risk is that the Fund's assets will fall short of its liabilities. The Fund's liabilities are sensitive to inflation via pension and pay increases, to interest rates and to mortality rates. The assets that would most closely match the liabilities are a combination of index-linked gilts as the liabilities move in accordance with changes in the relevant gilt yields.

In order to meet the Fund's objective of being fully funded within 10 years of the 2010 actuarial valuation, the fund managers have been set differing targets appropriate to the types of assets they manage. The overall target for the scheme is to outperform a weighted average of these benchmarks by 2.3 per cent on a rolling three year basis.

The Fund's assets are invested in a broad range of asset classes in terms of geographical and industry sectors and individual securities. This diversification reduces exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. The aim of the investment strategy is to minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the portfolio. Responsibility for the Fund's investment strategy rests with the Investment Committee and is reviewed on a regular basis.

(b) Price Risk

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

The fund is exposed to price risk. This arises from investments held by the fund for which the future price is uncertain. All securities represent a risk of loss of capital. The maximum risk resulting from financial instruments is determined by the fair value of the financial instruments. The Fund's investment managers aim to mitigate this price risk through diversification and the selection of securities and other financial instruments.

The following table indicates the potential for movements in market prices for different asset classes for the 2012-13 reporting period to affect the value of the Fund's assets. The degree of volatility has been determined by State Street Global Services from changes in the values of similar assets over the last three years. These potential movements assume the observed historical volatility of asset returns will be repeated and that the Fund's overall asset allocation and individual asset positions remain constant.

Asset Type	Market Value as at 31st March 2012	Move- ment	Value on Increase	Value on Decrease
	£'000	%	£'000	£'000
UK equities	11,883	13.20%	13,452	10,314
Overseas equities	99,231	14.60%	113,719	84,743
Global equities	212,105	14.60%	243,072	181,138
UK index-linked Gilts	4,250	6.40%	4,522	3,978
UK property	21,678	5.80%	22,935	20,421
Global absolute return funds	159,735	6.50%	170,118	149,352
Private equity	24,386	6.50%	25,971	22,801
Cash	6,954	0.00%	6,954	6,954
Total assets	540,222		600,743	479,701

(c) Interest Rate Risk

The fund invests in financial assets for the primary purpose of obtaining a return on investments. Fixed Interest securities and cash 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 Investment Committee 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. A 25 basis point (BPS) movement in interest rates is consistent with the movement in interest rates over the last three years. The analysis below 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 +/- 25 basis point change in interest rates:

Asset Type	Market Value as at 31st March 2012	Move- ment	Change in Year on Increase	Change in Year on Decrease
	£'000	%	£'000	£'000
UK index-linked Gilts	4,250	0.25	11	(11)
Cash	6,954	0.25	17	(17)

(d) 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 pounds sterling.

Following analysis of historical data by State Street Global Services, the Fund considers the likely volatility associated with foreign exchange rate movements to be 6.5 per cent. A 6.5 per cent fluctuation in currency values is considered reasonable based on the analysis of long-term historical movements in the month-end exchange rates over a rolling 36-month period. This analysis assumes that all other variables, in particular interest rates, remain constant.

A 6.5 per cent 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:

Asset Type	Market Value as at 31st March 2012	Move- ment	Value on Increase	Value on Decrease
	£'000	%	£'000	£'000
Overseas equities	99,231	6.50	105,681	92,781
Global equities	212,105	6.50	225,892	198,318
Global absolute return funds	159,735	6.50	170,118	149,352
Private equity	24,386	9.80	26,776	21,996
Total assets with currency risk	495,457		528,466	462,448

(e) Credit Risk

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

In essence the Fund's entire investment portfolio is exposed to some form of credit risk. However, the selection of high quality fund managers, counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

(f) Liquidity Risk

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

commitments. This will particularly be the case for cash to meet the pensioner payroll costs; and also cash to meet investment commitments. The Council has immediate access to its pension fund cash holdings.

12. Post Balance Sheet Events

Since the Balance Sheet date, one of the Fund's admitted bodies, the Specialist Schools Trust, has become insolvent. Officers and the Fund's actuary are working to establish the extent of any losses and how they might be recovered.

13. Additional Voluntary Contributions (AVCs)

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 do not permit Additional Voluntary Contributions to be paid into the Pension Fund, so they are not included in these accounts. The Council has made arrangements for current members to make additional payments through its payroll into a variety of funds operated by Prudential Assurance according to individuals' preferences. These funds are invested in equities, bonds, property and cash. A total of £679,000 was invested by members of this fund in this way during 2011-12.